



OUTSOURCING OF INTERNAL AUDITING SERVICES AND PERFORMANCE OF ORGANISATIONS IN NIGERIA: A CONCEPTUAL APPROACH

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Abstract

The spate of corporate collapses and financial scandals has resulted in an increased focus on internal auditing as an important consideration for organisations. The basic role of internal auditing is to help management achieve company goals. It also provides assurance that management has implemented a satisfactory internal control system to prevent risks. It is observed that sourcing of internal audit services internally always leads to lack of independence by the staffs that provide these services since they are employees of the entity and under the control of management. In addition to that, the external auditors find it difficult to place reliance on the work performed by internal auditor. This study examines outsourcing of internal audit functions and performance of organisations in Nigeria by reviewing some selected studies from within and outside Nigeria. The objective of the study is to conduct a conceptual review (to determine how outsourcing of internal audit function affects performance of organisations in Nigeria based on the findings) of previous studies. This paper discovered from previous studies that outsourcing of internal audit functions is the remedy to efficiency, cost savings and reliability of internal audit services in every organisation. This study is of the opinion that more researches should be conducted on the topic in Nigeria and that organisations in Nigeria should key into outsourcing of their internal audit functions as this brings about cost saving, reliability of record as well as independence of opinion.

Keywords: Internal audit, Internal Auditors, Outsourcing, Performance

1. Introduction

Outsourcing is a highly effective strategy, widely used in various types of business to gain a competitive edge. The tremendous growth of outsourcing first started in the manufacturing and information technology industries. It has spread into the accounting industry as well. However, in accounting, the major problems and benefits caused by outsourcing are different from those identified in the manufacturing and IT industries. This leads to the question of whether or not outsourcing of internal audit functions would have significant impact on the performance of firms. The central reason for internal audits is to help managing executives in the effective performance of their tasks by providing them with scrutiny, evaluation, approvals and relevant observations regarding the undertakings appraised (Okezie, 2004). Raja (2002) argued that the increase of internal audit normally adds value and improves on an organisation's operations because of its objectivity and the consultative forums with other departments in the same organisation. Meckling (2000) identified auditing as one of the methods for monitoring and controlling the activities in the agency theory. Accordingly, internal auditing is an independent,



goals reassurance and checking events premeditated to enhance significance and advance an organisation's maneuvers.

Internal audit has been defined as a strategy that helps in preserving and maintaining the resources or asset which facilitates the invention of the reliable accounting information that leads to a better decision making during organisational changes due to the global rivalry and overcapacity such as their non-core functions (Schneider, 2003). Outsourcing of internal audit functions refer to the engagement of external skilled and competent service providers (public accounting firm or other management consultancy firms) to perform one or more of the internal audit functions traditionally performed in-house. Outsourcing was created to solve challenges inside the companies' processes. It started with manufacturing companies that outsourced just part of their supply chain. After a while businesses started to realise the advantages that business process outsourcing (BPO) brings for the business and the usage of outsourcing expanded into other categories such as human resources (HR) and finance and accounting. Accounting services and functions play a very important role in the lives of any business organisation, because they provide better management control, assist in decision-making, help to access new market and maximise profits in the corporate world (Dorasamy, Marimuthu, Jayabalan, Raman & Kalianna 2010). Performance refers to the actual results or outputs of certain activities. Company's performance can be assessed based on its financial results. Performance may also be termed to mean the ability to achieve results. Suleiman and Dandago (2014) study the extent to which internal audit functions (IAFs) are outsourced by deposit money banks (DMBs) in Nigeria, and the finds that all the 15 identified IAFs are being outsourced by the Nigerian DMBs at varying degree (completely, partially, occasionally or rarely). It is also discovered that 6IAFs stand out as those that are more outsourced than provided in-house by the Nigerian DMBs (going by the 50% and above scores they attracted from the respondents), and that the other 9 IAFs are more discharged in-house than outsourced to outside experts. Olumbe (2015) examines the effects of outsourcing of accounting services on performance of deposit taking SACCOs in Nairobi County, and findings revealed that outsourcing, liquidity and Managerial quality do not significantly affect the performance of SACCOs in Nairobi County. Sulanjaku and Todri (2015) studied the perspectives of outsourcing of internal audit functions in Albania, and found that a full outsourcing of internal control functions is rarely observed in Albanian market. According to the interviews conducted there are potentials for more outsourcing of internal controls functions in Albania, especially for the medium sized companies, and the main factor is lowering the internal control costs.

