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Internal Audit

*Make it your strongest link*



# Forming strong linkages

An effective internal audit activity is a valuable resource for management, the board or its equivalent and the audit committee due to its understanding of the organization and its culture, operations, and risk profile. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organizations internal control, risk management, and governance processes. Similarly an effective internal audit activity provides critical assurance to other stakeholders, such as regulators, employees, providers of finance and shareholders.

Essentially, Internal Audit is a control and functions by reviewing and assessing the adequacy and effectiveness of all other controls. Ideally, internal audit serves as the eyes and ears of the board and audit committee, being an essential component in the system of checks and balances.

This function must provide assurance regarding governance and controls to management and the audit committee. Also, it should contribute to improved management and control as well as to organisational performance. Internal Audit is neither an internal checker of financial transactions nor an extension of the external audit function. It is different in that it focuses on all business risks.

Internal Audit:

- Identifies controls and control deficiencies;
- Identifies regulatory requirements and compliance therewith;
- Provides recommendations on internal control and governance improvements;
- Determines adherence with company policy and procedures; and
- Assists with channelling effective solutions for controls improvement.

When performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate risks, and to ensure that organizational goals and objectives are met.

## Internal Audit Related Services



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“Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps organisations accomplish their objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

Institute of Internal Auditors

# Benefits of having a strong Internal Audit function

A successful Internal Audit function becomes a necessity when an organisation is faced with the following challenges and requirements:

- **Focus on risk management, designing internal controls to manage risk:** Internal auditors can leverage their skills by directing their efforts in the risk areas, thereby enhancing the overall efficiency of the process and adding greater value with the same set of resources;
- **Intensive use of information technology:** Information technology (IT) is invariably embedded in all spheres of activities of a modern business enterprise, from data processing to resource planning to online sales and e-commerce. Use of IT has, however, increased the threat of data theft, losses on account of systems failure, hacking/ espionage, etc. The use of IT also results in a need to comply with the cyber laws, etc.;
- **Audit Committee support and interaction:** Aligning audit committee objectives with those of internal audit helps to unify oversight and allocate limited resources in the most efficient and effective way. The internal audit function provides audit committees with relevant reports and ongoing updates. This function identifies new risks and is entrusted to conduct high-level reviews in a strategic manner. Audit committees have a great deal to gain by developing and empowering internal audit, and by working more closely with internal auditors to improve organisational oversight;
- **King III Requirement:** “A strategically positioned, competent and independent internal audit function is required to provide a written assessment of the company’s system of internal control, after having conducted a risk based internal audit. This function must have direct relationships with the audit, corporate governance and risk committees and must be strategically positioned.” (King III report);
- **Increased size and complexity of businesses:** Increased size and business spread dilutes direct management oversight on various functions, necessitating the need for a full time, independent and dedicated team to review and appraise operations;
- **Enhanced compliance requirements:** An increase in the geographical spread of businesses has led to crossing of political frontiers by businesses in a bid to tap global capital. This has highlighted the need for compliance with the laws of the home country as well as the laws of other jurisdictions as a critical factor for the ability of businesses abroad to prosper;

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- **Unconventional business models:**  
Businesses today use unconventional models and practices, for example, outsourcing of non-core areas, such as accounting. These businesses require the assurance that controls relating to these models and practices are adequate and operating effectively;
- **Stringent norms mandated by regulators to protect investors:** Regulators, in their pursuit to protect the interests of the investors, are applying ever mounting pressure and stringent norms. Compliance with the latest regulations – being ethical conduct of business, enhanced corporate governance and financial reporting requirements – should be independently assessed by a competent internal audit function; and
- **An increasingly competitive environment:**  
Deregulation and globalisation have lowered the political and other barriers for entry in the markets for goods and services. The free flow of capital, technology and know-how between countries, as well as strong infrastructure has helped in decreasing the costs of production and resulted in better access to the existing and potential consumers. This in turn, has lured more and more players in the existing markets, thereby, resulting in stiffer competition. A well equipped internal audit function can assist businesses to identify opportunities for improved efficiency and effectiveness.

