Conceptual Paper

Moderating Role of Corporate Strategy on Relationship Between Technical Competence and Internal Audit Outsourcing: A Proposed Model

Dije Muhammad Suleiman
Department of Accounting
Bayero University Kano, 700241 B.U.K New Site, Kano, Nigeria
muhammadije@yahoo.com

Abstract

While a considerable amount of research has contributed to our understanding of the underlying factors influencing the outsourcing of internal audit function, literature suggest that there is a paucity of research examining the moderating role of corporate strategy on the relationship between internal audit outsourcing and its antecedents. To address this theoretical gap in the literature, the current paper proposes a conceptual framework for examining the role of corporate strategy as a potential moderator on the relationship between technical competence and outsourcing of internal audit function. Specifically, the paper proposes to examine technical competence as a potential moderating variable that explains how technical competence influence internal audit outsourcing.

Key Terms: internal audit outsourcing, technical competence, corporate strategy, resource dependency theory

1. Introduction

Strategic outsourcing has been defined "as the organizing arrangement that emerges when firms rely on intermediate markets to provide specialized capabilities that supplement existing capabilities deployed along a firm's value chain" (p.466). Over the past two decades, this kind of strategic option has been well practiced by both private and public organisations (Ellram, Tate, & Billington, 2008; Selim & Yiannakas, 2000; Shaw & Fairhurst, 1997; Thouin, Hoffman, & Ford, 2009; Webster & Harding, 2001). Examples of strategic outsourcing include, arranging with specialized service organisations to provide managed security services (Ding, Yurcik, & Yin, 2005), web design and hostage (Jayatilaka, 2009; Nugroho, Afghani, Hodosi, & Rusu, 2013), legal services (Kenny & Gordon, 2012; Tuft, 2010), procurement of specialized training (Chaudhuri & Bartlett, 2014; Ju & Shen, 2010), public employment services (Webster & Harding, 2001), and inventory management, among others (Tapiero & Grando, 2006; Zhang, 2006).

Evidence suggests that outsourcing of the internal audit function, which is the focus of this paper serve as a means of reducing organizational costs, providing flexibility and for capturing innovation (American Institute of Certified Public Accountants, 1997; Kiran, Richard, & Chris, 2005; McGee, 2005) due to the scrutiny of internal audit cost and improving
profitability (Kurtzman, 1996; Laura & Michael, 2003; Moeller & Witt, 1999; Robert & Stanley, 1993; Sawyer, Dittenhofer, Scheiner, Graham, & Makosz, 2003). Consequently, the practice of outsourcing internal audit especially public accounting firms, gained momentum, this is more so, due to the increased demand placed on the skills and competence of internal auditors (Spekle, Van Elten, & Kruis, 2007).

Theory and extant empirical studies have suggested that technical competence relates positively with internal audit outsourcing (e.g., Archibald, 2007; Barac & Motubatse, 2009; Hillman, Withers, & Collins, 2009; Pfieffer & Salancik, 1978; Quélin & Duhamel, 2003). Specifically, However, there is a paucity of research that has examined how technical competence influences internal audit outsourcing by means of one or more moderator variables. Hence, the present study suggests corporate strategy as a moderator variable on the relationship between technical competence and internal audit outsourcing. Therefore, the primary goal of this paper is to propose a moderation model of the relationships between technical competence and internal audit outsourcing. Towards this end, section 2 reviews the literature on link between technical competence and internal audit outsourcing, as well as the moderating role of corporate strategy on this relationship in order to advance research propositions. Next, on the basis of prior research, the paper offer several practical implications in section 3. In section 4, conclusion was drawn.

2. Literature Review Propositions Development

2.1 Technical competence and internal audit outsourcing

Technical competence refers to the ability of external service providers to perform professional services that requires specific knowledge or technical skills. As indicated earlier, empirical studies have suggested a significant positive relationship between technical competence and internal audit outsourcing. For example, Sharma and Subramaniam (2005) and Carey, Subramaniam, and Ching (2006) showed that technical competence of the external service provider plays a significant role in deciding whether companies should either outsource or in-house their internal audit function. In the same vein, Ketler & Willems, 1999) in their study in found that availability and quality of service providers and access to increased knowledge and expertise were positively associated with outsourcing of internal audit function. Barac and Motubatse (2009), investigated the extent of internal audit outsourcing practices within large listed South African companies, with a view of understanding the factors that determine internal audit outsourcing decisions. They showed that lack of appropriate skills as one of the factors that influence the decision of South African companies to outsource their internal audit function. In a more recent study, Quélin and Duhamel (2003) found, among others, that technical competence and attributes of the service providers’ to be among the factors that influence an organization to outsource its activities external service providers. In addition to the aforementioned empirical research, several other studies (e.g., Islam & Sobhani, 2010; Kamyabi & Devi, 2011) also found significant positive relationship between technical competence and internal audit outsourcing. Furthermore, from Resource dependency perspective, “an organization must engage in transactions with other actors and organizations in its environment in order to acquire resources” (Archibald, 2007, p. 1). Thus, we advanced the following proposition:

P1: Technical competence relates positively to internal audit outsourcing.

