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Outsourcing the internal audit function : a survey of the South African public and private sectors

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UNIVERSITY OF THE WITWATERSRAND

SCHOOL OF ACCOUNTANCY

RESEARCH REPORT

Outsourcing the Internal Audit Function: A Survey of the South African Public and Private Sectors

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Date: 4 June 2011

Degree: Master of Commerce in Accountancy
(50% Coursework)

A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, in partial fulfilment of the requirements for the degree of Master of Commerce in Accountancy.

Johannesburg, 2011

DEDICATION

Dedicated to my family and friends who help **me** succeed and continue to inspire **me.**

ACKNOWLEDGEMENTS

I would firstly like to express my gratitude to my supervisor and friend, Dr. Elmarie Papageorgiou, for her continuing guidance, wisdom, and ongoing support,

I would also like thank and acknowledge the following people for their support and assistance to the dissertation, without which this research would not have been possible:

- Priyanti Govender for the language editing.
- Benn Sartorius, for assistance in the Statistical Analysis.
- My parents, Fathima and Yakoob Yasseen for all their support and sacrifices over the years.
- My Creator, for giving me the strength, health and perseverance to complete this dissertation
- Ziyaad Byat, Mahdiyyah Moola and Nadir Somai for their valued support and assistance.
- Nirupa Padia for all her assistance and motivation.
- All respondents who took the time and effort to participate in the research
- Professor Jackie Arendse, Professor Beverley Jackson and Mrs. Mariam Vawda for the financial and operational support.

DECLARATION

I, Yaeesh Yasseen, declare that this research report is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Commerce in Accountancy in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Yaeesh Yasseen

Signed at ……

On the …….. Day of …… 2011

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LIST OF ABBREVIATIONS

ASX	Australian Stock Exchange
BEE	Black Economic Empowerment
CA (SA)	Chartered Accountant (South Africa)
CAE	Chief Audit Executive
CFIA	Competency Framework for Internal Auditors
CI	Confidence Interval
CIA	Certified Internal Auditor
CPA	Certified Public Accountant
EDP	Electronic Data Processing
FD	Financial Director
IAF	Internal Audit Function
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
Inc.	Incorporated
IT	Information Technology
JSE	Johannesburg Securities Exchange
King Code	King Code for corporate governance
King I	King Code for corporate governance
King II	King Code for corporate governance
King III	King Code for corporate governance
NASD	National Association of Securities Dealers
Nasdaq	National Association of Securities Dealers Automated Quotations
NYSE	New York Stock Exchange
OSP	Outside Service Providers
PFMA	Public Finance Management Act

PSB	Professional Standards Bulletin
RBT	Resource-Based Theory
RBV	Resource Based View
RSA	Republic of South Africa
SA	South Africa
SAICA	South African Institute of Chartered Accountants
TCT	Transaction Cost Theory
UK	United Kingdom

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ABSTRACT

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. These trends have now moved into the internal audit sphere, a function which was previously maintained in-house. With the outsourcing of Internal Audit Functions issues such as independence and the value adding approach of internal audit are brought into question. This paper explores similarities and differences between public sector internal auditing and its counterpart in the private sector in South Africa. Using survey data collected from a purposive mix of 72 organisations in the South African private and public sector, the degree of internal audit outsourcing, the rationales behind their outsourcing decisions, the types of internal audit services providers, the perceived status of in-house and the perception of Independence of outsourced Internal Audit Functions were investigated**.** 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 were more uncertain. No significant differences were observed between sectors with regards to interaction with external auditors in terms of coordination of areas of audit coverage and work schedule. Private companies were significantly more likely to have longer hours provided by interval service providers relative to outside providers when compared to the public sector. The biggest difference appears to be that private companies chose a big 4 accounting firm more often than in the government sector. Conversely the government sector had a higher frequency of choosing smaller accounting firms and specialised internal audit providers when compared to the private sector.

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 different perspectives of Internal Audit practice. Challenges that face this developing economy that are of particular interest when considering the sourcing arrangements of the Internal Audit Function, are events (political, social and economical) that have occurred in South Africa during the past 15 years. The public sector element is unique to other studies that were undertaken in South Africa.

Keywords

Core-function; independence; internal audit; outsourcing; private sector; public sector; service providers; South Africa

CHAPTER 1
ORIENTATION

1.1 INTRODUCTION

Companies are increasingly using innovative decisions to increase efficiency and profitability. Management buy-outs, business process re-engineering, and outsourcing are examples of the innovative decisions that may affect the continuing activities of the company and may require new internal controls and adequate disclosures. (Juma'h & Wood, 1999:2). According to Widener and Selto (1999:65), anecdotal evidence suggests that companies are countering economic pressures with focused strategies, and are outsourcing many service functions, including portions of their management control systems. A component of the management control system that many companies outsource is internal auditing.

Outsourcing of internal auditing is not a new phenomenon; outsourcing practice dates back to eighteenth-century England 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 & Kakabadse, 2000:670). This is in fact supported by Quinn (1999) as cited who suggested that "unless the company develops best-in-world capabilities, including transaction cost disciplines, the company should purchase goods and services from providers who have best-in-world skills, in order to achieve the competitive edge'' (Kakabadse & Kakabadse, 2000:672). 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, Subramanium & Ching, 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 & Yiannakas, 2000:1).

1.2 OBJECTIVES OF THE STUDY

The aim of this research is to determine the status quo in respect of outsourcing of the Internal Audit Function (IAF) within South African private and public organisations. The research will focus on the factors which motivate the decision to outsource the IAF and the intention is to examine how internal audit is perceived by South African organisations, the likely impact the outsourcing decision may have on an auditor's independence and the quality of the internal audit service provided. The objectives are summarised as follows:

Objective 1:
To establish the current status of outsourcing the Internal Audit Function in South African private and public entities.

Objective 2:
To ascertain from Finance Directors and Chief Audit Executives in both the public and the private sector, what are their perceptions of the Internal Audit Function.

Objective 3:
To establish the principal motive(s), factor(s) and implications behind the decision to outsource the internal audit function.

Objective 4:
To examine the impact of the decision to outsource the internal audit function on auditors' independence (internal and external) and on the quality of the internal audit service.

1.3 BACKGROUND TO THE RESEARCH

Internal Auditing as a profession on a global landscape is relatively new. For South Africa in particular the profession had started inaugural in 1984 with the formation of the Institute of Internal Auditors 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 Ikutu Report which was published by the Institute of Internal Auditors in 2010 and will be discussed in detail in the later part of this research.

The South African economy faces many challenges over the past two decades, the first being the transition from a racialist 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, Lesiurenet 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. Internal Auditing as a profession was placed in the spotlight and governance reports such as the King Code for corporate governance, (IOD, 1994) called on Internal Auditing to deliver. From the "backroom into the board

room", words of Judge Mervin King, chairperson of the King commission, the profession needed to evolve and assist management in the areas of risk, control and governance. For South Africa this was not easy as the post segregated economy lacked skills to resource this economy.

1.4 STATEMENT OF THE RESEARCH PROBLEM

This research study identified that there is a gap in the research with respect to understanding the practice of Internal Auditing in South Africa due to the infancy of the profession. The broad focus of the current study is 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 is incomplete in areas for example research with respect to the public sector had not been conducted.

This study investigates the implications of outsourcing the IAF in South African organisations with respect to:

- Determining the current status of outsourcing the IAF in South African private and public entities.
- Ascertaining from Finance and Chief Audit Executives, in both the public and the private sector, what are their perceptions of the IAF.
- Establishing the principal motive(s), factor(s) and implications behind the decision to outsource the Internal Audit Function.
- Examining the impact of the decision to outsource the IAF on auditors' independence (internal and external) and on the quality of the internal audit service.

The study of Selim, G. and Yiannakas, A., 2000 'Outsourcing the Internal Audit Function: A Survey of the UK Public and Private Sectors' that was published in the *International Journal of Auditing*. 4: 213-226, is adapted to a comparative study within a South African context. One might argue that it would be useful to base the study by

adapting the study to the IIA's position paper on outsourcing; however at the time when the original topic was researched it had always been that the rationale behind this research achieves two objectives as detailed below.

Firstly this Study will contribute to the existing body of knowledge and addressing some of the limitations identified in the Ikutu Report thus contributing to the principles and practice of the profession nationally. Secondly by adapting an international study this research will provide a comparative analysis to an international study from a developing economy perspective. The outcome of this comparative study which is exploratory in nature will provide a useful insight to stakeholders in both public and private sectors as to the status quo of resourcing the IAF in their respective organisations as well to as enhance the current perception of internal audit.

The problems of the research are summarised as follows:

Research Question 1:
What is the current status of outsourcing the internal audit activity in South African private and public entities?

Research Question 2:
What is the perception of the Internal Audit Function amongst Finance and Chief Audit Executives in both the public and private sectors with regards to outsourcing the IAF?

Research Question 3:
What are the principal motives, factors and implications of the decision taken by selected South African companies/entities to outsource the Internal Audit Function?

Research Question 4:
What is the impact of the decision to outsource the Internal Audit Function on auditors' independence (internal and external) and on the quality of the internal audit service?

1.5 RESEARCH METHODOLOGY

A comparative study of a quantitative nature will be conducted in the framework of a descriptive research study.

Descriptive research involves either identifying the characteristics of an observed phenomenon or exploring possible correlations between two or more phenomena.
The methodology employed for this study was adapted from the Selim and Yiannakas (2000:213) study to a South African context.

Electronic questionnaires were initially sent to a purposively selected sample of 80 South African organisations from both the public and private sector initially. There after the Institute of Internal Auditors – South Africa (IIASA) distributed the questionnaire via their newsletter to attract a better response rate. Individuals were approached at IIASA regional events to complete the questionnaire. 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 (20002:13) found this method to be the most effective vehicle for reaching a significant number of respondents.

The empirical study then proceeded through the following stages: data collection, data processing and data analysis. Chapter 4 details the research methodology adopted and supports the chosen methodology adopted with the relevant theory.

1.6 LIMITATIONS

Questionnaires were primarily aimed at Chief Audit Executives (CAEs) and Financial Directors (FDs), however, due to time pressures that these executives faced there was a lag in the completion of the questionnaire and the gathering of data. In some instances the completion of the questionnaire was delegated to senior managers or managers to complete, this may have resulted in diverging views at times.
Respondents were assured that all responses would be regarded as strictly confidential therefore controls were implemented to ensure that only the researcher had access to the information provided as a result organisation names were not identified in the research which could have been useful to users to aid in the economic value added by this research. Another limitation was that the questionnaire yielded 72 responses even though a larger purposive sample was eventually targeted.

Although the research conducted was limited to organisations in South Africa, the significance of the study may offer insight into similar issues emerging in developing economies and provide a comparative to established economies.

1.7 OUTLAY OF THE STUDY

The principal motive for the undertaking of this research study with respect to the outsourcing of the IAF in South Africa was to contribute to the existing body of knowledge from a developing economy and emerging market perspective. The information derived would be used by CAEs or their equivalents in deciding the overall internal audit strategy for their respective organisations.

The study explores the literature supporting outsourcing and the IAF respectively and is then further investigated through the conduct of an empirical study in which the current status of outsourcing the IAF in South African private and public entities is investigated , the perceptions of the IAF from Finance and Chief Audit Executives, in both the public and the private sector, are ascertained ; the principal motive(s), factor(s) and

implications behind the decision to outsource the IAF is established and the impact of the decision to outsource the IAF on auditors' independence (internal and external) and on the quality of the internal audit service.

The research study conducted and presented is outlined as follows: The objectives of the study, the research problems and the background to the study are introduced in Chapter 1. Chapter 2 provides insight into general outsourcing theory through a literature study. The literature published on the subject of the IAF is further explored in Chapter 3. Chapter 4 provides an account of the Research Methodology adopted in conducting the empirical study as well as theories supporting the use of the chosen methodology. The results of the quantitative data analysis are presented and discussed in Chapter 5. Chapter 6 provides readers with a summary of the results obtained as well as a conclusion to the research study performed.

CHAPTER 2
ECONOMIC APPROACH TO OUTSOURCING BEHAVIOUR

2.1 INTRODUCTION

The objective of this chapter is to establish and document the economic theory behind the decision to outsource a particular function. Functions that are typically outsourced in organisations today include information technology (IT), tax, legal, catering, cleaning, distribution, human resources and internal auditing, amongst others. By reviewing the existing literature from other studies, the behavioural approach of a firm that decides to outsource will be better understood. Once this is achieved, the study will focus on IAF by defining internal auditing and explore the changing roles of the IAF in the business environment. This will be dealt with in Chapter 3. To understand the economic rationale of outsourcing, an extensive literature review was conducted. A total of 9 theories have been identified that explain the reasoning behind outsourcing, in particular the outsourcing of the IAF occurring on a global scale.

2.2 THE GENERIC BASE OF OUTSOURCING

Espino-Rodriguez and Padrón-Robaina (2006:50) advocate that the term ‘outsourcing’ was capitalised in the late 1980s in relation to the subcontracting of information systems. As a result the majority of sources in this chapter identify ‘outsourcing’ with the function of information systems. However, according to Espino-Rodriguez and Padrón-Robaina (2006:51), the term ‘outsourcing’ has been applied to other types of functions

or activities. They summarised the most significant definitions of outsourcing that have emerged from the literature in Table 1:

Table 1: A chronological review of the different definitions of outsourcing

Author/s (year)	Concepts of outsourcing
Harrigan (1985)	A variety of 'make or buy' decisions' to obtain the necessary supplies of materials and services for the production of the organisation's goods and services.
Loh and Venkatraman (1992)	External vendors' provision of physical and/or human resources associated with the user organisation's information technology infrastructure.
Quinn and Hilmer (1994)	External acquisition of activities, including those traditionally considered an integral part of any firm, provided that they do not form part of the firm's core capabilities.
Ventura (1995)	Exchange relationships with independent firms with who stable co-operation agreements can be established.
Lei and Hitt (1995)	The act of trusting in external capabilities and skills for the manufacture of determined production components and other activities that have added value (often capital intensive).
Rothery and Roberson (1996)	The act of turning to an external organisation to perform a function previously performed in-house. It entails the transfer of the planning, administration and development of the activity to an independent third party.
Casani *et al.* (1996)	Long-term link related to the development of determined activities or tasks that are not essential to the firm by specialised professionals, who, in time, become strategic partners.
Blumberg (1998)	Process of making contracts with a third party to handle a part of the client firm's business.

Sacristán (1999)	Collaboration agreement between different types of firms in which one firm is a specialist in technology and makes a significant contribution to the other by providing physical and/or human resources during a certain period in order to attain a determined objective.
Greaver (1999)	The act of an organisation transferring periodic internal activities and decision-taking to external suppliers through contracts.
Gilley and Rasheed (2000)	It is the substitution of activities performed in-house by acquiring them externally, although the firm has the necessary management and financial capabilities to develop them internally. It is also an abstention from performing activities in-house.
Campos (2001)	It consists of contracting an external supplier to perform a task previously executed by the organisation itself, and may also even involve new activities.
Bailey W, Masson R and Raeside R. (2002)	Handing over some or all of that particular activity and related services to a third party management, for the required result.
Quélin and Duhamel (2003)	The operation of shifting a transaction previously governed internally to an external supplier through a long-term contract, and involving the transfer to the vendor.
McCarthy and Anagnostou (2004)	Not only consists of purchasing products or services from external sources, but also transfers the responsibility for business functions and often the associated knowledge (tacit and codified) to the external organisation.
Mol M.J*, Van Tulder R.J.M and Beige P.R* (2005)	The procurement of supplies from legally independent entities (suppliers).

