

---

## DETERMINANTS OF INTERNAL AUDIT FUNCTION OUTSOURCING AMONG MICRO, SMALL AND MEDIUM SIZED ENTERPRISES IN LAGOS STATE

**Yisa Ayinla Adeniji,**

Department Of Accountancy, Yaba College of Technology, Yaba, Lagos State, Nigeria.

---

**ABSTRACT:** *Micro, Small and Medium Scale enterprises (MSMEs) are recognized globally as the bedrock of meaningful development in any economy. MSMEs significantly contribute to employment and the Gross Domestic Product (GDP) in emerging economies. Sequel to the economic recession, the Federal Government through the Central Bank of Nigeria (CBN) established a ₦75billion survival fund to revitalize the MSMEs in the county. Consequently, and to ensure effective utilization of the fund, the study examines the key factors influencing the outsourcing of internal audit function (IAF) among MSMEs in Lagos State. The study adopted survey research design, using purposive sampling technique to select 170 respondents among registered MSMEs by SMEDAN in Lagos. An adapted structured questionnaire was used to collect data, validated using Cronbach alpha with 85% percent response rate. Descriptive and inferential analysis revealed that factors influencing (IAF) outsourcing include asset specificity (3.35), environmental uncertainty (3.53) and cost of auditing (3.43) mean value. This implies that insufficient in-house knowledge, availability of external service providers and cost benefit analysis are major reasons for IAF outsourcing by MSMEs in Nigeria. The study recommended that owners and managers' of MSMEs should ensure that audit functions are outsourced to external professionals in order to achieve high audit quality at a reduced cost.*

**KEYWORDS:** asset specificity, cost, environmental uncertainty, internal audit, outsourcing

---

## INTRODUCTION

According to the latest World Bank report for the year 2020, a contribution of collapse in oil prices and COVID-19 pandemic is expected to plunge the Nigeria's economy into a severe recession, the worst since the 1980's. The bank projected that Nigeria's economy would likely contract by 3.2 percent in 2020. The International Monetary Fund however estimated a negative growth of 5.4 percent for Nigeria in the same year due to the pandemic, calls for bold policies to save lives and livelihood. The reports opine that the macro-economic impact of the COVID-19 pandemic will likely be significant, even if Nigeria manages to contain the spread of the virus. Oil represents more than 80 percent of Nigeria exports, 30 percent of its banking sectors credit and 50 percent of the overall government revenue. IMF estimated further that debt servicing may likely gulp the entire revenue accruable to the country in the current year of 2020.

To buttress the position of the World Bank and IMF, the National Bureau of Statistics (NBS) reveals that in the first quarter of 2020, Nigeria revenue performances shows 30 percent deficit in oil revenue, 40 percent deficit in non-oil revenue with an overall average of 76 percent adverse variances. The statistics also reveals a 100 percent adverse variances in signature bonus, Domestic Recoveries, Stamp Duties, Grants and Donor Funding. With the drop in oil prices, government revenues are expected to fall from an already low 8 percent of GDP in 2019 to a projected 5 percent

in 2020. By the end of the third quarter of 2020, Nigeria's economy officially went into recession based on the report of NBS. This comes at a time when fiscal resources are urgently needed to contain the COVID-19 outbreak and stimulate the economy. The World Bank lead Economist for Nigeria, Marco-Hernandez opined that the unprecedented crisis requires an equally unprecedented policy response from the entire Nigerian public sector, in collaboration with the private sector, to save lives, protect livelihoods, and lay the foundation for a strong economic recovery. To achieve this objective, maximum contribution of MSMEs is required. Consequently, the Federal Government of Nigeria through the Central Bank (CBN) inaugurated a N75 billion (Seventy-five billion naira) survival fund to revitalize and reinvigorate the Micro, Small and Medium Enterprises (MSMEs) in the country. Analysis of the fund indicates that each firm would be credited with N50, 000 (fifty thousand naira) each.

