

## Chapter 12

# Outsourcing of Internal Audit Services Instead of Traditional Internal Audit Units: A Literature Review on Transition From In-House to Outsourcing

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### **ABSTRACT**

*The internal audit function traditionally establishes and continues its activities within the company, but it can also be provided by professionals outside the organization. Therefore, internal audit activities can be provided in three ways: the internal audit department established within the organization (in-house), the internal audit service provided by an audit firm (outsourcing), the joint operation of the internal audit department and the audit firm (co-sourcing). To choose the better approach for a company, the scale of the organization, the attitude and understanding of the management, and industry in which the company operates in must be taken into consideration. This study is a literature review that classifies the studies carried out on these methods that are used in performing internal audit activities.*

### **INTRODUCTION**

The Institute of Internal Auditors (IIA) describes internal audit as an objective assurance and advisory activity designed to improve the operations of an organization and to add value. The internal audit function, traditionally, is established and continues its activities within the company, but it can also be provided by professionals outside the organization. The outside party is the person or organization that is specialized in the field of internal audit that provides the internal audit activities from outside the

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## ***Outsourcing of Internal Audit Services Instead of Traditional Internal Audit Units***

company. Today, internal audit activities can be provided in three ways: the internal audit department established within the organization (in-house), the internal audit service provided by professionals outside the company (outsourcing), the joint operation of the internal audit department and professionals outside the company (co-sourcing). These structures, which appear as different resource uses in internal audit, emerge as alternatives to companies when planning and establishing their internal audit activities. To choose the better approach for a company the scale of the organization, the attitude and understanding of the management, and industry in which the company operates in must be taken into consideration. By using internal and external resources or both, an effective and value-added internal audit activity in the organization can be provided economically and efficiently with the enough competence. It also ensures the independent and impartial assurance and advisory function as stated in the definition of internal audit activity. The purpose of this study is to classify the studies carried out on these methods that are used in performing internal audit activities.

## **BACKGROUND**

When the history of internal audit is discussed, financial and compliance audits are the first issues put forward. Then, at the beginning of the 20th century, with the growth of companies and increasing transaction complexity, the need for competent managers and the necessity of effective and efficient operation of the business activities have been brought to the agenda. Thus, internal audit, which is added to financial audit and compliance audit, as well as managerial activities, has been accepted as an auxiliary tool for equipped managers. (Spraaakman, 2001, p.19) Internal audit was initially described as an “evaluation function”. Today, when the services provided by internal audit are examined, it is seen that this definition is insufficient. Internal audit continuously adds value to operational activities through prevention of problems and identification of potential risks. Internal audit helps to achieve the objectives of the company with a systematic and disciplined approach to evaluate the risk management process, control and governance processes of a company and to improve the disruptions. From this definition of internal audit, it is possible to deduce that internal audit is an assurance service. (Ahlawat & Lowe, 2004, p.148)

Competition between audit firms and mergers in the 1980s and 1990s caused decrease in audit revenues. For this reason, audit firms have begun to seek alternative resources by offering various professional services, including internal audit, risk management, and various assurance and consulting services in order to protect growth and profitability. (Swanger and Chewning, 2001, p.115)

Between 1982 and 1988, revenue from services other than independent audit services increased by 3.8% on average to 53% of total revenues in 1988 (Inua and Abianga, 2015, p.38). In the early 1980s, companies tended to provide some of the business activities outside of their main activities and internal audit activities carried out within the business so far from outside the company (Papageorgiou, Yasseen & Padia, 2012, p.11828). In the early 1990s, independent auditing organizations began to consider internal audit activities as a service area for both existing and new customers. Many of them have established units within themselves to market and provide internal audit services. (Geiger, Lowe & Pany, 2002, p.21)

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