This study is a conceptual review of previous studies, conducted both within and outside Nigeria, and from our review of literature; it is observed that researchers in Nigeria have not conducted adequate studies on the topic despite the benefits based on the previous studies from across the globe. This study therefore hopes to fill gap in literature by showing discrepancies in the subject matter and the need to conduct empirical research on the topic. This study is targeted toward achieving the following specific objectives: To determine whether outsourcing of internal audit services influence performance of both private and public organisations in Nigeria based on previous empirical findings. The study is expected to be of significance more especially to the following potential beneficiaries namely employees, management, policy makers and finally to the public at large. The study is restricted to the parties concerned.



2. Literature Review

Concept of Outsourcing

Carey, Subramaniam and Ching (2006) opine that outsourcing is the contracting with an external party to provide services or activities that could be provided by an internal source. The authors described outsourcing as a service that provided or surrendered to external parties. Everaert, Sarens and Rommel (2010) define internal audit outsourcing as the process which involves the ‘external accountant,’ including both the professional accountant and the accounting firm performing internal audit functions on behalf of the organisation. Barac and Motubatse (2010) define internal audit outsourcing as an approach where the functions were executed by the outsider, apart from the organisation that will provide the benefits of cost advantage, effectiveness and efficiency of the operations and professional gain.

Concept of Internal Audit

The Institute of Internal Auditors (IIA, 1995) state that internal audit is “an independent, objective assurance and consulting activity designed to add value and improve on an organisation’s operations”. The IIA also states that internal audit helps an organisation to accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Therefore, the process of internal audit actually goes beyond examining accounting controls, records and financial statements and reports. The role of an internal auditor is actually to evaluate the efficiency and adequacy of the internal control systems as well as to test the continuing effectiveness and maintenance of controls. Coram, Ferguson and Moroney (2008) in their view see internal audits as consisting of all the measures taken by the organisation for the purpose of; protecting its resources against waste, fraud and inefficiency; ensuring accuracy and reliability of accounting and operating data; ensuring compliance with the policies of the organisation; evaluating the level of performance in all organisational units of the organisation. Goodwin (2003) states that the new definition of internal auditing has shifted its focus on the IA function to add value by improving the operations of the organisation and by evaluating and improving the effectiveness of the organisation’s risk management, control and governance processes. Therefore, the new definition of internal auditing has changed the role of internal auditors to a value added and consulting function to management.

Internal auditors are also required to evaluate the following areas of an organisation: Compliance with laws and regulations; Effectiveness of administration controls and procedures; efficiency of operations. An effective internal audit and control program should assist in timely detection of operational errors, produce accurate financial reports as well as safeguard assets.

Concept of Financial Performance

Moradi, Saeedi, Hajizadeh and Mohammadi (2013) specifically take financial performance to mean a criterion which determines how a company utilises different components of Intellectual Capital to earn profit. It can therefore be inferred from the definitions that financial performance measures financially the way a particular company uses different categories of assets in order to increase owners’ wealth. Some of the financial performance measures provided by investopedia, (2013) and financial dictionary (2012) include revenue from operations, operating income or cash flow from operations, return on assets (ROA), return on investment (ROI), value



added (VA). Therefore, the researchers see financial performance as a process by which firm utilises resources entrusted to generate revenue as well as have value for money.

Internal Audit Functions

Messier (2011) states that internal audit function occupies a significant part of the organisational structure of in-house control. This facilitates effective internal auditing and reporting with assurance of highest possible level of review and appraisal of various activities in an organisation. Depending on its performance, internal audit could either earn a good or bad reputation in the firm (Sarens and Bedde 2006). For internal audit to remain reputable, it has to keep on evaluating its performance and continually improving its services. Hutchinson and Zain (2009) state that internal audit is a significant part of the control arrangements in a firm and corporate governance involves oversight undertakings by the panel of executives and audit committees to ensure that the financial reporting practice is sound and up to the mark.