Source: Espino-Rodriguez and Padrón-Robaina (2006:51)

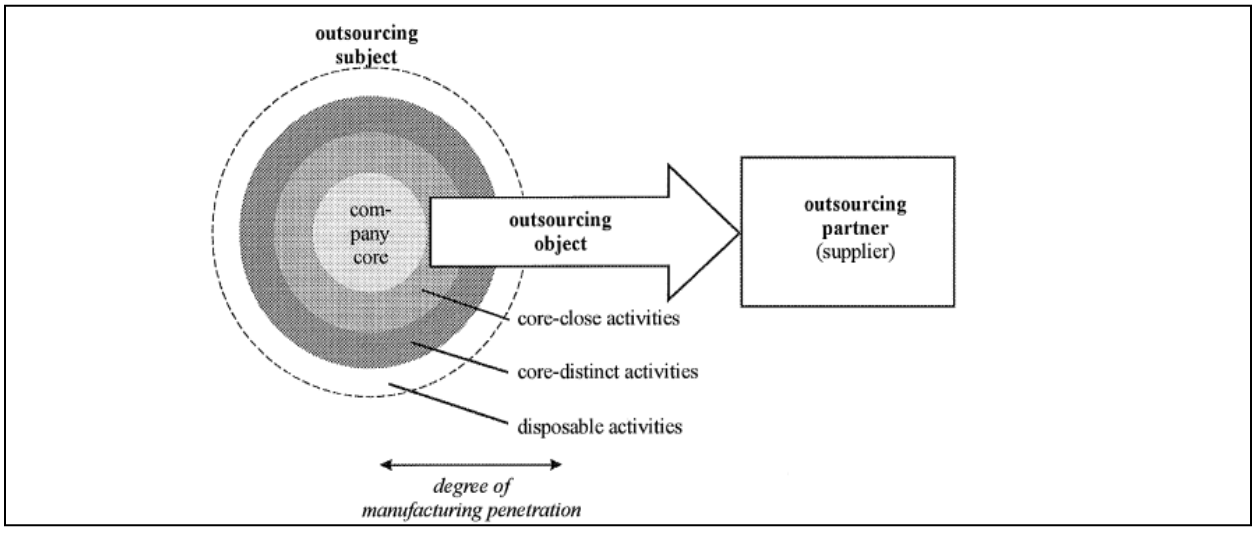
Arnold (2000:23) defines outsourcing traditionally as an abbreviation for 'outside resource using', and his outsourcing model consists of four major elements namely:

- Outsourcing subject;
- Outsourcing object;
- Outsourcing partner and
- Outsourcing design.

Each of these elements will now be further expanded upon. Arnold (2000:24) defines the ‘outsourcing subject’ as the economic institution which plans to outsource, or not. It is the subject who has to make the strategic decision to outsource. The ‘outsourcing object’ on the other hand according to Arnold (2000:24) is processes or process results which might be outsourced. In order to ascertain which processes need to be outsourced, it is important to distinguish between (1) the company core (all activities which are necessarily connected with a company's existence), (2) core-close activities (directly linked with core activities), (3) core-distinct activities (supporting activities), and (4) disposable activities (activities with general availability).

Outsourcing partners are all possible suppliers for the activities considered for outsourcing while outsourcing design is developed with governance structures. The design will directly be linked to markets and the organisational hierarchy (Arnold, 2000:24). The relationships between the elements are best illustrated in Diagram 1:

Diagram 1: The elements of the outsourcing model



Source: Adapted from Arnold (2000:24)

Ngwenyama and Bryson (1997:352) support the idea that outsourcing of a firm's value chain activities is not new. According to them, “firms in different industries have engaged in this practice for many years. For example, in the manufacturing sector, many industries, such as automotive, shipbuilding, air-conditioning, computer hardware, and others outsource the building of components to other specialised manufacturers. Ford and General Motors, for example, outsource more than 50% of the components that make up their final products.”

The central argument raised at this point, is whether outsourcing is a result of cost saving due to the vendor's economies of scale and labour specialisation.

Aubert, Rivard and Patry (1996:51) suggested that: “outsourcing decisions may be viewed as being either efficiency-based or politically driven.” The central idea posed here is that that driving force behind the efficiency-based perspective is the assumption that organisations maximise profits or minimise costs when selecting amongst competing strategic options.

According to Aubert *et al*. (1996:51), the efficiency based perspective is a consequence of the aggregating of demands that allow the outsourcer to take advantage of the economies of scale. “For instance, specialised firms can more easily attract highly skilled professionals and technicians that are in short supply. Other sources of cost reductions are the elimination of large fixed costs during recessions and the transfer of adjustment costs to the outsourcer when a new technology is adopted.”

While it is the energy-based motive that drives outsourcing, the study in addition noted that political motives also played a role in the decision to outsource.

According to Nooteboom (1992:284) the strategic need for outsourcing can be explained in the context of the competitive environment: “The competitive environment of firms is turbulent. Technological development is fast, yielding among other things, a faster obsolescence of products and production technology and more opportunities for differentiated products at low prices. Consumer preferences are becoming, at the same

time, more differentiated (within countries) and more similar (across countries). Many markets have developed from sellers' to buyers' markets, increasing pressure on price and stimulating product differentiation to escape from that pressure."

Holcomb and Hitt (2007:477) share the view that "the dominant goal most often cited for strategic outsourcing is cost efficiency." The position articulated is that firms may domesticate value chain activity to minimise costs from opportunism, the uncertainty of frequent market exchanges, and specific assets that may arise from this organising arrangement.

The definitions in table 1 can be classified into three categories: The first category of definitions deals with contractual theory and exchange theory with contraction firms. The second category of definitions considers core competency theory and the outsourcing of non strategic services while the third set of definitions encompasses knowledge management and contractual theory. Espino-Rodriguez & Padrón-Robaina (2006:52) realised that there was a gap in the definitions and concluded that the most applicable definition to outsourcing which encompassed all three categories as mentioned above would be:

"Outsourcing is a strategic decision that entails the external contracting of determined non-strategic activities or business processes necessary for the manufacture of goods or the provision of services by means of agreements or contracts with higher capability firms to undertake those activities or business processes, with the aim of improving competitive advantage.'' (Espino-Rodriguez & Padrón-Robaina, 2006:52)

For the purposes of this study the definition discussed above will be used as the basis for outsourcing and the development of the methodology.

2.3 THEORETICAL PERSPECTIVES

Subsequent to reviewing the various literatures, nine theoretical perspectives were identified to better understand outsourcing rationales. These nine theories will be discussed in detail in the following sections:

2.3.1 Theory of core competencies
2.3.2 Resourced based theory
2.3.3 Transaction cost theory
2.3.4 Contractual theory
2.3.5 Relational exchange theory
2.3.6 Social exchange theory
2.3.7 Agency theory
2.3.8 Theory of firm boundaries
2.3.9 Stakeholder theory

The theories identified in are explained in the context of Information Technology (IT), however, the substance of each theory applies to economic outsourcing and will build on to the implications for the IAF in Chapter 3 to follow.

2.3.1 Theory of core competencies

According to Gottschalk and Solli-Sæther (2005:686) “core competencies theory suggests activities should be performed either in-house or by suppliers. Activities, which are not core competencies, should be considered for outsourcing with best-in-the-world suppliers. Some non-core activities may have to be retained in house if they are part of a defensive posture to protect competitive advantage.” The definition of core is synonymous to critical or fundamental. Employees in non-core functions may feel excluded by the organisation because they are a non-dominant discipline. For example, IT employees working on web-based legal services in a law firm may feel excluded by lawyers in the firm (Gottschalk & Solli-Sæther, 2005:686). Linking this to the current

study, In South Africa the biggest outsourcing deal was struck when Ernst & Young secured the Transnet internal audit outsourcing bid. This trend to outsource IAF is somewhat not surprising and can be supported by earlier research which will be discussed in chapter 3. An analysis of the Transnet decision to outsource was that Transnet considered the IAF to be a non core activity.

On the other hand Smith, Morris and Ezzamel (2005:4) state that "outsourcing provides businesses with the ability to focus on core competencies, access state-of-the-art technology and increase flexibility and cost savings." The rationale behind core competency theory is to gear the organisation to have competitive advantage on the one hand and on the other, to purchase specialised skills without having to develop these skills internally.

Gottschalk and Solli-Sæther (2005:687) present an excellent example of a paradox with regards to the practical implementation of core competency theory: For instance an organisation may view IT itself as a core competence. However, some organisations outsource IT even though they see it as core and delivering competitive advantage. This may be that IT is considered core at the corporate level, but some of its aspects, at lower levels, might be commodities. This example shows the complexity of outsourcing IT and the constraints of practically implementing core competency theory.

2.3.2 Resourced Based Theory

Espino-Rodriguez and Padrón-Robaina (2004:711) observed that the Resource-Based View(RBV) of the firm is founded on the assumption that the organisation's ultimate objective is to achieve competitive advantage by obtaining resources and defending competitive positions which are important to production, service and distribution.

Espino-Rodriguez and Padrón-Robaina (2006:50) in a preceding study explain that "The RBV approach examines the relationship between the internal characteristics of the firm and its positioning." The study proposed that in order to achieve sustainable competitive advantage, fundamentally depended on the position of the markets and products.

Espino-Rodriguez and Padrón-Robaina (2006:65) concluded that "the propensity to outsource and the relationship between outsourcing and organisational performance using the basic premises of the RBV (resources and capabilities, competitive strategy and organisational performance) as the moderating variables were dependant on the framework which sets out the relationship between outsourcing and organisational performance, depending on the type of activity selected for outsourcing (i.e. core capabilities, complementary capabilities and non-core capabilities)." A final conclusion that was drawn from this study is that application of the RBV to outsourcing is still in its early days. This was accredited due to the complexity of considering aspects that are difficult to measure, such as organisational capabilities.

2.3.3 Transaction Cost Theory

Ngwenyama and Bryson (1997:354) claim that Transaction Cost Theory (TCT) has been used to analyse a wide variety of decision problems, such as, franchise contracting, structuring efficient administrative organisations, integration and efficient boundaries of the firm and make-buy decisions. McIvor (2000:25) outlines Williamson's (1975) that the theory of transaction cost analysis as the conceptual basis for outsourcing is best defined by Williamson's (1975) theory of transaction cost analysis.

According to Liang and Huang (1998:31) TCT is used to explain the rational why a transaction subject chooses a particular form of transaction instead of others. "The basic principle of TCT is that people like to conduct transactions in a way that minimises their transaction cost. TCT has been successfully applied in many domains. Among the well-known examples are TCT applications to facilitate the make-or-buy and business integration decisions. The market mechanism is popular when the transaction cost of buying outside is lower than manufacturing inside, while organisational hierarchy is used otherwise. In automobile and petrochemical industries, forward integration is common because transaction costs of forward-integrated companies are much lower than those of non-integrated ones" (Liang & Huang, 1998:31).

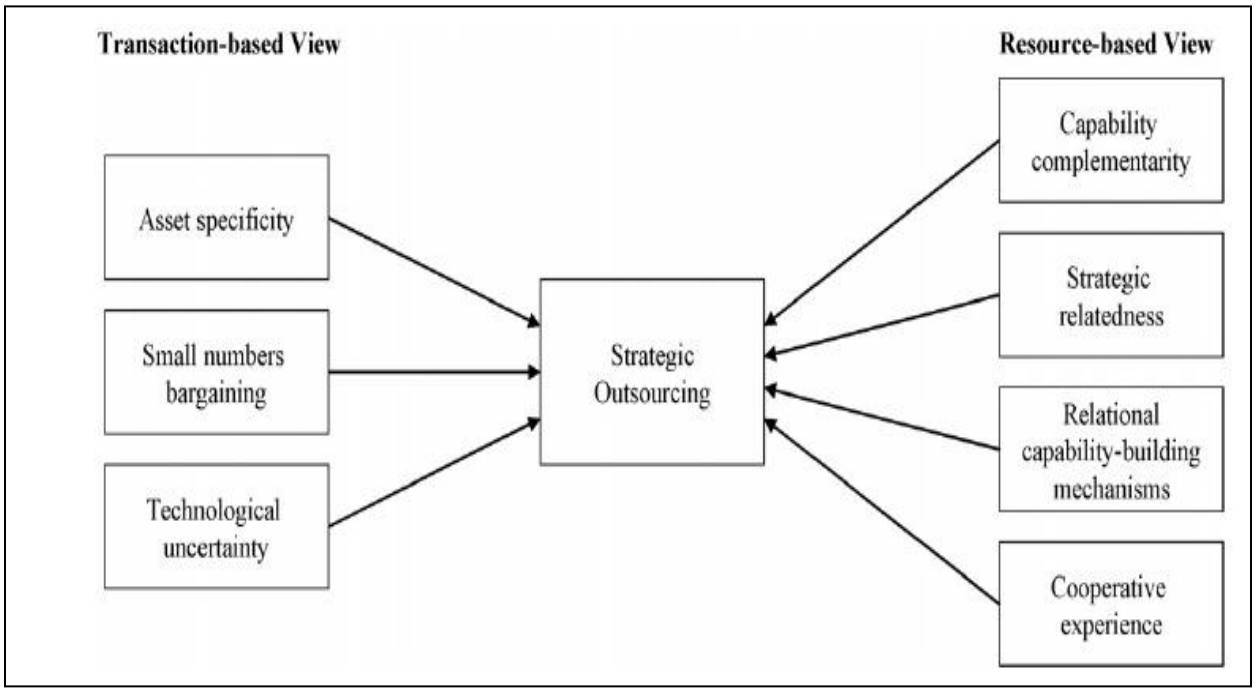
Bahli and Rivard (2010:213) consider that TCTis based on two behavioural assumptions "first, it operates on the assumption of bounded rationality, which refers to how the cognitive limitations of the human mind rule out a complete evaluation of the consequences of all possible decisions. Second, the theory operates under the assumption of opportunism, which posits that people do not only act in self-interest, but that they also act with guile." According to Bahli and Rivard (2010:213) the impact of 'bounded rationality' depends, in part, on the knowledge and skills the client can draw on in specifying requirements, selecting appropriate suppliers and managing and controlling the relationship when applying to an outsourcing context.

Duncan (1998:675) states that: "the primary reasons for outsourcing IT have been routinely identified as cost containment and acquisition of expertise. Managers outsource when they expect the market to be more cost efficient than vertical integration and/or when they believe skills, knowledge or experience are available via the market that are not available in-house." Duncan (1998:675) views that the transaction cost approach to outsourcing applies to the cost-containment objective. The reason being TCT is supportive in predicting models of outsourcing risk and success, as well as the outsourcing decision.

Nooteboom (1992:284) asserts that "while the solutions provided by TCT may not remain, at least not without important alterations, the problems raised by TCT do remain: in case of highly transaction specific investments, how does one cope with the resulting risks of discontinuity due to bounded rationality and opportunism under conditions of uncertainty?"

In a context of outsourcing TCT needs to be supplemented by other theories to fully understand outsourcing behaviour. Diagram 2 demonstrates how the transaction-based view can be combined with the Resource based view to develop a better understanding of economic outsourcing rationales.

Diagram 2: Transaction based view used in conjunction with the Resource-based view to understand strategic outsourcing.



Source: Holcomb and Hitt (2007:467)

2.3.4 Contractual theory

Gottschalk and Solli-Sæther (2005:689) state that an outsourcing contract provides “a legally bound, institutional framework in which each party's rights, duties, and responsibilities are codified and the goals, policies, and strategies underlying the arrangement are specified. Every outsourcing contract has the purpose of facilitating exchange and preventing opportunism. Appropriate contractual arrangements can attenuate the leeway for opportunism, prohibit moral hazards in a cooperative relationship, and protect each party's proprietary knowledge.” The basis of contractual theory is that the outsourcing contract should be complete and specific with respect to ensuring that both parties benefit from the contract, as opposed to one party bearing the risk of non return in the undertaking. An incomplete contract, according to Luo (2002), as cited in Gottschalk and Solli-Sæther (2005:689): “may bring about ambiguity, which creates a breeding ground for shirking responsibility and shifting blame, raises the

likelihood of conflict, and hinders the ability to coordinate activities, utilise resources, and implement strategies."

2.3.5 Relational exchange theory

Baker, Gibbons and Murphy (2002:39) state that firms are riddled with relational contracts: "informal agreements and unwritten codes of conduct that powerfully affect the behaviours of individuals within firms. Relational contracts within and between firms help circumvent difficulties in formal contracting." Contracts agreed upon under relational exchange theory allow parties to gain access to information that was not available before. The risk in the context of outsourcing is that once the relationship is terminated in the future, the party whom shared the outsourcing skill may be left undercompensated.