Micro, Small and Medium Enterprises (MSMEs) are recognized all over the world as the engine of growth in any development oriented economy. Due to their inherent labour intensive production processes, they provide a viable platform for job creation. In Brazil, MSMEs account for 62 percent of employment and 50 percent of national value (Punch, 2020). All over the developed world, the contribution of MSMEs to GDP averages about 47 per cent. However, in Nigeria, MSMEs account for only 10 per cent of our GDP. With over 200 million people and only about 6, 000 megawatts of electric power available (compared to South Africa's 51000MW), creating jobs and reducing poverty amid a population growth rate of 2.6 percent is a massive challenge (Punch, 2020). As reported by the Small Medium Enterprises Development Agency of Nigeria (SMEDAN), there are about 17.3 million MSMEs in Nigeria compared to the over 40 million MSMEs in Indonesia, whose population is only a little greater than Nigeria (Jonathan, 2014). Some of the reasons adduced for this disparity are limited access to finance, low technology, poor infrastructure and lack of market access. MSMEs play an important role in a nation's economy. In Malaysia, it represents the largest percentage of economic formations at 99.2 percent. This contributes 32 percent to Gross Domestic Products (GDP), 56.4 percent to total workforce and 19 percent to total exports of the country (SMECORP 2013). Micro, Small and Medium Sized Enterprises (MSMEs) significantly contribute to employment and the Gross, Domestic Product (GDP) in emerging economies (Ale-Ebrahim, Ahmed & Taha, 2010; Devi & Samujh, 2010). Many claim that the growth of emerging economies significantly depends on the performance of MSMEs (Ale - Ebrahim *et al.*, 2010; Zohari, 2008; Bayati & Taghavi, 2007). For example, in developing countries, MSMEs help to bring stability to the national economy and help buffer the shocks that came with the boom and burst of economic cycles (Ale - Ebrahim *et al.*, 2010), because MSMEs make up the most part of manufacturing enterprises (Zohari, 2008; Bayati & Taghavi, 2007). For example, Iranian MSMEs employed more than 63 percent of total Iranian manpower in the industrial sector which in total, represents 99.9 percent of all firms in Iran (Zohari, 2008).

In Nigeria, MSMEs contributed over 70 percent of national industrial employment represents about 90 percent of the industrial sector in terms of the number of enterprises. But the MSMEs development only accounted for 10 percent of manufacturing output and a meager 5 percent of gross domestic product (GDP) in 2008 (Ogundele, 2010). Over the years, MSMEs in Nigeria have been an avenue for job creation and empowerment of citizens providing about 70 percent of all job opportunities and also for wealth formation (Dauda & Akingbade 2010). Indeed, MSMEs in emerging economies are a major part of the industrial economies and their survival and

development (growth) is an important issue (Ale-Ebrahim *et al.*, 2010; Zohari, 2008). To further increase the generative capacity of MSMEs; outsourcing can be implemented. It is evident that outsourcing can be an important activity that MSMEs can adapt in other to enhance their competitiveness. In this context, this study examines the key determinants of internal audit function outsourcing among MSMEs in an emerging economy like Nigeria.

## LITERATURE REVIEW

The term “outsourcing” was created at the end of the 1980s for contracting out information systems (Espino Rodriguez & Padron-Robaina 2004; Hussey & Jenster 2003). For example, in the past, most subcontracted functions related to information systems or component manufacture, even though, in recent years, many other service functions in various sectors have been outsourced (i.e., accounting functions, internal audit functions administrative services, human resources activities, catering services, logistics, procurement etc.) (Espino Rodriguez & Padron-Robaina, 2004). Primarily, the emphasis is on outsourcing support and professional activities in firms, such as accounting functions or human resources. (Caniels & Troelleveld, 2009). The word outsourcing is seen to be synonymous with the decision to externalise (Espino Rodriguez & Padron-Robaina, 2004, 2006). For instance, many claim that outsourcing involves processing outside the firm to obtain specific activities or services that are not provided inside the firm (Hamzah, Aman, Maelah, Auzair & Amiruddin, 2010; Espino-Rodriguez & Padron-Robaina, 2006). Overall, outsourcing is usually explained as the contracting with an external service provider to make available a function internally (Nicholson, Jones & Espenlaub *et al.*, 2006 Wood, Barrar, Jones & Sullivan, 2001).

### Outsourcing of Internal Audit

According to The Institute of Internal Auditors; UK (Definition of internal auditing, 2013), internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization operations. Carey *et al.* (2006) however, described outsourcing as a service that are provided or surrendered to external parties. Barac and Motubatse (2010) on the other hand defined internal audit outsourcing as an approach where the functions were executed by the outsider apart from the organization that will provide the benefits of cost advantage, effectiveness and efficiency of the operations and professional gain. Thus, Internal audit outsourcing is an activity where the firms employ or appoint independent public accounting firms and other professionals to execute the function that have not been done by traditional internal auditors. According to Tahajuddin and Kertali (2018), the study stated that internal auditor independence helps to improve the organization by enhancing the audit effectiveness and quality which will eventually assist the management to recognize the problems and thus achieve the objectives of the particular organization. Muqattash (2011) says that having the internal audit within the organizations will have more advantage rather than completely outsourced to third parties. A study found out that in South Africa, company policies, lack of appropriate skills, perceived objectivity of the auditors together with the cost implications are major reasons for internal audit outsourcing (Barac & Motinbatses, 2010). But Carey *et.al* (2006) opine that the technical competence of the external provider and perceived cost savings are major factors influencing internal audit outsourcing. According to Okpara, Ezirim and Mohammed (2017), managerial factors that influences internal audit outsourcing decision among MSMEs in Nigeria includes cost saving and professional competence but excludes risk management considerations.