Previously, internal auditors were not recognised in organisations and were treated as mere accountants but that scenario has changed in that their services are currently treated as management oriented services (Hutchinson & Zain, 2009). Beyanga (2011) opines that internal audit greatly assists organisations to achieve their expected goals through use of strategic methodologies for determining and refining the usefulness and proficiency of the governance procedures of organisational threats and how they can be controlled. The Internal Audit Function (IAF) represents a unique research setting for some important reasons. First, the Internal Audit Function often serves parties integrally involved in governance processes, such as the board of directors, audit committee, external auditor, and senior management. The IAF also serves and adds worth to those who are governed, such as management and individual organisational units (treasury, information technology management, and operations). Also, many activities performed by IAFs can be incorporated into an organisation's control structure. For instance, the IAF frequently performs significant monitoring activities that could be incorporated into an organisation's control process. For the purpose of this study, outsourcing of internal audit functions refers to the engagement of external skilled and competent service providers (public accounting firm or other management consultancy firms) to perform one or more of the internal audit functions traditionally performed in-house.

Reasons for Outsourcing of Internal Audit Functions - Services which were initially or nearly all performed within an organisation have now started to change with the evolving of time. In fact, a major portion of services within an organisation have been outsourced out to a third party. The services outsourced by an organisation vary and ranges from intellectual property development, information technology related services, event organising services as well as accounting and internal auditing services. According to an article published in the Catalyst (a management issues paper), the following are the major reasons for outsourcing the internal audit function in an organisation: Provides savings in budget; improves the internal audit product by contracting for audit skills not available on current internal audit staff; provides operational as well as financial reviews; follows the fashion everyone else is doing it; the accounting firms have done too good a job indicating that CPA's (certified public accountants) can do the work better than CIA's (certified internal accountants); and to gain access to quality services and technical expertise (Van, Peurseem & Jiang, 2008).



Review of Empirical studies

Gilley, Greer and Rasheed (2004) examined the association between outsourcing and firm performance, and concluded that outsourcing activities (for example, payroll and training) had a significant positive influence on firm performance. Espino and Padrón-Robaina (2004) found that outsourcing has a positive influence on the financial performance. Gooderham, Tobiassen, Doving and Nordhang (2004), examined the degree to which small firm uses its authorised accountant as a business advisor in Norway. The independent variable considered are: Long term relationship with accountant, perceived competence in statutory accountancy services, perceived competence in business advisory services and the firm size. Structured telephone interview of 320 SMEs were conducted by the researchers and the data collected were analysed using linear regression, ordered logit, and Binary logit. Their findings support perceived competence in statutory accountancy services and perceived competence in business advisory services. Khumalo (2006) assessed the critical success factors for outsourcing strategies in the Mpumalanga coal mining industry in South Africa and revealed that the low impact of outsourcing in most companies stems from lack of knowledge of the critical success factors and failure of the companies to focus on these areas in their outsourcing endeavours. Carey, Subramaiam and Ching (2006) investigated the determinants of internal audit outsourcing using survey data on 99 companies listed on the Australian Stock Exchange, where 54.5 per cent fully rely on in-house facilities and 45.5 per cent outsource some or all of their internal audit function. Results from logistic regression analyses suggested that internal audit outsourcing is associated with perceived cost savings and the technical competence of the external provider. For a subsample of firms that have previously undertaken internal audit activities before outsourcing, contrary to expectations, the larger the organisation the greater the propensity to outsource. In addition, smaller firms are found to be adopting internal audit for the first time, through outsourcing.

Ruto (2010) examined benefits and setbacks of outsourcing accounting services among SACCOS in Nairobi. The study adopted a descriptive survey design, on working sample of 200 SACCOS in Nairobi and used questionnaires to collect data. The study found that not all the SACCOS outsource their accounting services. The study did not clearly explain the benefits and setbacks arising from outsourcing of accounting services. Yaseen (2011) study internal audit outsourcing practices in the South African private and public sectors. The study did not distinguish between private and public sector results reports on the views of the chief audit executives (CAEs) and accounting officers only. The study found that two main factors in opting to outsource the IAF are the legal liability insurance of external service providers and the flexibility in scheduling of the outsourced service. Furthermore, the study found that threats to the independence of the external service provider are similar in both the public and private sectors. Kamyambi and Devi (2011) examined the impact of outsourcing accounting services on Iranian SME performance. The objective of the study was to identify the factors affecting outsourcing intensity of accounting activities and the impact of outsourcing on firm performance. They used questionnaires to collect data and selected a sample of 1750 manufacturing SMES. The study concludes that outsourcing of accounting services fully mediates firm's performance. Muqattash (2011) concludes that having the internal audit within the organisations will have more advantage rather than completely outsource to third parties.