This can be motivated by Baker *et al*. (2002:39) who claim that "a relational contract thus allows the parties to utilise their detailed knowledge of their specific situation and to adapt to new information as it becomes available. For the same reasons, however, relational contracts cannot be enforced by a third party and so must be self-enforcing: the value of the future relationship must be sufficiently large that neither party wishes to renege."

2.3.6 Social exchange theory

According to Kern (1998:41) social exchange theory is "a dyadic exchange relations consisting of 'voluntary transactions involving transfer of resources between two or more actors for mutual benefit." The focal idea of social exchange theory as outlined by Kern (1998:41) is founded on the exchange relation between two specific factors. The reason for employing exchange theory is to understand the underlying social structures, which after all "are structures composed of the social relations among actors, whether these actors are individual or collective" Cook (1977) as cited in Kern (1998:41).

Blau (1987) as cited in Kern (1998:41) describes that in order to “dissect the transaction process to explain the interdependent contingencies in which each response is dependent on the other’s prior action and is simultaneously the stimulus evoking the other’s further reaction”. The study found that in the context of an outsourcing venture, the actual operation of the contract, guides not only the prior, but also future actions, which, when combined, introduce a certain amount of predictability into the relationship. The inter-reliant contingencies which are evident in the contract should be explored in using relational contract theory.

However Gottschalk and Solli-Sæther (2005:690) claim that “a social exchange perspective places the study of international relations, such as global outsourcing, in a framework of negotiations. Central to this perspective is issues of equivalence and contingency.”

According to Gottschalk and Solli-Sæther (2005:690) the challenge is to define a precise medium for exchange. The notion argued is that the more precise the medium, the less likely actors will misperceive one another's move, except, the more precise the medium the less likely will actors explore their relationships. This is also a dilemma for IT outsourcing relationships. The more precise the medium of exchange, the easier it is to follow-up service levels, thus, value-added benefits will be difficult to achieve.

2.3.7 Agency theory

Eisenhardt (1989:58) postulates that “agency theory is directed at the ubiquitous agency relationship, in which one party (the principal) delegates work to another (the agent), who performs that work. Agency theory is concerned with resolving two problems that can occur in agency relationships. The first is the agency problem that arises when (a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing.”

According to Bahli and Rivard (2010:213) “the major issue in agency relationships is ensuring that the agent acts in the interests of the principal. The theory would assume,

in the case of IT outsourcing, that each party in the relationship has their own profit motive, because the parties' goals are not congruent. The principal cannot monitor the actions of the agent perfectly and without cost."

The dilemma with agency relationships is that the principal cannot authenticate that the agent has acted in the principal's best interest. In an internal outsourcing arrangement, a problem might arise if the principal and agent do not adopt the same methodology to mitigate risk. The underlying debate will always be whether the agent can be warranted to act in good faith on behalf of the principal.

Adams (1994:9) confirms this assertion that agency theory is based on the premise that agents have more information than principals and that this information asymmetry adversely affects the principals′ ability to monitor effectively whether their interests are being properly served by agents. The other peril is that there is an assumption that principals and agents act rationally and that they will use the contracting process to maximise their wealth.There is always the human element of greed and wanting to benefit oneself and as such there is a self fulfilling prophesy that the agent is most like to not to act in the best interests of the principal. Capens (1985) as cited in Adams (1994:9) refers to this dilemma as the 'moral hazard' problem. Another type of agency problem which arises is adverse selection. This occurs when the principal/owner(s) do not have access to all available information at the time a decision is made by a manager and is thus unable to determine whether managers' actions are in the best interests of the firm.

2.3.8 Theory of firm boundaries

Garicano and Hubbard (2003) as cited in Gottschalk and Solli-Sæther (2005:691) summarise firm boundaries: "as the scope of revenue-sharing arrangements across individuals – reflect trade-offs associated with referral problems, which are problems of matching economic opportunities to individuals' efficiency." The notion according to Garicano and Hubbard, (2003) is that individuals with specialised skills sometimes have private information about economic opportunities for which others have a comparative

advantage in exploiting. A practical example to illustrate this is when a client with a legal problem involving corporate law approaches a tax lawyer. Incentive problems arise because private information about such opportunities is valuable and transferring them involves adverse selection problems (Gottschalk & Solli-Sæther, 2005:691).

2.3.9 Stakeholder theory

According to Reed (2002:168) stakeholder analysis has become a key conceptual device over the past couple of decades in fields such as business and society, business ethics and management. As with most popular conceptual tools, stakeholder analysis admits of a variety of competing conceptions, some of which are complementary and others contradictory.

Reed (2002:169) is of the view that "stakeholder analysis has been used for different functions including, among others, describing and explaining the factors that encourage managers to identify some groups as stakeholders, describing and explaining the effects of management decisions on different groups of affected actors, identifying which actors have valid claims upon the firm, explaining how employing stakeholder analysis can help firms to achieve traditional goals."

Shankman (1991) as cited in Gottschalk and Solli-Sæther (2005:692) states that stakeholder theories of the firm are used to institute economic relationships within a context of ethical management. "Contrary to the traditional understanding of the principal-agent relationship, used in several outsourcing studies, a stakeholder orientation will include at least two new dimensions:

- A number of stakeholder groups; and
- The interpretation of the moral principles that underlie stakeholder theory." (Gottschalk & Solli-Sæther, 2005: 692)

According to the literature discussed above, neglecting any of the two dimensions may result in firms with less satisfied stakeholders and consequentially will be evidence for financial performance that is consistently lower than industry average.

2.4 SUMMARY

Outsourcing decisions in the literature stem from two branches, the desire to maximise resources or it could stem from politics. The objective of being in business is to maximise wealth. The theory of the firm substantiates this notion as the question which is posed is if firms do not exist to maximise wealth, then why do firms exist at all? From the literature study, it is evident that not all activities are outsourced. To determine when, how and why a firm should outsource its IAF still needs to be addressed.

Duncan (1998:675) argues that the theoretical question that needs to be raised is when, how and why should a firm outsource, or not outsource anything? Why does a firm exist at all? Using this approach, it can be concluded that theory helps to answer not 'which resources should be outsourced,' but rather, 'which ones should not?
No single theory that stands on its own, adequately explains the rationale for a firm's decision to outsource. The rational to outsource is mutually dependant on interlocking all the theories discussed. It is evident from the definitions studied that outsourcing originates from the strategic decision to focus on what the company's primary activity is, i.e. core competencies and to outsource functions which are secondary.

The main motivations regarding outsourcing as summarised from the literature above include:

- The outsourcing phenomenon has grown exponentially and does not only pertain to information systems. As firms become more globalised this trend will probably continue into the future. There is no evidence in the literature to predict otherwise.

- The outsourcing practice allows management to concentrate upon the core functions of the company. It would therefore be attractive to outsource all ancillary functions.

Core competency theory is a mechanism that organisation use to have competitive advantage whilst obtaining specialised skills without any internal investment on these skills. The resource-based view of the firm supports core competency theory. By aligning the organisation's purpose to attain competitive advantage and by obtaining resources and protecting competitive positions, serves as a motivation to outsource functions that do not enhance the competiveness of the firm as opposed to devoting more resources in maintaining the function in-house.

Transaction cost theory assists in examining a wide spectrum of decision problems such as outsourcing by combining economic theory with management theory to establish the optimal category of relationship a firm should develop with respect to its economic status in the market.

Contractual theory is important as it provides a legislative framework in which each party's obligations under the contact are specified. Every outsourcing contract has the purpose of facilitating exchange and preventing opportunistic gains. Appropriate contractual arrangements can soothe the flexibility for promoting unfair gains, as well as serve as a deterrent in mitigating risk in this mutual relationship and guards each party's trade secrets. Contracts agreed upon under relational exchange theory allow parties to gain access to information that was not available before. The risk in the context of outsourcing is that once the relationship is terminated in the future, the party who shared the outsourcing skill may be left undercompensated.

Agency Theory highlights the dilemma with agency relationships, which is that the principal cannot authenticate that the agent has acted in the principal's best interest. In an internal outsourcing arrangement, a problem might arise if the principal and agent do not adopt the same methodology to mitigate risk. The underlying debate will always be whether the agent can be warranted to act in good faith on behalf of the principal.

While the theory of the boundary of the firm illustrates the impasse that individuals with expertise from time to time receive confidential information concerning opportunities for which others have a comparative advantage to take advantage of, whereas, stakeholder theory of the firm establishes economic relationships within a context of ethical management. .

The different economic theories of the firm offer valuable perspective on a firm's decision to outsource. In conclusion this is a hermeneutic discussion which is intended to lay down preamble for the decision to outsource the IAF in the context of the organisation as a whole. This links to the next chapter, which reviews outsourcing of the IAF by comparing continental trends of internal audit outsourcing.

CHAPTER 3
THE INTERNAL AUDITOR AND THE IMPLICATIONS FOR OUTSOURCING THE INTERNAL AUDIT FUNCTION

3.1 INTRODUCTION: THE ORIGIN AND DEVELOPMENT OF INTERNAL AUDIT

The origins of internal auditing lie in ancient times. However, it was not until the 1940s that the practice of internal auditing began to assume 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, Rodrigues & Craig 2009:79).

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. Internal auditing is also performed in diverse legal and cultural environments; within organisations that vary in purpose, size, and structure; and also by persons within or outside the organisation (Fadzil, Haron & Jantan 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 & Woldeyohannis 2008:567)

Over the past few years, 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). A research team studied the internal auditing profession from several perspectives, e.g. the global profession, internal auditing knowledge and the future of the profession to name a few. The study concluded among other things that the then prevailing definition of internal auditing was insufficient to articulate the modern internal auditing profession (Coetzee & Du Bruyn 2001:63).

In January 2002, the IIA Inc. Board of Directors approved the following new definition of internal auditing:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes (IIA Standards, 2011:1).

Chapman and Anderson (2002) (as cited in Ramamoorti, 2003:13) explain that this new definition of internal auditing implies that the IAF as an objective activity does not necessarily have to 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, Marais & Fourie 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*. The IIA position paper advises that management should consider when evaluating outsourcing alternatives within the context of the following constraints :Available Resources; Size of the Organisation; Types of Outsourcing Alternatives; Law, Statute, or Regulation; Advantages and Disadvantages of Outsourcing; Contracts and Engagement Letters for Outsourcing Engagements and Policy for Outsourcing Engagements

Even though international data gathered indicates that there is a huge trend towards outsourcing "The Institute of Internal Auditors (IIA), is of the stance that the IAF is best performed by a fully resourced and professionally competent staff member who is internal and integral to the management structure of an organisation. The IIA states openly that a competent internal auditing department that is properly organised with trained staff can perform the IAF more efficiently and effectively than a contracted audit service (IIA, Professional Issues Pamphlet 94-1). The Standards and Guidelines for the Professional Practice of Internal Auditing on the other hand, leave the door open to the possibility of externally provided services, by suggesting that if the internal audit department does not possess the necessary knowledge, skills, and disciplines necessary to carry out its audit responsibilities, then it is advisable to obtain these from an outside service provider'' (Selim & Yiannakas, 2000:216).

3.2 THE STRUCTURE OF INTERNAL AUDIT SYSTEM.

Based on the current international practice, there are three different system structures of establishment of internal audit units in a business enterprise (Li 2006:6). The three structures of a typical IAF consist of an in-house function (where all the activities are performed by internal auditors appointed by the organisation), an outsourced function, or co-sourcing (a combination of the two previously mentioned forms). 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. It enables an organisation to be cost-effective and derive external expertise, while retaining the advantage of direct control over internal auditing (Ikutu Brochure, 2010:4)

IAFs are transforming their organisations in a variety of ways including: retooling existing resources, hiring new skills into the function, implementing rotational programs, and developing relationships with third-party service providers. Respondents are facing a number of hurdles in the drive to find and train “the right people” (Global Internal Audit Survey, Ernst and Young nd). 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, Reed & Heywood 2005:235).

3.3 THE RESPONSIBILITY AND ACCOUNTABILITY OF INTERNAL AUDIT IN THE PUBLIC AND PRIVATE SECTOR.

International practices have indicated that different types of audit institutions all have their auditing emphases: government audit institutions mainly audit enterprises having an important bearing on the national economy and the people’s livelihood; internal audit departments carry out preventive audits for protection of enterprise interests; public audit institutions focus on economic certification under conditions of the market economy (Enyue1997:206) .

In the South African public sector the division of accountability is evident from the Public Finance Management Act, 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 Public Finance Management Act, 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, Thornhill & De Jager, 2008:547).

In South Africa, the IAF in the public sector is governed by the Public Finance Management Act of 1999 (PFMA). The PFMA determines how all business internal audit units are established according to the government's administrative guidelines. The directive of internal audit vests in Sections 38 (1) (a) (i) and 76 (4) (e) of the PFMA, which states:

- The accounting officer must ensure that a risk assessment is conducted regularly to identify emerging risks of the institution. A risk management strategy, which must include a fraud prevention plan, must be used to direct internal audit effort and priority, and to determine the skills required of managers and staff to improve controls and to manage these risks. The strategy must be clearly communicated to all officials to ensure that the risk management strategy is incorporated into the language and culture of the institution.
- Each institution to which these Regulations apply must have an IAF.
- If considered feasible, the relevant treasury may direct that institutions share IAFs . If such a determination is made, the Auditor-General must be informed within 30 days of the determination.
- An IAF may be partly or wholly contracted to an external organisation with specialist audit expertise, provided that its selection is in accordance with the relevant government's competitive tendering procedures.

- The purpose, authority and responsibility of the IAF must, in consultation with the audit committee, be formally defined in an audit charter and be consistent with the IIAs definition of internal auditing.

The PFMA explicitly states that the IAF forms part of the framework of control and supports accountability and good governance. The establishment and functioning of the Internal Audit and Audit Committees which are determined in the PFMA and Treasury Regulations are to fulfil the purpose that the IAF as part of the control system, is to assist the accounting officer in maintaining efficient and effective control by evaluating those controls to determine their effectiveness and efficiency, and by developing recommendations for enhancement or improvement. This function is seen as auditing the various control systems to ensure that fraud and losses for the department are minimised (Fourie 2007:740).

It is evident that in South Africa that Public sector requirements are for internal audit is legislated and formally explained in the Public Finance Management Act of 1999. It can be argued that there are significant differences between internal audit in the private sector and its equivalent in the public sector in South Africa.

For instance, in South Africa there is no requirement for private sector entities to use internal audit, however the need for an IAF was recommended by the first King Code for corporate governance (IOD, 1994). Even though there is no mandatory requirement in that there is no legislation that requires South African entities to comply with the King code(s) for corporate governance, the Johannesburg Securities Exchange (JSE) Limited requires listed companies to apply or explain non-compliance with the King Code in their annual financial statements.

Carhill and Kincaid (1989) as cited in Goodwin, (2004:641) suggest two reasons for these differences. Firstly, public sector agencies operate in a rigid framework where activities are authorised by legislation. Secondly, these agencies are service-oriented and hence attach lower priority to cost factors and issues associated with profitability.

Because of this, it is argued that public sector internal audit activities need to be of a much broader scope than in the private sector. It is therefore the intention of this research to only use listed and public accountable companies and entities by virtue of the link between laws, governance and internal audit.

3.4 RISKS OF OUTSOURCING

Experts investigate whether or not a hasty outsourcing decision could open an intellectual drain or create a loyalty rift in the organisation. Talented staff who are displaced following a shift in process ownership might take with them innovative ideas and work approaches that would have benefited the future direction of the company. Perhaps even more dangerous is the potential of outsourcing to raise staff loyalty issues. "Employees might be waiting for the other shoe to drop after a process is outsourced," maintains Al Marcella, author of Outsourcing, Downsizing, and Reengineering - Internal Control Implications, published by The IIA.

"If staff perceives that the organisation doesn't care about its personnel, employees won't waste their loyalty on the business," he says. "They'll update their resumes and start hunting for new jobs" (Figg, 2000:50).

The literature is informative as to what might be expected from risks of outsourcing. In strategic terms, outsourcing some functions, and contracting too much of their core competencies, is dangerous to the entity. Doing so may compromise an organisation's ability to generate new core competencies that would otherwise come about if these functions were kept in-house (Matusik & Hill, 1998; Prahalad &Hamel, 1990 as cited in Van Peursem & Jiang, 2008:4).

