



Outsourcing the Internal Audit Function in Hong Kong

Following the Enron and WorldCom scandals, people around the world began to talk about improving corporate governance and the internal audit (IA) function. However, whether an organization should employ its own internal audit staff to perform this essential check or outsource the function to external consultants has in recent years become a debatable topic.

There were 1,496 listed companies in Hong Kong by the end of year 2011.¹ Hong Kong Exchanges and Clearing Limited have conducted analysis of corporate governance practices disclosures for all issuers of annual reports in 2009, 2007 and 2006. There is a trend towards more and more listed companies not maintaining their own IA function. Only 41.7 per cent of issuers in 2009 stated in their annual reports that they had an IA function. This compares with 43.4 per cent of issuers that replied in 2007.²

Literature review

The Hong Kong Institute of Certified Public Accountants states in a written document:³ "It can be expensive to maintain an IA function consisting of employees of the company. It is possible that the monitoring and review required by a certain company could be done in a small amount of time and full-time employees cannot be justified."

Research on the same debate was conducted in South Africa in 2010.⁴ The interviewees believed that a degree of co-sourcing or partial outsourcing was in general the most beneficial practice.

Non-audit services

Sometimes clients prefer to engage

auditors to perform the IA role. In Hong Kong, many of the larger accountancy firms offer internal audit services. However, according to the Code of Ethics for Professional Accountants, auditors are expressly prohibited from carrying out internal audit services for listed companies.

Disadvantages of outsourcing the internal audit

Of course, external consultants will not stay 365 days a year and the outsourced staff may have only a limited knowledge of your organization.

Advantages of outsourcing the internal audit

From my more than ten years' auditing experience, I can say that the most important advantage of outsourcing the IA is the independence issue. Some organizations require internal audit departments to report to the financial controller.

"The internal audit department should perform independent assessment and objective assurance to the board of directors and executive management," says Mr. Pont Chiu, head of internal audit of Hong Kong Exchanges and Clearing Limited.⁵

If our clients outsource the IA function, they do not need to recruit staff for the purpose. CT Partners has good-quality staff members who are properly trained to perform the role.

The other advantages of outsourcing the IA function include speed, cost and a tailored

answer to internal audit requirements.

Conclusion

I do believe that the trend towards outsourcing IA function will continue to grow in Hong Kong. We do not offer statutory audit services to listed companies; instead we concentrate on providing IA services. The market demand for outsourcing IA services is large, especially for small- and medium-sized listed companies.

Reference:

- 1) <http://www.hkex.com.hk/eng/stat/statrpt/factbook/factbook2011/fb2011.htm>
- 2) http://www.hkexnews.hk/reports/corpgovpract/Documents/CG_Practices_2010_e.pdf
- 3) Module C: Business Assurance, Qualification Programme by the Hong Kong Institute of Certified Public Accountants
- 4) "Outsourcing The Internal Audit Function" by Errol Campbell, University of Johannesburg, October 2010
- 5) <http://www.hkex.com.hk/eng/newsconsul/newsltr/2008/documents/2008-10-13-e.pdf>

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