



OUTSOURCING AMONG AUSTRALIAN FIRMS: INTERNAL AUDIT SERVICES EVIDENCES

ABSTRACT

Even though internal auditing services have been performed traditionally in-house, companies are now looking into outsourcing these types of services. With the use of a Transaction Cost Economics (TCE) point of view, this research will focus on the influence offered by a number of organizational-level factors when it comes to the decision whether to in-house or outsource their various internal audit functions. This study has also further identified the specific types of IA services which were most likely to be outsourced instead of completed in-house. The extent of these services includes some external financial auditors participating in different outsourced arrangements, including the interaction levels between the audit committees and internal audit provider. The results offer implications for corporate governance, auditor independence, as well as organizational performance.

INTRODUCTION

Through the years, internal audit functions has seen evolving from the standard watchdog to an overall value-added function in business. This term is defined by the American Institute of Internal Auditors (IIA) as a “sole function for appraisal which is determined inside an organization to evaluate and examine the activities as a service provided to the organization”. While the internal audit factions has been performed traditionally in-house, there is an obvious increase in the trend of outsourcing different internal auditing services (Markson & Langh, 2002).

Much of the available empirical evidence regarding the different factors which influence the decision of outsourcing or in-housing internal audit functions is anecdotal, unfortunately, with the scarcity of empirical studies which examine different factors systematically, affecting the decision to outsource. The study on how different factors on outsource decision are related to the output is non-existent, virtually speaking. Furthermore, there is scarcity in empirical evidences regarding the practices involved in outsourcing internal auditing activities in different business firms. Coop, Matt and Leng's (1995) survey regarding chief executive officers (CEO) as well as internal audit managers in different firms offer certain description on internal auditing activities. The research, however, was considered as descriptive by nature, and does not investigate outsourcing consequences and antecedents. The objective of this research is to extend previous research and to further advance our understanding of the related influence of various organizational variables regarding the decision to either in-house or outsource internal auditing activities.



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THEORETICAL BACKGROUND

According to the principles behind Transaction Cost Economics (TCE), the selection of the structure of governance will highly depend on the combination of both human and environmental factors. The latter usually involve three different types of transaction costs, namely asset specificity, uncertainty and frequency (Wilhelm, 1977). Asset specificity refers to the specific degree in which the needed assets in performing an activity are non-transferrable with other activities. Uncertainty refers to the variations in activities as function of dynamism and environmental complexity. On the other hand, frequency refers to a function of the rate or volume at which certain activities occur.

TCE has also been used in explaining different firm activities, including HR practice outsourcing, transferring of pricing policies, as well as make-or-buy decisions. Findings of previous studies support some essential associations in between the different types of transaction costs, including the degree with which internal audits is outsourced. Most importantly, the findings also suggest that internal audit tends to be outsourced for specific firms which work with lower levels of firm specific as well as proprietary knowledge, as well as for firms that follow a defender strategy. These findings, however, did not offer support to the established hypothesis in which firms with higher levels of uncertainty has the tendency to in-house internal audit services. At the same time, no found support for the hypotheses in which increasing frequency of internal audit services will also lead to high levels of internal audit activities outsourcing. Further research is recommended in order to determine the implications of the internal auditing outsourcing for auditor independence and audit quality.

REFERENCES

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