Suleiman and Dandago (2014) studied the extent to which internal audit functions (IAFs) are outsourced by deposit money banks (DMBs) in Nigeria. The extent to which the banks outsourced each of the 15 identified functions traditionally attached to the internal audit unit/department was tested, using a structured questionnaire to elicit responses from the top and middle level management staff of the banks. Bank' management normally establishes and safeguards internal control system and internal audit system. Accordingly, heads of operations, branch managers, regional/area managers and internal auditors/controllers of all the 22 DMBs existing in Nigeria as at 31July, 2013 were used as respondents. 25 copies of the questionnaire are administered to the targeted respondents from each of the 22 banks, making a total of 550 copies. Of the copies returned, 435 (79%) were accepted for analysis. As the data were collected on an ordinal scale, non-parametric confirmatory analysis was employed. The study finds that all the 15 identified IAFs are being outsourced by the Nigerian DMBs at varying degree (completely, partially, occasionally or rarely). It was also discovered that 6IAFs stand out as those that are more outsourced than provided in-house by the Nigerian DMBs (going by the 50% and above scores they attracted from the respondents), and that the other 9 IAFs are more discharged in-house than outsourced to outside experts. Olumbe (2015) examined the effects of outsourcing of accounting services on performance of deposit taking SACCOs in Nairobi County. To satisfy the research objective, the study population was the 42 deposit taking SACCOs in Nairobi in Nairobi County. The data was collected using secondary data collection mode, by use of financial performance reports, journals and past studies. The data collected was analysed using descriptive statistics and presented using tables; regression analysis was also performed in establishing the relationship between outsourcing practices and performance of SACCOs in Nairobi County. The regression analysis revealed that outsourcing, liquidity and Managerial quality do not significantly affect the performance of SACCOs in Nairobi County.

Sulanjaku and Todri (2015) studied the perspectives of outsourcing of internal audit functions in Albania. The authors conducted the research by interviewing some selected certified public accountants and selected businesses to better understand the extensions of internal control outsourcing and its perspective in Albanian market. The study concluded that large companies in Albania are already benefiting from the advantages of internal control outsourcing. The big companies are hiring specialised companies in performing these tasks. The study also found that a full outsourcing of internal control functions is rarely observed in Albanian market. According to the interviews conducted there are potentials for more outsourcing of internal controls functions in Albania, especially for the medium sized companies, and the main factor is lowering the internal control costs. Kiema, Ahmed and Ndirangu (2015) investigated the relationship between the internal audit function and financial performance of mid-size manufacturing firms in Kenya. The study sought to investigate the existing relationship between the internal audit function and financial performance of mid-size manufacturing firms in Nairobi County, Kenya. To fulfill its objective, the study operated a descriptive research approach. The target population in the study was the medium size manufacturing firms. 30% of the medium size manufacturing firms in Nairobi were selected for the study. This generated 30 firms. Primary data was collected using a quantitative approach. The respondents were either of the three (3) business unit heads designated as CEOs or senior Managers, general managers and functional heads from each of the firms who are responsible for day – to day operations of the enterprises. The data obtained was mainly quantifiable in nature and hence was analysed by



descriptive analysis. The researcher conducted inferential analysis which included a multiple regression analysis. The study concluded that internal audit functions have a significant effect on the financial performance of mid- size manufacturing firms in Nairobi. There was a strong positive relationship between financial performance of mid-size manufacturing firms and internal audit aspects of functions. There is therefore the need for mid-size manufacturing firms to adopt effective internal processes and practices that address key internal auditing practices for effectiveness of audit quality.