Frost (n.d.:35) argues that by outsourcing certain business processes, financial institutions can greatly improve the performance of these functions or departments, as they support the overall business element of most institutions' core business processes and, as a consequence, risk management outsourcing is rare. On the other hand

Internal audit outsourcing may cover the management and execution of every aspect of internal auditing, including: defining the role and responsibilities of internal audit; organisation and staffing; scope of examinations; risk assessment; audit plans; work programmes; visitations; computer auditing; special projects and reporting. The outsourcing of any process raises a number of critical risk-related issues. Simply put, the operational change it necessitates, involving human resources, physical assets, business processes, technology and so on, can bring about new operational risk exposures that require extra overseeing by management. Internal auditing can support the decision-making process by evaluating the organisation's rationale for outsourcing a function and determining whether or not outsourcing can deliver the quality and cost improvements that have been purported (Figg, 2000:50).

Table 2 explains and highlights risk and rational for outsourcing the IAF.

Table 2: Rationales for and against outsourcing internal audit

Outsourcing Internal Audit:		
	Perceived Opportunities	Perceived Risks
Internal operational	Dispose of functions that are difficult to manage The opportunity to offload unproductive or unwanted employees The inability of the in-house audit function to fulfil the audit plan on-time The organisation's inability to retain (or recruit) people with the necessary skills	An insider will know the business' operations better than outsiders, leading to more efficiencies/ effectiveness Information theft more likely Managing contractors can be difficult and lead to poor performance

Access to quality services	Access to auditors with specialised skills Can ensure high quality of service through contract and targeting skills needed for task at hand Share risks of business failure due to poor control systems Accountability improved from having an independent party review operations	Competency from externals is unknown Internal auditors available when needed Internal audit services needed regularly, not just on occasional basis Independence of external auditors may be surrendered if performing too many functions for company
Strategic response to competition	Cost savings that would result compared to in-house auditor Improve company focus or strategy Respond to fundamental business climate change Support for global and/or geographic initiatives	Anticipated cost savings may be overrated 'Core' functions should not be outsourced or strategic position is lost
Managers' perceptions of services and service availability	The presence of a large number of internal audit providers in the market The high rate of other organisations' success when they outsourced their IA functions Impartiality of an outside contractor It's a core function of business	Business will lose the benefit of their own internal audit (or related) management operations if outsourced

Source: Van Peursem and Jiang (2008:25)

3.5 AUDITOR INDEPENDENCE AND OUTSOURCING

Independence is both an ethical and a professional issue crucial to auditors. Independence has been viewed as "a deeply felt professional credo" (Vanasco, 1996:1). Internal auditors have seen their role evolve from performing traditional IAFs to focusing upon adding value to the organisation. As evidenced by the new definition of internal

auditing (as adopted by the Institute of Internal Auditors), the work performed by internal auditors is not limited to the area of assurance services, but now includes consulting activities. Internal auditors are being asked to provide consulting in various activities of the organisation such as acquisitions, mergers, and strategic alliances. This recent emphasis on consulting has brought new questions and concerns regarding the ability of internal auditors to function in an independent and objective manner (Brody & Lowe, 2006:169).

To ensure investor confidence, auditors must be constantly aware of factors that affect the audit environment that could influence or harm their independence For instance, over the past few years; revenue from non-audit services has become increasingly important as firms seek to increase their profitability (Arnold, Bernardi, and Neidermeyer,1999:45).These non-audit services include: "investment banking and other capital-raising activities; strategic planning and operational consulting services; assistance in finding business partners or acquisition candidates; assistance in gaining regulatory approval for major transactions; outsourcing services such as internal audit and tax departments and other traditional management activities" (Sutton, 1997:88). As these types of relationships between clients and auditors increase, firms may become dependent on the revenue from these non-audit services (Arnold *et al*, 1999:45).
IIA Standard 2210.C1 recognises that management when setting the overall strategy for the organisation may decide that the IAF should be outsourced to an outside service provider.IIA standard 2210.C1 concludes that if such is the case then “the consulting engagement objectives should address risks, controls and governance processes to the extent agreed upon with the client. Cascarino and van Esch (2007:195) point out that large professional firms of accountants and auditor have recognised the marketing opportunity of rendering internal audit services and as such have aggressively moved into this area drawing on the firm’s reputation and the focusing on the niche of offering better technologies and more streamlined internal audit engagements. Drawing to the public sector, Picket and Spencer (2003:17) state that outsourcing in local and central governments may provide an avenue for public sector internal auditing engagements to be undertaken by outside service providers as an attractive marketing tool.

The Institute of Internal Auditors believes that a clear conflict of interest exists when the CPA (Certified Public Accounting) firm that performs the external audit also has primary responsibility for the internal audit. The IIA asserts that under such an arrangement the CPA firm becomes an indirect advocate of management assertions in the financial statements, thus possibly predisposing external auditors to serve corporate management rather than shareholders and investors however little evidence exists as to whether financial statement users believe that auditor independence or financial statement reliability is jeopardised when the external auditors are engaged to perform internal audit activities (Geiger, Lowe, & Pandy, 2002:22).

The academic literature on contemporaneously performing the external audit and performing internal auditing services has not definitively shown the impact of these joint services on perceptions of independence (Hill, 2004:8).

“Through audit committee resolution arrangements, the external audit firms began to take responsibility for the IAF many corporations. Although details varied, a corporate IAF would become employees of a separate division of their external audit firm. They would continue their internal audit work but often with a greater emphasis on the audit of the financial statements. An increasing trend, to outsource internal audit arrangements became a major issue with the fall of the Enron Corporation in late 2001. Enron’s IAF had been outsourced to its then external auditor, Arthur Andersen. The two groups shared the same physical office area and worked together on many projects. With the fall of Enron and the subsequent hearings and investigations that led to the SOA, there were frequent questions regarding the independence of these internal auditor outsourcing arrangements. Internal audit was viewed as being tied to closely to their external auditors” (Moeller, 2004:42).

“The definition of internal auditing provides some clues as to the incentives and environmental forces faced by internal auditors. Management employs internal auditors, yet these same internal auditors are also often asked to review the performance of management and others. In addition, management often relies on internal auditors for consulting services and incorporates audit recommendations into the reengineering of

business processes. Auditors, in their role as assurance providers, evaluate these processes" (Mutchler, 2003:236).

The combination of the internal auditor's dependence on management, the increasing importance of internal audit activities, and the growth in the demand for internal audit consulting activities with the resultant problem of internal auditors assessing their own work product, and increasing internal audit outsourcing, leads to escalating concern about internal auditor objectivity. There are situations, for example, where an internal auditor may have special knowledge and skills to undertake an in-house project but such participation may raise concerns about a potential compromise of objectivity through a lack of independence.

The company faces the trade-offs of allowing the project to go forward and managing the associated independence/objectivity risks, or using more costly outside experts or outsourcing providers to complete the project with the internal auditors only playing a monitoring/review role, or the adverse trade-off of simply dropping the project. Internal auditors, because of the nature of the services they perform, gain a deep knowledge and understanding of the company. As such they face conflicts of interest simply because they are the only ones who understand, can undertake, and/or are qualified to perform such consulting services. If they then perform related assurance services, conflicts of interest (i.e., threats to objectivity) arise (Mutchler, 2003:237).

"Independence is so relevant to internal auditors that the IIA issued eight interpretations in its Professional Standards Bulletins (PSBs). PSB 85-6, Independence of Internal Auditors vs. External Auditors notes that the greatest single issue concerning the independence of internal auditors is that they are 'inside looking in'. All auditors, when in compliance with their standards, are equally independent; therefore, all internal and external auditing organisations strive to maximise management's knowledge and understanding of, and agreement with, standards governing their efforts. In this way, practical independence is enhanced" (Vanasco, 1996:13).

The following paragraphs will look at the external outside service provider independence with regards to rendering of internal audit services(non assurance services) and the independence implications that could arise. In South Africa, the provision of internal audit services is governed legislatively by both the Companies Act of 2008 as well as the Auditing Professions Act of 2005.The provision of internal audit services is designated as a provision of a non-assurance service by the auditors.

The Companies Act 61 of 1973 states that an auditor appointed to a widely held company, may not, for that company perform any internal audit which may be subject to an audit by the said auditors. The International Federation of Accountants (IFAC) Code of Ethics (which has been adopted by The South African Institute of Chartered Accountants - SAICA) reinforces this principle by stating that professional accountants in public practice must remain independent, and therefore should not undertake an engagement which would threaten this independence.

The Companies Act 71 of 2008 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”. The onus therefore rests on the audit committee of the company to evaluate the independence of the auditors and approve the provision of internal audit work by the audit firm.

The provision of both assurance and non-assurance work by the audit firm would also be contrary to the King III Report on Corporate Governance. An auditor providing internal audit services as well as carrying out the external audit would be responsible for the re-evaluation of his own work and the Auditing Profession Act sets forth the regulations that all registered auditors in South Africa must comply to. Section 44(6) of this Act states that “a registered auditor may not conduct the audit of any financial statements of an entity, whether as an individual registered auditor or as a member of a firm if, the registered auditor has or had a conflict of interest in respect of that entity, as

prescribed by the Regulatory Board." Safeguards may be implemented to reduce this risk of self review to an acceptably low level, the most practical of which would be to ensure that separate engagement teams are used to provide the different services.

3.6 INTERNATIONAL REVIEW OF INTERNAL AUDIT OUTSOURCING TRENDS

The end of the twentieth century has been captivated with the outsourcing phenomenon. Almost every industry has turned on to the benefits of outsourcing. According to Figg (2000:49) the main reasons behind this include; reducing and controlling operating cost, improved company focus, and gaining access to world class capabilities. Internationally, the current global emphasis on the need for sound corporate governance has led to an increasing interest in internal audit.

"In the United Kingdom, the establishment of an IAF was recommended as 'good practice' by the Cadbury Committee. In the United States, the Blue Ribbon Committee (New York Stock Exchange (NYSE) and National Association of Securities Dealers (NASD)) noted that a strong IAF can improve the effectiveness of the audit committee'' (Goodwin & Yeo, 2001:108).

It has been noted (Goodwin-Stewart & Kent 2006:82) that the NYSE has endorsed the proposals of its Corporate Accountability and Listing Standards Committee (NYSE, 2002) that all companies listed on the NYSE should be required to have their own IAF.

The New York Stock Exchange (NYSE) requires all companies listed there to "maintain an IAF to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control" - and to comply hereby before October 31, 2004. This rule will affect CPAs in many companies. While most of the 2,800 NYSE-listed companies already maintained internal audit departments. The rule however prompted the other NYSE listed companies to comply as well.

The Institute of Internal Auditors (IIA) 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).

Carcello, Hermanson and Raghunandan (2005:70) examined factors associated with U.S. public companies' investment in internal auditing. Data from a survey administered to Chief Audit Executives of mid-sized U.S. public companies were supplemented with publicly-available data. Based on data from 217 companies, the results indicated that total internal audit budgets (in-house and outsourced portions) were related to several factors associated with company risk, ability to pay for monitoring, and auditing characteristics. Specifically, the study produced evidence that internal audit budgets are positively related to company size; leverage; financial, service, and utility industries; relative amount of inventory; operating cash flows; and audit committee review of the internal audit budget. 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.

They also noted that "one large international company predicted that internal audit outsourcing will constitute 25% of their total accounting and auditing services within a short period of time. Furthermore companies specialising solely in internal audit work were being formed'' (Rittenberg & Covaleski, 1999:227).

Trends in the research conducted by Rittenberg and Covaleski 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. The rationale behind this is that internal auditing is perceived to

be an attractive function to consider for outsourcing because it may represent cost savings potential for the corporation (traditional economic imperatives of the 1990s, e.g. downsizing and focus on core business).

“Outsourcing also represented a significant revenue enhancement opportunity for the outsourcing providers (predominantly the Big 5 professional service companies). As an example of these changes, Arthur Andersen reached an agreement with the Camp Fire Boys and Girls (an organisation with revenue of $US50 million) to provide full-time, on-site accounting and system services and to give up the audit. The fees for this outsourcing agreement were between $300,000–$400,000 per year while the audit fees were less than $50,000 per year. Arthur Andersen said that the outsourcing deal strengthens their relationship with the client and that they can better serve their client by providing services other than the audit” (Rittenberg & Covaleski, 1999:227).

Allegrini, D’Onza, Paape, Melville and Sarens, (2006:848) found that 61% of the responding internal audit departments do not use outsourcing or co-sourcing today but they expect to use, to some extent, more 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.’’

They further confirmed that growth in the revenues earned from these services have been significant. “In constant 1999 dollars, non audit services fees grew from $2.8 billion in 1990 to $15.7 billion in 1999 – an increase of over 460%’’ (Jenkins & Krawczyk, 2002:3).

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. The study concluded that the implications of these findings for sound corporate governance

were serious, and suggested that it would be difficult for audit committees to be effective without the support of the internal audit. The study recommended that there was considerable scope for strengthening the relationship between internal audit, audit committees and external auditors (Goodwin & Kent, 2001:85-86).

Goodwin (2004:1), explored similarities and differences between public sector internal auditing and its counterpart in the private sector. “Features examined include organisational status, outsourcing, and using internal audit as a “tour of duty” function, audit activities and relationships with the external auditor. The study was based on a survey of chief internal auditors in organisations in Australia and New Zealand. 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. While a similar amount of work is outsourced, public sector organisations were more likely than those in the private sector to outsource to the external auditor.’’

In addition, Goodwin (2004:1) exposed that “there was little difference between internal audit activities and interactions with external audit in the two sectors. However, private sector internal audit was perceived to lead to a greater reduction in external audit fees compared to that in the public sector.’’

It has been noted by Cooper, Leung and Wong (2006:832) that “Carey *et al*. undertook a study to investigate the determinants of internal audit outsourcing using survey data of 99 companies listed on the Australian Securities Exchange. According to the research findings, 54.5 percent of companies fully rely on an in-house IAF, with the others outsourcing all or some of their internal audit activities. Outsourcing according to the study was associated with perceived cost savings and the technical competence of the provider. Analysis of results differed as observations indicated that 75 percent of those companies outsourcing did so to their external auditor, which may have implications for perceptions about the independence of the external auditor.”

Selim and Yiannakas (2000:216) maintain that the IAF represents one of the newest, traditionally in-house functions that are now being targeted for outsourcing. The fundamental questions are: “Should organisations even contemplate outsourcing the IAF? Does everyone involved with internal auditing need to be a full-time employee of the organisation? Is the IAF an activity that can be safely, sensibly and successfully outsourced in order to generate cost savings whilst improving – where possible – the quality of the service?’’

They further argue that those who are against outsourcing internal audit will go as far as to suggest that the decision to outsource the entire internal audit department is the most ill-advised move senior management can make and it will subsequently be regarded as a serious mistake. In fact, Acciani, (1995) and Courtemanche, (1991) as cited argue that, “while outsourcing might look like an attractive arrangement at the beginning, eventually it will cost the organisation more than to retain the in-house internal audit team. They continue by stating that outside service providers may initially go for low-balling in order to obtain the contract but, after a while, they usually tend to push the billing-rates to more ‘normal’ levels” (Selim & Yiannakas 2000:216).

Selim and Yiannakas (2000:216) highlight that fact that “critics of outsourcing are quick in pointing out concerns regarding independence, conflicts of interest, and confidentiality that are raised when the same public accounting company provides both internal and external audit services.”

Hass, Abdolmohammadi and Burnaby (2006:6) state that “balancing the complex, competing demands of stakeholder needs with limited IAF resources requires effective management by the Chief Audit Executive (CAE).To be perceived to add value, the IAF must strategically align with the needs and priorities of all of its key stakeholders, including the audit committee, executive management and external auditors. The reasoning behind this is that this will result in a reordering of priorities for the CAE as the link between the IAF and the audit committees with their oversight responsibilities has significantly strengthened their relationship. Communicating the needs of the audit function, both orally and in writing, to key stakeholders is critical to successfully

maximising resources. Effective risk analysis, time management and prioritisation of tasks are important skills for internal auditors to ensure effective utilisation of scarce resources.''