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“As a cornerstone of strong governance, internal auditing bridges the gap between management and the board assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization’s safety net for compliance with rules, regulations and overall best business practices.”

**Institute of Internal Auditors**



# Making the right link

The table below illustrates both benefits and challenges organisations need to consider when deciding on where the internal audit function should be housed.

	In-source	Co-source	Out-source
	Company maintains full responsibility for recruiting, hiring, retention, development, deployment and management of internal audit team.	Company hires a limited core internal team of management and/or staff and uses an outside professional provider to supplement the team and/or to provide strategic direction to the internal audit service.	Company uses an external professional provider for all internal audit activities.
<b>Benefits</b>	<ul style="list-style-type: none"> <li>Enables strong development of in-house experience;</li> <li>Internal resources can be a consistent, internal source of in-depth knowledge of company;</li> <li>Internal audit resources become networked within the organisation and integrated into company initiatives;</li> <li>Can enable efficient team if audit universe is homogenous; and</li> <li>Can be a lower cost option, depending on the efficiency and experience of internal personnel.</li> </ul>	<ul style="list-style-type: none"> <li>Enables a balance of internal knowledge with external leading edge experience;</li> <li>Enables team resource flexibility as required (level, skill set, fit with company);</li> <li>Leverages subject matter specialisation when required;</li> <li>Enables team load levelling and flexible staffing to balance out demand without full-time commitment of resources;</li> <li>External providers usually maintain integrated technologies and toolsets that can be shared internally;</li> <li>Provides access to professional knowledge bases and benchmarks;</li> <li>Can be viewed as “one team” that is committed to internal goals;</li> <li>Can enable management development and rotation of internal resources with the external provider providing continuity; and</li> <li>May provide an optimal pricing structure with limited commitment.</li> </ul>	<ul style="list-style-type: none"> <li>Leverages external resources for the management and execution of the internal audit function;</li> <li>Does not require commitment to internal recruiting, retention and development of resources;</li> <li>The external provider can provide a complete, turnkey approach to internal audit (e.g. methodology, tools);</li> <li>The entity pays for core audit time only with limited administration or overhead costs;</li> <li>Enables team resource variability as required (level, skill set, experience, fit with company, location);</li> <li>Can be a lower-cost option, but need to weigh cost and benefits, given challenges;</li> <li>Enables global resourcing when required for language, location, cultural understanding; and,</li> <li>Reduces the travel expense where the service provider has local representation amongst auditees.</li> </ul>
<b>Challenges</b>	<ul style="list-style-type: none"> <li>Permanent staffing requires significant commitment to hiring, retention and development of team members;</li> <li>It can be difficult to recruit and retain skilled resources;</li> <li>Significant internal effort is necessary to maintain a quality internal audit function;</li> <li>Difficult to manage the need for diverse subject matter specialisation that is required for audit needs;</li> <li>Difficult to build a global team in diverse locations;</li> <li>Can result in high travel costs; and</li> <li>Resources often look for employment options throughout other areas of the company. This can have advantages for company, but is also a challenge for continuity in internal audit.</li> </ul>	<ul style="list-style-type: none"> <li>Requires coordination, oversight of, and contracting with external service provider;</li> <li>Requires hiring, training, and development of core management and/or staff;;</li> <li>Requires clearly defined roles/ responsibilities between internal and external resources; and</li> <li>May result in increased internal audit costs vis-a-vis the in-house option.</li> </ul>	<ul style="list-style-type: none"> <li>Requires coordination, oversight of, and contracting with external service provider;</li> <li>Does not maintain value of function internally to the company;</li> <li>It can be a challenge to fully integrate the internal audit function into the company or as a consistent resource option for special projects;</li> <li>Requires independent learning curve on the organisation by an external provider;</li> <li>Possible loss of immediate availability of internal audit resources for sudden ad hoc requirements;</li> <li>Loss of training ground for management trainees, future line appointments; and</li> <li>May result in increased internal audit costs vis-a-vis the in-house or co-sourced options.</li> </ul>

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