Hoglund and Sundvik (2016) examined whether the financial reporting quality of small firms differs between firms that outsource accounting tasks and firms that perform these tasks internally. Using accruals quality as a measure for the financial reporting quality and a sample of small Finnish limited liability firms, the study found that the quality among the firms is positively related to the decision of purchasing accounting services from an external service provider. The evidence shows that outsourcing of accounting tasks such as the preparation of the statutory financial statement and longer outsourcing relationships increases reporting quality. However, outsourcing of additional tasks, such as payroll processing, does not result in higher quality. Amarajeewa, Dedunu and Bandara (2017) investigated the factors affecting outsourcing of internal audit function of Sri Lankan Finance companies. The independent variables are independence, internal audit quality, management support, expertise knowledge and cost. The dependent variable is internal audit outsourcing. The sample consists of fifty management level and operational level employees of Finance companies which outsource internal audit function in Kandy urban area. Questionnaire was used to identify the factors affecting outsourcing of internal audit function in finance companies. Statistical Package for Social Sciences was used to analyse the data. Different analysis tools are used in this research to measure the relationship between independent variables and dependent variable such as reliability testing, descriptive statistics, correlation analysis and multiple regression analysis. The researcher builds descriptive hypotheses to identify the impact of independence, internal audit quality, management support, expertise knowledge and cost on the internal audit outsourcing. The study concludes that internal audit quality, expertise knowledge and cost significantly impact on the internal audit outsourcing. Wadesango and Makerevi (2018) investigated the possible value creation of an effective internal audit function in a business organisation and the impact of the value creation on financial performance. A quantitative research approach was adopted. The research targeted 40 employees in management positions, audit department and finance department. Questionnaires were administered to a selected sample size of 25 African Sun Limited employees. The major finding was that internal audit function has been found to have a positive association with an organisation's financial performance with both its assurance and consultative role proving to add value. Also internal audit characteristics were tested against organisational performance, with internal audit size and competence/experience proving to have a positive association but CAE qualification has a negative effect. The study concludes that management should ensure that their Internal Audit Function (IAF) are fully resourced and fully receive their support and also management should engage internal auditors intensively on both assurance and consultative assignments as they tend to possess vast business knowledge and both the roles have proven their capabilities of improving business performance.



Resource Based View Theory

Resource Based View (RBV) originated by Penrose (1995), has been employed for outsourcing decisions, shifting the attention from transaction costs and opportunism to competitive advantage, however, the central tenet in RBV is that unique organisation resources are the real source of competitive advantage, hence the RBV explains that the degree of competition is a vital factor affecting a firm's decision to outsourcing of their accounting functions. This theory therefore, underpins this study.

3. Methodology

This study adopted a descriptive research. The study reviewed the findings of other researchers, and then takes a stand based on the justifications given by the previous studies.

4. Findings and Discussions

The following are some of the findings from the study. Research has clearly shown that the typical organisation that outsource its internal audit functions experienced positive impact on performance, reduced cost of operations and attract better skills. This paper discovered that outsourcing of internal audit functions is the remedy to efficiency, cost savings and reliability of internal audit services in every organisation. Moreover, many studies have also equally established positive relationship between outsourcing of internal audit functions and firms performance (Sulanjaku *et al* 2015; Kiema *et al* 2015; Kamyambi *et al* 2011). However, this is not supported by Olumbe (2015) who did not find any significant relationship between outsourcing of internal audit functions and firm performance

It has been observed from studies reviewed that sourcing of internal audit services internally always leads to lack of independence by the staff that provide these services since they are employees of the entity and under the control of management. In addition to that, the external Auditors find it difficult to place reliance on the work performed by internal auditor.

5. Conclusion and Recommendations

The analytical reviews revealed that there is a significant relationship between outsourcing of internal audit functions and performance of organisations in both public and private sectors in Nigeria. The study makes the following recommendations:

The application of outsourcing of internal audit functions may not only minimise cost, but can make the organisation perform better and more efficient. Also it has been observed from previous studies that sourcing internal audit services externally brings about credibility and reliability to the internal audit functions. In addition, based on the previous studies, outsourcing of internal audit functions enhances efficiency and increase the performance of organisations in Nigeria.

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