The argument is that increased demand for the IAF services places strain on many departments' limited time budgets resulting in outsourcing and/or co-sourcing of activities. The central idea in their research is that outsourcing would be viable for functions that are not unique. For areas with specialised needs or competencies, outsourcing may be a viable alternative. "Outsourcing reduces the demand for a scarce resource but requires management of external contract workers and their employers. Chief audit executives must therefore ensure that their management of internal audit staff is a transferable skill that can be used for the management of external co-sourcing relationships" (Hass *et al*., 2006:6).

Roth (2003:34) argues that "beyond in-house staff, world-class departments are complementing their own resources with selective outsourcing." "Even a large audit staff cannot maintain in-depth knowledge of every computer application, investment product, and benefit plan in the organisation. In fact, 45 percent of respondents to The Institute of Internal Auditor's Value-added Services survey (year not cited) used outside contract auditors to either co-source select assignments or outsource a substantial portion of their work. Of these, the average amount of work outsourced was 19 percent. Though well-staffed and endowed with a broad range of expertise, many of the best audit shops are still finding the need to enlist outside help'' (Roth, 2003:3).

Van Peursem 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 Peursem and Jiang (2008:17) survey indicated that 43% still do not carry out an IAF. The study also revealed that New Zealand companies do appear to be responding to expectations of accountability through internal audit, but they may have started from a smaller base. What was brought to light here was that New Zealand managers seemed to look for otherwise inaccessible expertise in making their outsourcing choices.

The past ten years has seen a substantial amount of international research been undertaken on the occurrence of outsourcing the IAF, and taking into cognisance of the service providers to whom the function is being outsourced as well the motivations prompting the decision to outsource. In South Africa however there seems to be a lag with regards to research being conducted with regards to outsourcing the IAF when comparing this with international research.

Carcello, Hermanson, and Raghunandan (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. The results from this study demonstrated that internal audit budgets were negatively related to the percentage of internal auditing that was outsourced. The overall conclusion was that companies facing higher risk will increase their organisational monitoring through internal audit, providing evidence of the importance of the IAF. The outcome of the study further supports the argument against fully outsourcing.

Coram, Ferguson and Moroney (n.d) showed that organisations with an IAF are more likely to detect and self-report fraud through misappropriation of assets than those that do not. The results also proved that having some in-house IAF is more effective in detecting fraud than completely outsourcing IAF. The results indicative important to stakeholders such as investors and regulators because they provide evidence on the value of the IAF.

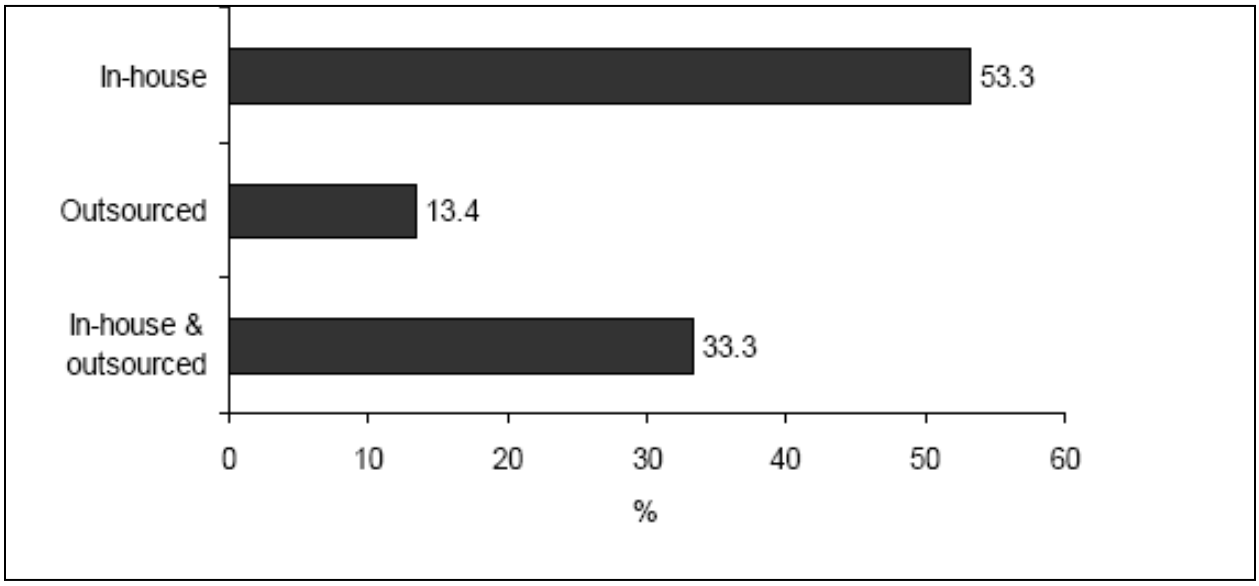
Only two studies have appeared to have addressed the internal audit outsourcing decisions in South Africa. The first documented study of outsourcing the internal audit activity was conducted by Mjoli (1997:1). The dissertation discussed the role of internal audit and the reasons for outsourcing the IAF amongst others (Mjoli 1997:7). The study found that internal audit was not considered to be a core function (91.3% respondents of the study expressed this view) (Mjoli 1997:67). The study concluded that although the outsourcing of internal audit may help 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 study has its limitations as firstly, it was conducted more than a decade ago and since then governance reforms and secondly, the revised definition of internal audit has come into existence.

The second study was conducted by the iKutu Research Team (2010), which provided a broader insight into the internal audit outsourcing practices of large listed companies in South Africa. The study revealed that the participating companies mainly used in-house (53,3%) and co-sourced IAFs (IAFs) (33.3%), but complete outsourcing (13.4%) was also present in their IAF structures, see Diagram 3.

Diagram 3: Structure of IAFs



Source: iKutu Brochure (2010:21)

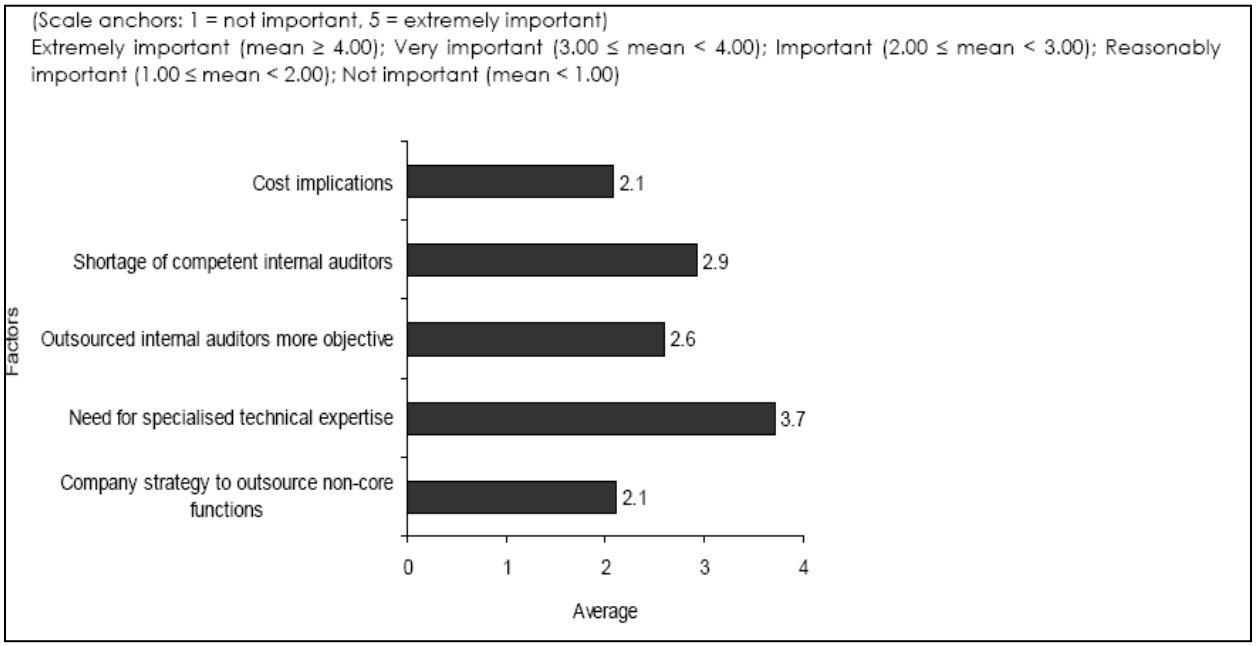
The iKutu Brochure showed that respondents perceived the need for specialised technical expertise as being the most important rationale for outsourcing all or certain services of IAFs. Respondents perceived the shortage of competent internal auditors in South Africa as a very important rationale. According to the iKutu Research Team (n.d)

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 indicated that 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. The study found that certain or all services of participating companies' IAFs were mostly outsourced to one of the Big 4 public accounting firms.

To determine the perceived status of both in-house and outsourced IAFs, the iKutu Research Team examined the importance of certain attributes (IAFs competence, commitment, effective service delivery, flexibility, added value and whether they meet expectations), 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.

Diagram 4: Reasons for the decision to outsource the IAF



Source: iKutu Brochure (2010:21)

The results revealed that respondents were extremely satisfied that their in-house IAFs demonstrated compliance with each of the identified five attributes, as well as being extremely satisfied with the competence, commitment and flexibility to accommodate managements' needs displayed by their outsourced IAFs. See diagram 4.

The first shortcoming of the iKutu Brochure, as cited from the brochure, is that the study was limited to 30 large listed companies in South Africa, and secondly the final the research was limited to the private sector. The Ikutu Brochure therefore recommended that 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. This study makes a valid contribution to internal audit outsourcing practices in South Africa.

3.7 Summary

The upsurge in outsourcing over the last 20 years has been fuelled by arguments from leading academics that an organisations 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 & Anastasiadis 2003:355). This chapter has presented the relevant literature and evidence illustrating that outsourcing of the IAF has been rigorously debated conceptually from an IIA Standards perspective, as well as academically as evidenced in the review of local and international literature.

The literature reveals that for internal audit to maintain its objectivity does not imply that the IAF be maintained in-house and acknowledges that quality internal audit services can be provided by outside service providers. However there are pertinent issues concerning risk, opportunities and independence when an organisation decides to elect the outsourcing route.

Internal Audit is a fairly new profession and as such is continually being revised and re-specified for specific purposes and environments; a review of domestic and international literature reveals how other countries have extensively tested the internal outsourcing phenomena. Empirical literature generally found significant relationships between outsourcing and socio economic consequences. The rational used in the literature studies examined was that increased demand for the IAF services places strain on many departments' limited time budgets resulting in outsourcing and/or co-sourcing of activities. The central idea was that outsourcing would be viable for functions that are not unique. For areas with specialised needs or competencies, outsourcing may be a viable alternative. The next chapter presents the research hypothesis, framework, and data that underpin the hypothesis for this study.

CHAPTER 4
RESEARCH METHODOLOGY

4.1 INTRODUCTION

In order for society to progress, new knowledge about the world must be constantly generated. Gaining new knowledge involves a process of formulating specific questions and then finding answers to them (Bless, Higson-Smith & Kagee, and 2006:1).

As cited by White (2003:21), research has been defined by Johnson (2004) as: “A focused and systematic enquiry that goes beyond generally available knowledge to acquire specialised and detailed information, providing a basis for analysis and elucidatory comment on the topic of enquiry.”

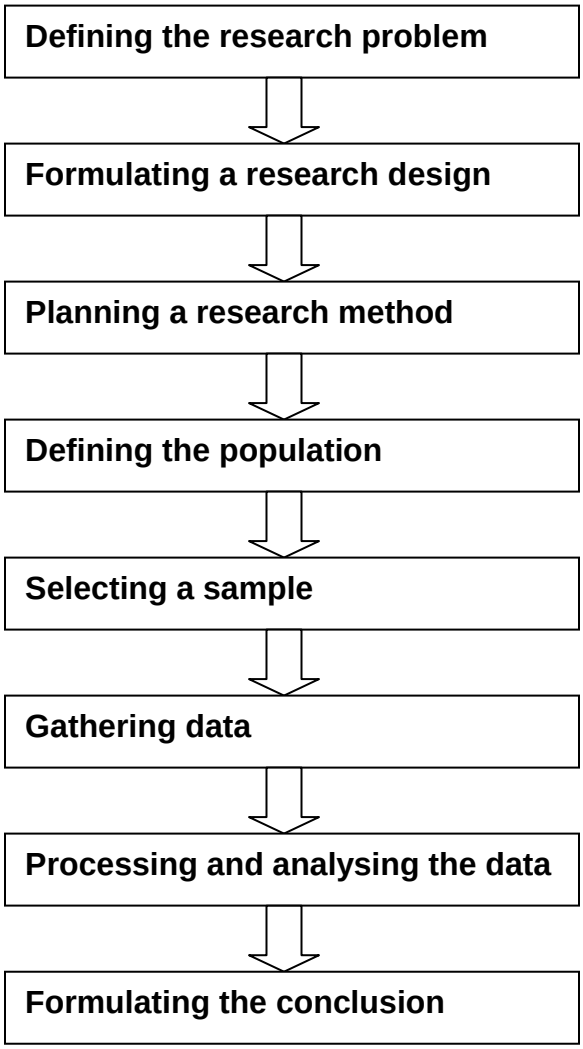
The research conducted takes the form of a descriptive research study. A literature study was conducted which formed the theoretical basis to the questionnaire designed to complete the empirical study. This chapter focuses on the research methodology and research methods adopted to conduct the empirical study to investigate the status of the IAF in South Africa.

The following elements contribute to an empirical research study:

- Research design;
- Research method;
- Research format;
- Research technique;
- Research data collection methods;

- Research population;
- Research sampling;
- Data collection instruments, sources and procedures; and
- Data analysis.

The research process may be depicted as follows:



4.2 RESEARCH DESIGN

Research design is a framework or blueprint that plans the action for the research project (Zikmund, 2003:65). Research design can be categorised broadly into the following categories: exploratory research, descriptive research and causal design. (Hair, Babin, Money & Samouel, 2003:57). This empirical study can be classified as descriptive research as the aim of the research is to "portray an accurate profile of persons, events or situations" [Robson (2002:59) as cited by Saunders, Lewis & Thornhill, 2003: 97].

The data obtained in this study will contribute to a cross-sectional study. Descriptive studies can provide the user with a snapshot, or a description of business elements at a given point in time. These types of studies provide cross-sectional data. (Hair *et al*, 2003:61)

The research was designed to use structured questionnaires to evaluate each of the research problems previously identified. Research design closely incorporates the elements of validity and reliability and the use of structured questionnaires strengthens the outcome of the research in terms of population validity and reliability as supported by the statement presented below. "Validity is concerned with the idea that the research design fully addresses the questions and objectives aimed to be achieved. Reliability is about consistency and research, and whether another researcher could use the design and obtain similar findings" (White, 2003:25).

"Surveys usually entail the careful random selection of samples that enable results to be generalised to wider populations with a high degree of confidence. Concurrently, by using highly structured questionnaires to gather data in a form that is quantitatively analysable, survey research is usually regarded as easily replicable and hence reliable" (Gill 1991:123).

4.3 RESEARCH METHOD

Research methods reflect the research philosophy adopted and the research aims identified. Data and methodology are inextricably intertwined. For this reason, the methodology to be used for a particular problem must always take into account the nature of the data that will be collected in the resolution of the problem (Leedy & Ormrod, 2010:93).

The nature of data to be collected in the resolution of the research problems identified comprised data collected from a sample of the population, in a form easily convertible to numerical values. Classification of the research method as quantitave is therefore appropriate as "quantitative data collection approaches typically are used when the researcher is using well-defined theoretical models and research problems. (Hair *et al*, 2003:124). "Quantitative research reflects the principles of positivism and aims to establish, confirm, or validate relationships and to develop generalisations that contribute to existing theories" (Leedy & Ormrod, 2010:95).

4.4 RESEARCH FORMAT

Descriptive research designs are usually structured and specifically designed to measure the characteristics described in a research question (Hair *et al*, 2003:60). From the above it can be concluded that the study encapsulates the characteristics of a descriptive research study.

4.5 RESEARCH TECHNIQUE

A descriptive study was conducted to investigate the status quo of outsourcing the IAF within South African private and public organisations by focusing on the factors which motivate the decision to outsource the IAF by examining how internal audit is perceived by South African organisations, the likely impact the outsourcing decision may have on an auditor's independence and the quality of the internal audit service provided.