2.2 Corporate strategy as a potential moderator variable

How does technical competence relate positively to internal audit outsourcing? Overall corporate strategy might be a possible answer to this research question. Research suggests that overall corporate strategy of an organization towards outsourcing may be a determining factor in the decision and extent of internal audit function to be outsourced. Outsourcing lends its support to the management theorists’ assumption that management should focus on core
competencies of the business of the organization, by emphasizing a strategy to remove non-core activities and concentrating on core value adding, revenue generating activities (Carey et al., 2006). They concluded that when a firm adopts a strategy to outsource a non-core activity such as security guards, drivers, canteen and payroll, the chances of outsourcing a non-traditional function such as internal audit function, which has traditionally been believed to be a support mechanism rather than a core activity, increases as well.

Furthermore, it has been argued by (Carey et al., 2006) that firms that emphasize the core competence strategy are likely to gain outstanding and significant experiences and competencies in managing the risks associated with outsourcing because the more activities outsourced by the firm, the better result obtained by the management in using external service providers. (Quélin & Duhamel, 2003) are of the view that in addition to other factors mentioned earlier, the degree of the internalization or externalization of a firm’s activities is determined by the corporate strategy adopted by the firm. They claimed that some of the internal audit function considered by the firm to constitute sources of competitive advantages or core competencies the firm may decide to keep the function in-house. At the same time, it may decide to adopt a corporate strategy to outsource all other activities considered to be a non-core activity. It can therefore, be argued that when an organization adopts a strategy to outsource non-core functions, such as security guards, drivers, canteen and payroll, the likelihood of outsourcing non-traditional functions such as the internal audit function, which has traditionally been believed to be a support mechanism for monitoring organizational performance and governance rather than as a core function that creates competitive advantage for the organization (Rittenberg & Covaleski, 2001) increases as well. Therefore, on the basis of aforementioned theory and empirical studies, the following proposition is advanced:

P2: Corporate strategy will moderate the positive relationship between technical competence and internal audit outsourcing. Such that this relationship would be stronger (i.e. more positive) when corporate strategy is high than when it is low.

2.3 Proposed research framework

Building on the foregoing empirical evidence and theoretical perspectives, this paper proposes a conceptual framework to understand the potential moderating role of corporate strategy on the relationship between technical competence and internal audit outsourcing as illustrated in Figure 1.

![Figure 1: Conceptual framework](image)

3. Potential Implications of the Research

The primary goal of this study was to replicate and extend extant research relating technical competence with internal audit outsourcing. The present study has several important practical implications in terms of Human Resource Accounting practices. For example, the significant positive relationship between technical competence and internal audit outsourcing
reported in the past studies (e.g., Islam & Sobhani, 2010; Kamyabi & Devi, 2011; Sharma & Subramaniam, 2005) have underlined the importance of management interventions, which specifically focus on internal audit outsourcing decisions. In other words, this study suggests that organizations that intend to outsource its internal audit functions should only engage technically competent service providers, preferably, reputable accountancy firms rather than consultancy services. A technically competent external service provider brings about improvement in skill, reduces cost of operations and expenses in the form of training and pension, enhances quality services and as well as provides expert help and experience that are not available in-house for the organizations.

Furthermore, this paper suggests that in addition to taking technical competence into outsourcing decisions, the managerial decision to outsource should not be based solely on top down corporate strategy to outsource non-core activities. In other word, management should in addition evaluate the following three options before it finally reaches a decision. Firstly, it should examine the in-house function adequately for the proposed purpose. The potential impact on employees' morale and performance should be considered, especially where substantial existing staff are going to be affected by outsourcing. Secondly, management should assess whether outsourcing would add value to the firm. Thirdly, to consider if it is a better option to co-source by partially outsourcing some of the functions where skills can be improved or cost saved. Where the in-house internal audit staff is technically more competent than the external service provider, it is better to use the in-house audit staff despite the organisation's top down corporate strategy to outsource internal audit functions in order to cut cost.

The paper suggests that to be able to compete globally, organizations should embrace all the functions of internal audit, such as establishment of accounting system within the organization; monitoring and evaluation of accounting system (Sharma & Subramaniam, 2005; The Institute of Internal Auditors, 2001), among others to ensure that they are executed diligently either in-house or by an outsourcer. This is because the functions are similar to those covered by the expanded role of the internal audit functions as contained in the new definition of internal audit provided by (The Institute of Internal Auditors, 2001) which states that an internal audit unit, in addition to safeguarding the assets of the organization, should add value by being involved in risk management. This is quite relevant to private firms, such as banks considering the volatile nature of their operations and transactions. In choosing an external service provider, management should choose provider that can easily and quickly appreciate the organizations and relate with its ethics and values. Conflicts of interest that may compromise the independence of external services should be avoided. If possible, the firm should conduct a trial outsourcing of an external service provider or a one-off audit project before considering outsourcing a larger function.

4. Conclusion

In conclusion, the preceding discussion in the current paper is aimed at proposing a moderation model of the relationships between technical competence, corporate strategy, and internal audit outsourcing. The next important stage is to carry out an empirical investigation towards validating the proposed framework illustrated in Figure 1. Such a scientific inquiry is particularly important given the benefits of internal audit outsourcing to organizations. Thus, based on prior research, one is able to see to what extent does corporate strategy explain internal audit outsourcing. This in turn can help management organizations to maximize the strategic benefits of outsourcing internal audit functions.
References