Questionnaires were used as the data collection instrument to determine the status quo of outsourcing the IAF within South African private and public organisations. The questionnaire used to collect data was based on a study performed by Selim & Yiannakas (2000) and adapted to the South African environment. The following research questions, derived from the research objectives were investigated:

Research Question 1:
What is the current status of outsourcing the Internal Audit Function in South African private and public entities?

Research Question 2:
What is the perception of the Internal Audit Function amongst Finance Directors and Chief Audit Executives in both the public and private sectors with regards to outsourcing the IAF?

Research Question 3:
What are the principal motives, factors and implications of the decision taken by selected South African companies/entities to outsource the Internal Audit Function?

Research Question 4:
What is the impact of the decision to outsource the Internal Audit Function on auditors' independence (internal and external) and on the quality of the internal audit service?

The objectives underpinning the above research questions of the study were:

Objective 1:
Establish the current status of outsourcing the Internal Audit Function in South African private and public entities.

Objective 2:
Ascertain from Finance Directors and Chief Audit Executives, in both the public and the private sector, what are their perception of the with regards to outsourcing the Internal Audit Function.

Objective 3:
Establish the principal motive(s) and factor(s) behind the decision to outsource the Internal Audit Function.

Objective 4:
Examine the impact of the decision to outsource the Internal Audit Function on auditors' independence (internal and external) and on the quality of the internal audit service.

The research approach adopted may be described as follows:

Structured electronic questionnaires were developed based on questionnaires used in a study performed by Selim & Yiannakas (2000) and adapted to reflect the current South African internal auditing environment to obtain the primary data required for the study. The questionnaire first had to undergo an ethics clearance and permission was sought from the University's ethics committee. The questionnaire was designed to obtain organisational information, ascertain managements' attitude towards the IAF, determine the level of outsourcing management is involved in and the status quo of the IAF with regards to it being outsourced. The questionnaire also aimed to establish the level of interaction between the providers of external audit services and the providers of outsourced internal audit services. A cover letter was attached to the questionnaire detailing the objectives of the study as well as providing assurance to respondents regarding the confidentiality of the information provided.

Compilation of the initial sampling list was done using the McGregor BFA database. This database provided the name of the organisation (public and private organisations),

the postal address, telephone and fax numbers as well as a contact person. The database did not however include the e-mail addresses of the contact persons required for the purposes of the survey. Existing contacts, searching organisations websites as well as telephoning organisations requesting the e-mail addresses of the Chief Audit Executive, Financial Director and /or Senior Internal Audit manager, completed the data set required.

Electronic questionnaires were sent to a purposively selected (non probability sampling) sample of 80 South African organisations from both the public and private sector initially on 01 July 2010. There after the Institute of Internal Auditors – South Africa (IIA-SA) distributed the questionnaire via their newsletter to attract a better response rate. Individuals were approached at IIA-SA regional events to complete the questionnaire. 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 (2000:213) found this method to be the most effective vehicle for reaching a significant number of respondents.

A mail merge was used to merge the questionnaire with the mailing list. The recipients of the e-mail included Chief Audit Executives, Financial Directors, Senior audit managers and executives responsible for the IAF within their organisations (in the case of organisations with an IAF that is fully outsourced). A control spreadsheet was developed to monitor responses and the delivery reports received were compared to the mailing list. Unsuccessful e-mails were re-sent and followed up on by contacting the organisations to ensure the contact e-mails and details provided were correct, recent and valid.

The addressee was provided with a brief background to the study as well as the principal objective of the study. Addressees were informed that results of the survey would be sent to them on completion of the study.

The questionnaire begins by enquiring from the respondent as to whether outsourced internal functions have been used and if not, was consideration given to outsourcing this function. The questionnaire then goes further to establish the factors affecting the outsourcing decision made by managers as well as to enquire as to the service providers contracted to provide the outsourcing function and whether these service providers also provide external audit services to organisations. The questionnaire employed close-ended questions, requiring respondents to simply select an option from a drop down menu.

This questioning technique was considered appropriate to ensure comparison of responses and to facilitate statistical manipulation. Respondents were encouraged to provide additional thoughts and views relating to the outsourcing of the internal function separately in an attempt to elicit data "with greater depth and meaning, revealing insights into pertinent issues" (Gill, 1991:89). A reminder letter, attached to a questionnaire was sent to respondents on the 7 July 2010 to ensure a higher response rate and improve the overall quality of the research. Completed questionnaires were returned via e-mail to the sender. An e-mail was sent to each recipient on completion and return of the survey, to thank all respondents for their contribution to this study. A spreadsheet was developed to capture the raw data obtained from the survey.

Problems most commonly encountered during the collection of data included:

- Out of office replies received on e-mailing the participant.
- Difficulty in obtaining the e-mail addresses of CAE's, FD's and senior managers as only e-mail addresses of general contact persons within organisations were available on their websites.
- Information not available due to websites undergoing maintenance during the survey period.

4.6 RESEARCH DATA COLLECTION METHODS

The study performed incorporates a literature study as well as a survey performed. These components provide the data from which conclusions could be reached. Data can be classified according to the way in which it was collected or in terms of its intrinsic properties (Bless *et al*, 2006:111). Primary data are data gathered and assembled specifically for the project at hand (Zikmund, 2003:63). The data gathered from the structured questionnaires therefore constitutes primary data.

Secondary data are "data previously collected and assembled for some project other than the one at hand" (Zikmund, 2003:63). Secondary data includes documentary data and survey based data that has previously been analysed for its original purpose, amongst others. The literature study performed constitutes secondary data.

4.7 RESEARCH POPULATION

According to Thomas (2004:105), a population may be defined as the total set of elements we are interested in. The size of the population usually makes it impractical and uneconomical to involve all members of the population in a research project (Welman & Kruger, 2001:47). Samples are therefore drawn for investigation.

Defining the population we wish to study is an important prelude to being able to draw samples from it (Thomas, 2004:105). The research objectives and scope of the study are critical in defining the target population that will be studied (Hair *et al*, 2003:209). As the objective of this study is to determine the status quo in respect of outsourcing the IAF within South African private and public organisations, the population specific to this study may be defined as South African private and public organisations.

From the defined population it is necessary to define the sampling frame as "the sampling frame provides a working definition of the target population (Hair *et al*, 2003:211). The sampling frame takes into account practical issues relating to the

availability of information. An accurate sampling frame is very important as it helps to reduce bias, and ensures that the sample used truly represents the population from which it is taken (White, 2003:60). The sample frame has been defined as listed companies and public (Government) entities.

4.8 RESEARCH SAMPLING

Sampling involves any procedure that uses a small number of items or a portion of a population to make a conclusion regarding the whole population. (Zikmund, 2003:70).
Since the aim of research is to determine some characteristics of a certain population, one of the objectives of sampling is to draw inferences about the unknown population parameters from the known sample statistics (Bless *et al*, 2006:98). This study uses sampling techniques to obtain information regarding the population of interest.

4.8.1 Research Sampling Method

Selecting the sampling method to use in a study depends on a number of related theoretical and practical issues (Hair *et al*, 2003:211) including the nature and objectives of the study.

The selection of an appropriate sampling method greatly influences the conclusions reached as well as the success of the study. According to Leedy and Ormrod (2010: 213) population parameters and sampling procedures are of paramount importance and become critical factors in the success of the study.

Sampling methods may be grouped into probability sampling techniques and non-probability sampling techniques. In probability sampling every element in the population has a known non-zero probability of selection (Zikmund, 2003:379). Non-probability sampling involves sampling where “not every element of the target population has a chance of being selected into the sample” (Hair *et al*, 2003:211).

The empirical study conducted, employed purposive sampling techniques, a form of non-probability sampling to extract the sample. Purposive sampling involves sampling with a predetermined purpose in mind where the researcher usually seeks to obtain responses from a specific predefined group of people. The sample sought in this study comprises Chief Audit Executives, Financial Directors, Senior Internal Audit managers of organisations and executives responsible for the IAF of their respective organisations (in the case of organisations with IAFs fully outsourced).

4.8.2 Research Sample

In selecting a research sample a fine balance must be struck between complex factors including “both technical and practical considerations” (Thomas, 2004:108).

The population has been defined as South African public and private organisations, whilst the sampling frame has been defined as South African companies listed on the JSE and public entities. The sample has been identified as 40 companies listed on the Johannesburg Stock Exchange at 1 July 2010 and a combination of Government Departments, Government Agencies, and Provincial Departments. A questionnaire was electronically mailed to the Chief Audit Executive/Financial Director, Senior Audit manager or relevant executive of each organisation with a request to complete the questionnaire. Thereafter the Institute of Internal Auditors – South Africa (IIA-SA) distributed the questionnaire via their newsletter to attract a better response rate. Individuals were approached at IIA-SA regional events to complete the questionnaire.

4.9 DATA COLLECTION INSTRUMENTS, SOURCES AND PROCEDURES

A research project stands or falls on the quality of the facts on which it is based. An excellent research design and a very representative sample are not sufficient to ensure good results if the analysis rests on incorrect data. The importance of constructing an appropriate and accurate instrument for measuring and collecting data is an absolute necessity (Bless *et al*, 2006:111). The data collection instrument used in the

performance of the study was the questionnaire. The questionnaire is one of the most widely used survey data collection techniques. Because each person (respondent) is asked to respond to the same set of questions, it provides an efficient way of collecting responses from a large sample prior to quantitative analysis (Saunders *et al*, 2003:281).

Questionnaires generate data in a very systematic and ordered fashion. The responses to questions are quantified, categorised and subjected to statistical analysis (White, 2003:50).

An electronic questionnaire was adapted to probe the objectives of the study and research questions identified. Respondents were requested to complete the questionnaire and return it by e-mail to the researcher. The completed questionnaires were thereafter analysed by a statistical consultant at the University of the Witwatersrand. To further increase the response rate, the researcher attended a local IIA-SA regional networking event and distributed the questionnaire to targeted individuals. The questionnaire covered the following sections:

- Entity information
- The existence of an outsourced internal auditing function or the consideration given to outsourcing this function.
- The factors affecting the decision to outsource the internal auditing function.
- The outsourcing service provider and distribution of activities performed by the service provider.
- The interaction between the internal audit service provider and the external audit service provider.

The raw data was electronically collected from the questionnaires by the server from the institution (University of the Witwatersrand) and thereafter analysed.

4.10 DATA ANALYSIS

Data are of little or no value merely as data (Leedy & Ormrod, 2010:218).Data analysis is therefore an essential element in completing descriptive research. The process of data analysis itself takes many forms depending upon the nature of the research question and design, and the nature of the data itself (Bless *et al*, 2006:163) .The study performed embodied a descriptive research design and collected quantitative primary data. The data analysis tools most appropriate are therefore statistical techniques, the most common of which are descriptive statistical tools and inferential statistical tools.
Descriptive statistics are statistics used to describe or summarise information about a population or sample (Zikmund, 2003:402).

Descriptive statistics uses a wide range of techniques to describe the sample investigated. The techniques employed include standard deviation correlations, factor analysis and frequency counts. Each technique extracts a somewhat different meaning from a set of data (Leedy & Ormrod, 2010:260). Inferential statistics allow us to make inferences about large populations by collecting data on relatively small samples. (Leedy & Ormrod, 2010:260).

The statistical analysis was done by a statistical consultant at the University of the Witwatersrand. The software package that was used in the analysis was Stata SE 10.0. A descriptive analysis was conducted using basic frequency tabulations and graphic material (pie charts and bar graphs) to describe the sample, for example sector (public versus private), company size, current provision of IAF (in-house, partially outsourced, to name a few), type of provider, outsourced functions and factors affecting the decision to outsource. 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 mean hours provided by internal and external service providers by sector.

4.11 SUMMARY

In summation, this chapter describes the research methodology adopted in conducting this study as well as provides theoretical support for the methodology used. The following chapter details the analysis of the results obtained from the survey using the various data collection techniques described in this chapter.

CHAPTER 5
QUANTITATIVE RESULTS

5.1 INTRODUCTION

The research process consisted of three main phases: stage one - an in-depth investigation of the relevant literature; stage two - drafting of the questionnaire and gathering of data and stage three - analysis of the results, with each stage serving as a pre-requisite for the next stage. The questionnaire, after encountering and overcoming various issues associated with response rates, provided a comprehensive interaction with executives whose otherwise tight schedules provided limited time for feedback.

To facilitate the analysis of data, a number of questions were posed using a likert scale measurement technique as these questions indicated more realistic results regarding the respondent's selection of alternatives. A limited number of open-ended questions and suggestions were also asked as these questions provided respondents the opportunity to express their views about the capabilities, competitiveness, strategies, benefits, shortcomings and the future of their businesses with respect to outsourcing of the IAF.

Each of these three stages contributed to the study and the cumulative results of the three stages are highlighted and discussed in this section. These results were discussed in tabular and diagrammatic format and in instances combining responses from the questionnaire. These tables, figures and discussions are in the context of the research questions posed at the onset of the study. The research study is limited to quantitative design analysis.

5.2 QUANTITATIVE RESULTS - RESULTS OF THE QUESTIONNAIRE

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 survey data from the questionnaires provide useful insights into the *status quo* of both private and public organisations with respect to the outsourcing of the IAF. Questions in the questionnaire were designed to satisfy the research objectives of the study:

Objective 1:
Establish the current status of outsourcing the Internal Audit Function in South African private and public entities.

Objective 2:
Ascertain from Finance Directors and Chief Audit Executives, in both the public and the private sector, what are their perception of the with regards to outsourcing the Internal Audit Function.

Objective 3:
Establish the principal motive(s), factor(s) and implications behind the decision to outsource the internal Audit Function.

Objective 4:
Examine the impact of the decision to outsource the Internal audit function on auditors' independence (internal and external) and on the quality of the internal audit service

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.

5.2.1 Basic Frequencies

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.

5.2.1.1 Respondents

Out of the entire purposive sample approached, 72 organisations responded. Respondents comprised Chief Audit Executives (CAE), Internal Auditors, Senior Managers and Managers with the majority of respondents occupying the position of CAE or equivalent. In instances where more than one survey was completed by an organisation, only one questionnaire (the questionnaire completed by the most senior personnel within the organisation) was included in the study, as an organisation was defined as a research unit of the study.

Some of the addressees responded to the sender's e-mail via e-mail that they were unable to respond to the survey due to the following reasons:

- due to time restrictions and management commitments;
- travelling overseas;
- hectic schedule and high priority meetings;
- as a consequence of too many requests to participate in questionnaires;
- heavy workloads;
- companies immediately responded via e-mail as e-mail notifications were automatically generated by their company's system;
- anti-spam to only accept e-mails from confirmed addresses if the e-mails content are distrustful, so the e-mails were suspended by the system;
- Out-of-office replies.

5.2.1.2 Number of employees

As per Table 3, 55.6% of organisations indicated an employee size of 1000 employees or more with the next largest category being 100-1000 employees which represented 37.5% of respondents.

The organisations in the survey represent a variety of different sized organisations, very small, small, medium, large and extra large, classified by the number of employees. The organisations surveyed comprised JSE listed companies, influential non-listed companies, and government departments and municipalities. Due to the confidentiality of information and to protect both the organisation and the individual completing the questionnaire, the organisations have not been identified in the research study.

Table 3: Number of employees

Number of Employees	Frequency	Valid Percent
Less than 50	4	5.6%
50-100	1	1.4%
100-1000	27	37.5%
1000+	40	55.6%
Total	**72**	**100.0%**

5.2.1.3 Highest level of education

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 8 respondents holding the Certified Internal Auditor (CIA) qualification. In some instances members did not disclose the type of professional qualification they held. An additional internet search was done into the profile of respondents and revealed that eighteen CIA's and thirteen CA's were amongst the respondents. In three instances a holder held both designations. Table 5 listed below does not include the results of the internet search.

Table 4: 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 5: Professional Qualifications

Highest level of professional qualification	Frequency	Valid Percent
CIA	8	11.1%
CA(SA)	7	9.7%
Total	**72**	**100.0%**

5.2.1.4 Respondents position occupied in the organisation

Respondents were then grouped according to the position occupied in the organisation, as per Table 6. 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.

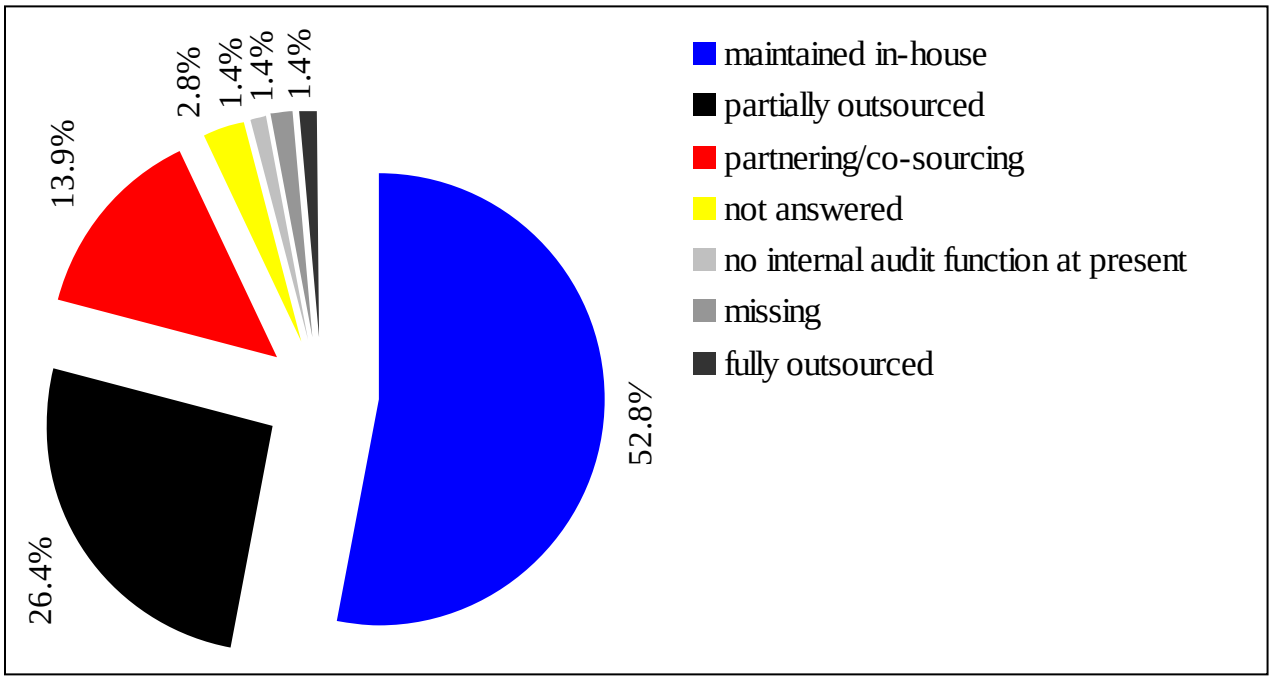
Table 6: Respondents by position in the organisation

Respondents by position in the organisation	Frequency	Valid Percent
CAE	42	58.3%
FD	1	1.4%
Manager, Senior Manager, or Internal Auditor	26	36.1%
Director	2	2.8%
Other	1	1.4%
Total	**72**	**100.0%**

5.3 CURRENT PROVISION OF INTERNAL AUDIT SERVICE IN SOUTH AFRICAN PRIVATE AND PUBLIC SECTOR ORGANISATIONS

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. 41.6% of the respondents 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. A further breakdown, as indicated in Figure 1 below, 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.

Figure 1: Current provision of internal audit service in South African private and public sector organisations, 2010.



5.4 ORGANISATIONS WITH AN IAF MAINTAINED IN-HOUSE

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. 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:

- Taking into account of SAS70/ISAE3402 services to be external audit/other consulting and not outsourced internal audit.
- We don't outsource the internal audit, as it is not cost effective.
- As we operate and have to perform audits in Europe, we consider it less costly to have an IAF based in RSA and to travel to foreign offices than to outsource these audits to European audit firms.
- We have not outsourced our IAF, but rather decided to co-source with a Big 4 firm in order to get the specialist skills we need in many areas and couldn't 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.

The opinions expressed may be interpreted that organisations perceived internal audit was able 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 7, 22.2% of respondents had considered outsourcing their IAF. Of all respondents, 17.2% of the public sector and 26.2% of private sector respondents had considered outsourcing their IAF. 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 7, 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 & Yiannakas, 2000:219) which is not the case in a South African context.

Table 7: 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
Spoiled 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)

Further analysis was done by asking respondents to disclose their level of agreement with various reasons that would motivate the organisation to outsource their IAF. A Likert scale was used as a measurement tool with, -2=strongly disagree, -1=disagree, 0=neutral, +1=agree and +2=strongly agree. Public sector organisations were significantly more likely to agree that legal liability insurance of Outside Service Providers (OSP) (significant at 5% level) and scheduling flexibility or time management (marginally significant or at 10% level) were reasons for outsourcing of the IAF as per Table 8.

This relates to a mean agreement score of 0 for private sector organisations and 0.92 for public sector organisations with regard to response scores for legal liability insurance of OSP. With regard to scheduling flexibility or time management, public sector organisations had a mean agreement score of 0.71 compared to 0.24 for private sector organisations using Wilcoxon rank sum test to ascertain if there were significant differences in the distribution of responses scores to these criteria by sector.

Table 8: Level of agreement with reasons to outsource the IAF

Reason	Valid n	Mean	Median	Mode	p-value i (public versus private)
Expertise of OSP	45	1.29	2.00	2.00	0.8713
Legal liability insurance of OSP	47	0.51	0.00	0.00	0.0082
Scheduling flexibility/time management	45	0.49	0.00	0.00	0.0637
Reduce overall cost of internal audit	47	-0.02	0.00	-1.00	0.2533
Improve internal audit quality	**45**	**0.78**	**1.00**	**1.00**	**0.1158**

i: Using Wilcoxon rank sum test to ascertain if there were significant differences in the distribution of responses scores to these criteria by sector

5.5 OUTSOURCING THE IAF

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 9 responses varied with 19.4% of organisations who do 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 1-5 years and 6.9% of respondents had been outsourcing for more than 5 years.

As per Table 9 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.

Table 9: The duration of outsourcing the IAF

	Frequency	Percentage
N\A	41	56.9%
Not answered	2	2.8%
Spoiled 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%**

5.6 PROVIDERS OF INTERNAL AUDIT SERVICES

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 10, 33.3% of respondents utilised the services of a Big 4 accounting firm while 19.4 % utilised a smaller 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 10 below, 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 abovementioned 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 10 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.

However from a statistical perspective there appears to be no significant difference in the provider of IAF by sector. (Table 10, footnote ii) The biggest difference appears to be that private organisations chose a Big 4 accounting firm (43%) more often than in the public sector organisations (20%). 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.

The results discussed above 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.

Table 10: Providers of internal audit services by sector

	Public		Private		Total	
	Count	% within sector	Count	% within sector	Count	% of Total
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
Spoiled data	7	23.3	3	7.1	10	13.9
Total	**30**	**100**	**42**	**100**	**72**	**100**

i: Includes other, local public accounting firm or financial services

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

5.7 PERCEPTION OF INTERNAL AUDIT

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. 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.

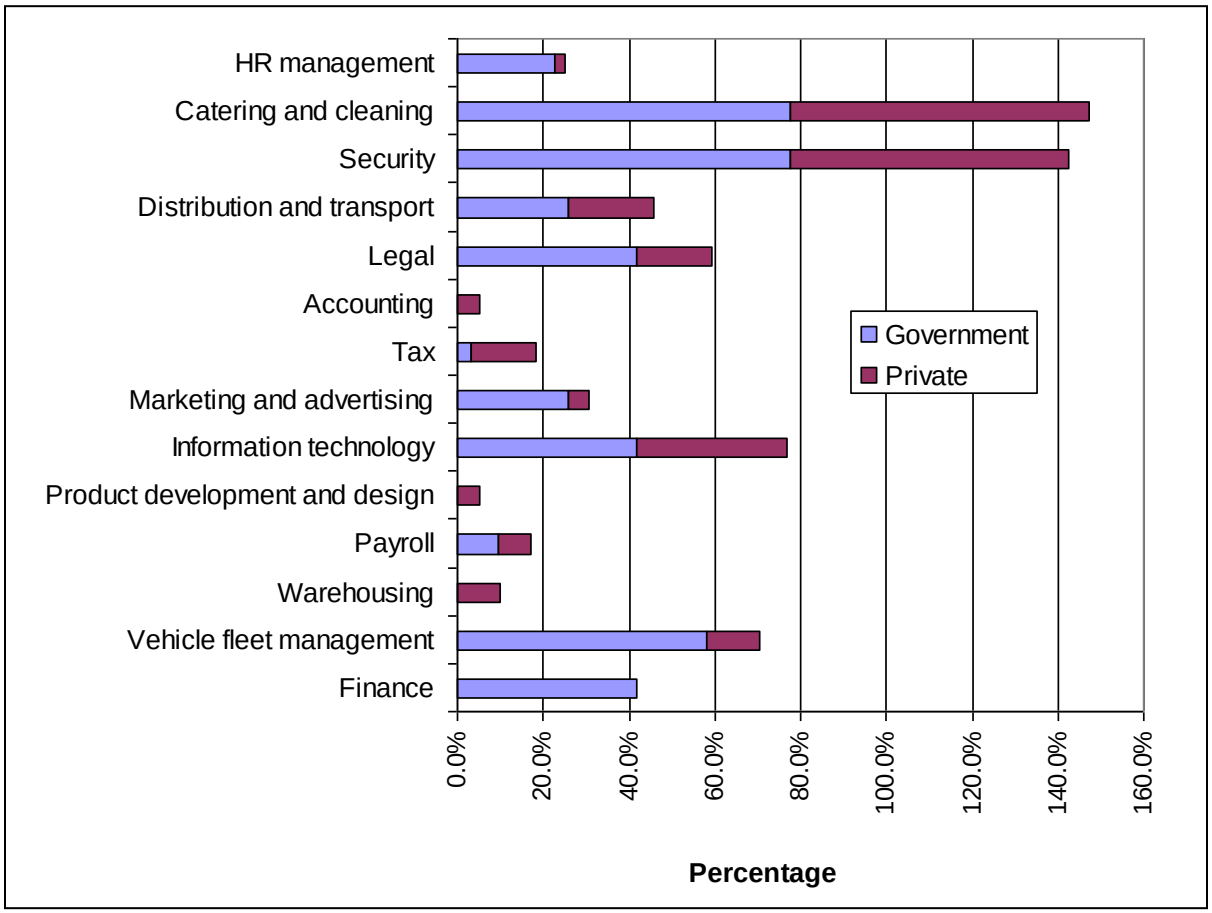
In South Africa, the PFMA requires all government organisations to establish an IAF. From this it can be deduced that the public sector did not fully understand the value added approach that internal audit offered and hence were uncertain as to whether the

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.

To establish the extent of outsourcing within South Africa and to determine the benchmark against which outsourcing of internal audit can be compared, survey participants were required to provide information on other services that were currently outsourced. As depicted in Figure 2, the largest proportions of functions being outsourced, in both sectors, appeared to be in catering/cleaning and security. Conversely very low proportions of accounting and product development and design functions were outsourced.

This phenomenon may be explained by the rationale that accounting and its related disciplines which encompass internal audit are a technical skills resource that requires long term development whereas catering, cleaning and similar functions are more labour intensive and therefore fall within the administrative ambit of the organisation as opposed to constituting a value adding service.

Figure 2: Functions currently being outsourced by organisations



5.8 FACTORS AFFECTING THE DECISION TO OUTSOURCE THE IAF

An organisation's decision to outsource the IAF is dependent on a number of factors including the confidentiality of information, scheduling of flexibility /time management and a reduction of the total audit costs. An investigation was done by asking respondents to indicate the importance they attach to each of these factors using a five point likert scale (where 1 = Not Relevant, 2 = Not Important, 3 = Important, 4=Very Important, and 5 = Extremely Important).

An analysis of Table 11 presented below brings to light that confidentiality of information was rated as a very important factor by the majority of respondents with the scheduling of flexibility/time management being noted as important to organisations in deciding to

outsource their IAF. With respect to the factors important to each sector there were no significant differences in the distribution of importance scores for criteria used in the decision to outsource by sector for the criteria listed in Table 11.

Even though a marginally significant difference (p-value=0.0573, Table 11) was identified for reduction of total audit cost, with the public sector organisations generally ranking this more importantly as a deciding factor for outsourcing when compared to organisations within the private sector (mean of 2.31 and 1.89 respectively).

Table 11: Factors affecting the decision to outsource the IAF and significance differences between sectors

	N	Mean	Median	Mode	p-value i (public versus private)
Confidentiality of information	67	2.70	3.00	4.00	0.5263
Alignment of organisational culture	67	2.49	3.00	2.00	0.2467
Scheduling of flexibility/time management	67	1.99	2.00	3.00	1.0000
Reduction of internal audit cost	67	1.96	2.00	2.00	0.1529
Reduction of external cost	67	2.07	2.00	2.00	0.9582
Reduction of total audit cost	**67**	**2.07**	**2.00**	**2.00**	**0.0573**

i: Using Wilcoxon rank sum test to ascertain if there were significant differences in the distribution of responses scores to these criteria by sector.

5.9 IMPACT OF THE OUTSOURCING DECISION

5.9.1 The Issue of Independence

To reiterate the significance of maintenance of independence, from the literature review, in South Africa, the provision of internal audit services for companies is governed legislatively by both the Companies Act of 2008 as well as the Auditing Professions Act of 2005. The provision of internal audit services is designated as a provision of a non-assurance service by auditors.

The Companies Act 61 of 1973 states that an auditor appointed to a widely held company, may not, for that company perform any internal audit which may be subject to an audit by the selected auditors. The International Federation of Accountants (IFAC) Code of Ethics, which has been adopted by South African Institute of Charted Accountants (SAICA), reinforces this principle by stating that professional accountants in public practice must remain independent, and therefore should not undertake an engagement which would threaten this independence.

The Companies Act 71 of 2008 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". The onus therefore rests on the audit committee of the company to evaluate the independence of the auditors and approve the provision of internal audit work by the audit firm. The provision of both assurance and non-assurance work by the audit firm would also be contrary to the King III Report on Corporate Governance.

An auditor providing internal audit services as well as carrying out the external audit would be re-evaluating his own work, and the Auditing Profession Act sets forth the regulations that are to be complied with by all registered auditors in South Africa. Section 44(6) of this Act states: "A registered auditor may not conduct the audit of any financial statements of an entity, whether as an individual registered auditor or as a member of a firm if, the registered auditor has or had a conflict of interest in respect of that entity, as prescribed by the Regulatory Board." Safeguards may be implemented to reduce this risk of self review to an acceptably low level, the most practical of which would be to ensure that separate engagement teams are used to provide the different services.

Nevertheless respondents were asked to indicate where applicable if their organisation utilised the same service provider for both internal and external audit services and the

unanimous response was that the same service provider was not used to provide both external and internal audit services.

To probe further, respondents were asked to disclose the level of interaction between the IAF and external auditors. Co-ordination with respect to areas of audit coverage and work schedule between the IAF and external audit as well as the external auditors' access to working papers by internal audit were probed. 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 as per Table 12.

The majority of organisations for which data was available indicated that external auditors had access to work papers, 92.3% and 100% indicated access to reports.

Table 12: Interaction between internal audit and external audit by activity and sector

	Public		Private		Total	
	Count	% within sector	Count	% within sector	Count	% of Total
Co-ordinate areas of audit coverage (i)						
No	7	16.7%	4	13.3%	11	16.7%
Yes	29	69.1%	25	83.3%	54	81.8%
Spoiled data or N/A	6	14.3%	1	3.3%	1	1.5%
Co-ordinate work schedule (ii)						
No	12	28.6%	7	23.3%	19	28.4%
Yes	25	59.5%	22	73.3%	47	70.1%
Spoiled data or N/A	5	11.9%	1	3.3%	1	1.5%

i: Fisher's exact p-value = 0.742 (note: significance tests does not include missing or N/A)

ii: Fisher's exact p-value = 0.586 (note: significance tests does not include missing or N/A)

5.9.2 Satisfaction with the quality of the provided service

When asked about the level of satisfaction with the quality of the provided service, it was observed that in both sectors respondents were generally satisfied with the provided service. No statistically significant difference was observed between sectors.

A total of two respondents were very dissatisfied with the quality of the service provided and one of the respondents provided the following additional comment: “We have only recently went solely in-house. In my opinion it was wasteful expenditure in terms of PFMA, someone should have been charged. They were not utilised correctly and cost us a lot of money that could be used more fruitfully. I am also of the opinion that they sometimes are out to make a ‘quick buck’ and integrity is often compromised.”

Table 13: Level of satisfaction with the quality of the provided service by sector

	Public		Private		Total	
	Count	% within sector	Count	% within sector	Count	% of Total
Very dissatisfied	1	3.3	1	2.4	2	2.8
Dissatisfied	1	3.3	1	2.4	2	2.8
Uncertain	8	26.7	9	21.4	17	23.6
Satisfied	18	60.0	19	45.2	37	51.4
Very satisfied	1	3.3	3	7.1	4	5.6
N/A or missing	1	3.3	9	21.4	10	13.9
Total	**30**	**100%**	**42**	**100%**	**72**	**100%**

i: Fisher's exact p-value = 0.244 (note: significance tests does not include missing or N/A)

5.9.3 Analysis of hours spent on internal audit services

Respondents were asked to approximate the number of hours that were devoted to internal audit services by external service providers versus internal service providers. An Analysis of Table 14 indicates that private sector organisations were significantly

(p<0.001) more likely to have longer hours provided by internal service providers relative to external service providers when compared to public sector organisations.

Table 14: Proportion of internal audit service hours provided by external service providers versus external and internal service providers combined

Category	Valid n	Mean	Standard error	Standard deviation	95% CI	p-value i
Overall	53	0.20	0.04	0.27	0.12,0.27	---
Public	22	0.37	0.07	0.34	0.22,0.52	---
Private	31	0.07	0.02	0.12	0.03,0.12	---
Difference (public vs. private)	**---**	**-0.30**	**0.07**	**---**	**-0.42,-0.16**	**<0.001**

i: test p-value with null hypothesis that the mean difference is equal to zero

Respondents were further asked to indicate the percentage breakdown of outsourced internal audit hours by activity as per Table 15. The largest percentage of hours of outsourced internal audit by activity was attributed to internal control evaluation (20.8%), followed by routine IAF (19.5%) and Electronic Data Processing (EDP) auditing (16.6%).

The statistical analysis also highlighted the following findings regarding the level of IAF outsourcing planned for the 2010 financial year, the majority of respondents indicated that they would maintain the current level of IAF outsourcing (37.5%), followed by an indication by 29.2% of respondents to decrease their current level of IAF outsourcing. A small minority indicated that this level would be increased (5.6%). The remainder (27.8%) did not answer or indicated that this question was not applicable to their organisation. No significant difference was observed between public and private organisations with regard to changes in the level of internal audit outsourcing in the 2010 financial year (Fishers exact p-value=0.271).

Table 15: Percentage breakdown of outsourced internal audit hours by activity

Activity	Valid n	Mean (standard deviation)	Min-Max
Financial statement audits of subsidiaries	53	5.06 (14.25)	0-100
Special consulting projects	52	6.11 (11.05)	0-55
Routine internal audits	52	19.46 (24.38)	0-100
EDP auditing	52	16.60 (25.62)	0-100
Internal control evaluation	53	20.75 (25.16)	0-100
Other	41	5.83 (18.78)	0-9

An alarming finding was that the majority of organisations indicated that they did not view internal audit as a training ground (57.1% with 95%CI: 44.05-69.50%). As can be seen by the 95% binomial confidence interval, the lower limit is less than 50% so it cannot say this view was significant based on the non-random sample used. There was also no significant difference in response to this question between organisations in the public and private sector (p-value= 0.268).

5.10 SUMMARY

The results of the study address problems that arise from the fact that limited research has been conducted in South Africa with regard to outsourcing the IAF and no research has been conducted within the South African public sector. In order to build on existing research, it was considered necessary to perform an empirical study using survey based methodology.

The results of the study are documented, analysed and explained in this chapter using quantitative research and analytical methods from data collected in the survey. The following chapter provides a summary of the results gathered and analysed in the

empirical study and discusses limitations of the study as well as outlines areas for future research within South Africa.

CHAPTER 6
CONCLUSION

6.1 SUMMARY

This research was undertaken to determine the current status of outsourcing the IAF in South African private and public organisations by: surveying Finance Directors and Chief Audit Executives amongst others in both the public and the private sectors to determine what their perceptions with regards to outsourcing IAF were; establishing the principal motive(s) and factor(s) behind the decision to outsource the IAF; and examining the impact of the decision to outsource the IAF on auditors' independence (internal and external) and on the quality of the internal audit service. There are no previous studies that have been performed in South Africa that incorporated the public sector as part of value relevant research. Previous studies in South Africa were limited to private sector organisations.

A review of the literature was performed in Chapter 2. This included a description of the conceptual theory of outsourcing behaviour and a discussion of subsequent economic theories, incorporating criticism and arguments for and against outsourcing. The different economic theories of the firm offered valuable perspective on a firm's decision to outsource but were limited to the context of IT.

Chapter 2 was a hermeneutic discussion which was intended to lay down preamble for the decision to outsource the IAF in the context of the organisation as a whole. Chapter 3 examined the history of the internal auditing profession in different contextual settings and the perceived risks and opportunities were discussed. The different regulatory environments under which internal audit operates in South Africa were then examined,

followed by a discussion of the issue of independence and the auditing environment and lastly an international review of the internal audit outsourcing was done.

Chapter 1 introduced and Chapter 4 expanded upon the research methodology adopted, including the research methods applied, and the limitations and scope of the study. Chapter 5 presented the results obtained from the empirical study and an analysis thereof beginning with a description of the quantitative study.

6.2 RESULTS

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 CAE's, Finance Directors and others 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 (43%) 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 rationales supporting these findings had been explained in the detailed analysis. 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%).

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. Codified governance reforms combined with legislation mitigated the threat to independence and respondents clearly indicated that the same provider for external audit services did not provide their internal audit services.

6.3 CONCLUSION

Research that has been done on the practice of internal auditing in South Africa is narrow, with most of the emphasis being placed on the private sector. There is particularly an insufficiency of research into the IAF within the public sector. This insufficiency can be partly attributed to the fact that internal audit is currently an

emerging professional practice with relatively new research being conducted in this field.

The principal motive for the of undertaking this research study into the outsourcing of Internal Audit in South Africa was to contribute to the existing body of knowledge from a developing economy and emerging market perspective . Challenges that face this developing economy that are of particular interest when considering the sourcing arrangements of the IAF, are events (political, social and economical) that have occurred in South Africa during the past 15 years. These include the abolition of apartheid in the 1990's, the installation of a democratic government, the financial and stock market liberalisation, the introduction of and revision of the King Codes for corporate governance and legislative reforms within both the private and public sectors.

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.

6.4 LIMITATIONS

The findings of the present 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.

6.5 RECOMMENDATIONS FOR FUTURE STUDY

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 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.

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ANNEXURE A – QUESTIONNAIRE

Research Survey

My Name is Yaeesh Yasseen, an academic and lecturer at The University of the Witwatersrand, Johannesburg (WITS). As an academic, we aim to contribute to an advancement of governance and economic development through developing and increasing knowledge and skills.

The School of Accountancy (SOA) is one of the oldest teaching units within the University. Accounting education at the University commenced in the 1930s and has a proud educational history of the more than 75 years. Graduates of the school now lead major public and private institutions in South Africa and beyond. Within the higher education landscape, it is pleasing to note that Wits is rated in the top 400 of world universities and the School's chartered accountancy programme is rated as one of the best in the country.

The School of Accountancy is a vertically integrated and research vibrant institution.

In accordance with this, I am currently completing my Masters' dissertation and require assistance from CAE's/Directors such as yourself to complete the required empirical research (attached).

I appreciate the sensitivity of such organisational information and accordingly provide assurance that all data gathered would be to provide my research with practical insights into the outsourcing of the internal audit function within organisations' such as yours. Neither yourself, nor the organisation will be specifically identified or mentioned, but rather the overall results and recommendations will be shared with all participants of the survey.

I thank you for your assistance and co-operation in this regard, and hope that we develop a mutually beneficial and lasting relationship between our respective organisations.

Date: _____

Dear Sir or Madam:

I am a Lecturer in the School of Accountancy at the University of the Witwatersrand. I am conducting a brief survey as part of my Masters dissertation to obtain data about the degree of outsourcing of the internal audit function present in your company and the primary factors in the outsourcing decision. Based on current publications, there is little research on the subject of outsourcing the Internal Audit function in South African Companies and as a result many questions still remain unanswered. After the analysis of the questionnaire you will be informed of the outcome and your valuable contribution to the research. Your insight is vital to this project, so please take a few minutes to complete the survey.
Please be assured that all responses will be strictly confidential, and no company or individual will be specifically identified. Thank you.

1. Name of company/government department? _____

2. Number of employees?

   A. ☐ Less than 50 employees
   B. ☐ 50-100 employees
   C. ☐ 100-1000 employees
   D. ☐ 1000+ employees

3. Name of person completing the questionnaire? _____

4. Highest level of education passed? _____

5. Position of person completing the questionnaire?

   A. ☐ CEO
   B. ☐ Managing Director(MD)
   C. ☐ Financial Director(FD)
   D. ☐ Manager
   E. ☐ Chief Audit Executive
   F. ☐ Other(please specify) _____

6. Email Address: _____

7. Web Address: _____

8. Type of Industry? _____

9. Type of government department? _____

10. Did you use any outsourced internal audit services during the past year?

    A. ☐ Yes
    B. ☐ No

If you answered ***NO*** in question 10 above please answer question 11, if not, **select *not applicable*** to the question below.

11. Has your organisation considered, at any stage, outsourcing the whole or part of its internal audit function?

A. ☐ Yes
B. ☐ No
C. ☐ Not Applicable

12. Which answer best describes your primary internal audit outside service provider (OSP)?

A. ☐ Big 4 accounting firm
B. ☐ Smaller accounting firm
C. ☐ Local public accounting firm
D. ☐ Specialised service provider
E. ☐ Other(please specify) _____

13. What is the current provision of internal audit services in your company?

A. ☐ Maintained in-house
B. ☐ Partially Outsourced
C. ☐ Fully Outsourced
D. ☐ Partnering/co-sourcing
E. ☐ No internal audit function at present

If you answered ***partially outsourced, fully outsourced, or partnering/Co-sourcing*** in question 13 above please answer question 14, if not, **select *not applicable*** to the question below.

14. When did you start outsourcing the internal audit function?

A. ☐ Not Applicable
B. ☐ Less than a year
C. ☐ 1 -5 years
D. ☐ 6 –10 years
E. ☐ 11-15year
F. ☐ 16 yrs+

15. Do you consider internal audit to be a:

A. ☐ Core activity
B. ☐ Non-core activity
C. ☐ Uncertain

16. What other functions in your organisation are currently being outsourced?

	Yes	No
Finance		
Vehicle fleet management		
Warehousing		
Payroll		
Product development/ design		
Information technology		
Marketing/advertising		
Tax		
Accounting		
Legal		
Distribution/transportation		
Security		
Catering/cleaning		
Human Resource Management		
Other (please specify)		

17. A number of factors affect the decision to outsource the internal audit function, please specify how important each of the below is in your organisations decision to outsource the internal audit function:

	Not relevant	Not important	Important	Very important	Extremely important
Confidentiality of information					
Alignment with organisational culture					
Scheduling flexibility/ time management					
Reduction of internal audit cost					
Reduction of external cost					
Reduction of total audit cost					
Other (please specify)					

18. Do you make use of the same service provider for internal and external audit services?

A. ☐ Yes
B. ☐ No

19. How satisfied is your organisation with the quality of the provided service?

A. ☐ Very Dissatisfied
B. ☐ Dissatisfied
C. ☐ Uncertain
D. ☐ Satisfied
E. ☐ Very Satisfied

20. During the last financial year, approximately how many hours were devoted to internal audit services by:

Outside service providers? _____ Hours

Internal service providers? _____ Hours

21. If you are currently outsourcing all or part of the internal audit function, how long has the current arrangement been in effect?

A. ☐ Less than a year
B. ☐ 1-5 years
C. ☐ 6-10 years
D. ☐ 11-15 years
E. ☐ 16+ years

22. If you do outsource internal audit, please indicate your level of agreement with the following reasons for doing so:

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Expertise of outside service provider (OSP)					
Legal Liability insurance of OSP					
Scheduling flexibility/ time management					
Reducing overall cost of internal audit					
Improve internal audit quality					

23. Of the total internal audit hours currently being outsourced, please give the appropriate percentage distribution of activities:

Financial Statement audits of subsidiaries _____ %
Special consulting projects _____ %
Routine internal audit functions _____ %
EDP Auditing _____ %
Internal control evaluation _____ %
Other (please specify) _____ %

24. What are your plans regarding the level of internal audit outsourcing in the 2010 financial year?

A. ☐ Increase % of outsourcing
B. ☐ Decrease % of outsourcing
C. ☐ Maintain level of outsourcing

If you answered INCREASE to question 24 above, please answer question 25.
If you answered DECREASE or MAINTAIN to question 24, **select *not applicable*** to the questions below.

25. Please indicate your level of agreement with the following reasons for increasing the level of outsourcing:
☐ Not Applicable

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Expertise of outside service provider (OSP)					
Legal Liability insurance of OSP					
Scheduling flexibility/ time management					
Reducing overall cost of internal audit					
Improve internal audit quality					

26. Is internal auditing viewed as a training ground in your company?
A. ☐ Yes
B. ☐ No

27. If you do not outsource internal audit, please indicate your level of agreement with the following reasons for not doing so:

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Confidentiality of information					
Alignment with organisational culture					
Scheduling flexibility/ time management					
Reduction of internal audit cost					
Reduction of external cost					
Reduction of total audit cost					

28. Does internal auditing do the following with respect to interaction with external auditors:

Co-ordinate areas of audit coverage?

A. ☐ Yes
B. ☐ No

Co-ordinate work schedule?

A. ☐ Yes
B. ☐ No

29. Do the external auditors have free access to all:

Work papers?

A. ☐ Yes
B. ☐ No

Reports?

A. ☐ Yes
B. ☐ No

We are very interested in your views on the reasons your firm chose one type of internal audit sourcing (in-house vs. externally provided) over another, and the level chosen. Please include any comments you may have on a separate sheet.

Thanking you for your time and effort in completing this questionnaire

Yours Sincerely

Yaeesh Yasseen
Course Coordinator and Lecturer
School of Accountancy
University of the Witwatersrand, Johannesburg

ANNEXURE B – ETHICS CLEARANCE

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

Division of the Deputy Registrar (Research)

HUMAN RESEARCH ETHICS COMMITTEE (NON MEDICAL)
R14/49 Yasseen

CLEARANCE CERTIFICATE	**PROTOCOL NUMBER H100 208**
PROJECT	Outsourcing the internal audit function: A survey of the South African public and private sectors
INVESTIGATORS	Mr Y Yasseen
DEPARTMENT	Accountancy
DATE CONSIDERED	12.02.2009
DECISION OF THE COMMITTEE*	Approved Unconditionally
NOTE:	

Unless otherwise specified this ethical clearance is valid for 2 years and may be renewed upon application

DATE 24.02.2010 **CHAIRPERSON** .....
(Professor R Thornton)

cc: Supervisor : Dr E Papageorgiou

DECLARATION OF INVESTIGATOR(S)

To be completed in duplicate and **ONE COPY** returned to the Secretary at Room 10005, 10th Floor, Senate House, University.

I/We fully understand the conditions under which I am/we are authorized to carry out the abovementioned research and I/we guarantee to ensure compliance with these conditions. Should any departure to be contemplated from the research procedure as approved I/we undertake to resubmit the protocol to the Committee. **I agree to a completion of a yearly progress report.**

_____
Signature

PLEASE QUOTE THE PROTOCOL NUMBER IN ALL ENQUIRIES