In examining the determinants of internal audit outsourcing. Jiem, Nam, Mei, Khoan and Sheemon (2013), posit that asset specificity, frequency of the audit, cost of the audit and environmental uncertainty are influencing factors among MSMEs in Malaysia. In Australia, firm size, cost pressure, asset specificity and perceived environmental uncertainty are significant variables affecting firm decision to outsource their internal audit function (Sherman & Subramaniam, 2005). From the perspectives of the Siri-Hankan firms, internal audit outsourcing are significantly influenced by the cost of the audit, expertise knowledge of the service provider and the internal audit quality (Amerageewa, Dedunu & Bandara, 2017). According to Sulanjaku and Todri (2015), benefit of outsourcing the internal audit function in Albania is to obtain higher quality services and reducing the administrative cost of the internal control system. In Albania, 90 percent of the establishments are regarded as small companies, 9 percent are medium while 0.4 percent are big company with over 200 employees. Small companies generally outsource the entire bookkeeping operations to CPA's. However, there are mixed findings on the impact of outsourcing of internal auditing services on quality, cost, independence and availability of resources (Mubako, 2018).

### **Theoretical perspective of outsourcing**

The Transaction cost Economics (TCE) perspective founded by Coase (1937) and developed principally by Williamson (1975, 1985, 1996), situate that there are cost in using a market. TCE perceptive merges economic theory with management theory to posit an ideal type of relationship a firm must possess in the marketplace (McIvor, 2000, 2009). According to Espino-Rodriguez, Hai and Baum (2008) TCE emerges as the main theory to explain outsourcing practice over the past 20 years. TCE perspective has laid the bases for the buying discipline that utilises an investigation of the factors, which establish the internal and external boundaries (e.g., insourcing or outsourcing) of the firm (McIvor, 2009). The notion of TCE is that the properties of a transaction establish what constitute the efficient governance structure market (buy=outsourcing), hierarchy (make=insourcing) or alliance (insourcing and outsourcing) (McIvor, 2000). Markets are assumed to be efficient, but efficiency requires that all information is available to all parties (i.e., firms and service providers) (Marshall *et al.*, 2007). If this condition is not met, firms can incur costs, called transaction costs (Marshall *et al.*, 2007). Inevitably, TCE theory is established to be one of the most popular theoretical paradigms for investigating outsourcing practice (Reeves *et al.*, 2010; Everaert *et al.*, 2010; Lamminmaki, 2007; Espino-Rodriguez & Gil-Padilla, 2005). TCE perspective suggests that firms are organized in such a way that minimizes transaction costs (Lamminmaki, 2000). TCE argues a firm seeks to balance transaction and production costs in their decision to internalise (insource) or externalise (outsource) a transaction (Jiang, Belohlav & Young, 2007). Therefore, the greater the transaction costs, the more likely that the transaction form (mode) goes to managing within the firm (i.e., insourcing) rather than buying (e.g. outsourcing) (Jiang *et al.*, 2007). When a firm decides to outsource a service function, it suggests to the market that the cost of this new external transaction mode (form) must be lower than its former in-house transaction cost (Jiang, *et al.*, 2007).

### **Asset Specificity**

The transaction cost attributed to any activity or function depend largely on the key factors of the activity. According to Williamson (1996), McIvor (2009); Dibbern and Heinzl (2009) and Lamminmaki (2007), such attributes may include asset specificity, behavioural uncertainty, environmental uncertainty, trust in service provider and the frequency of the transaction.

According to TCE theory, asset specificity is one of the major factors influencing the desire to outsource the internal audit functions (Everaert, *et al*, 2006). Asset specificity refers to transaction that need high investment that are specific to the exchange relationship (Dibbern & Heinzl, 2009). It refers to the degree to which an asset is important and in this case can be viewed from two different perspectives, namely physical or tangible assets (i.e. specific equipment and machinery) and intangible or human assets (such as human capital). In the context of auditing, physical asset refer to the audit software used in the enterprises while human asset refers to information and knowledge which may be acquired from the market (Everaert *et. al*, 2010). However, a data analysis with Channels Television, Ogunsanwo (2020), opine that majority (more than 50 percent) of micro-enterprises in Nigeria are managed by people with first school leaving certificate only.

### **Environmental Uncertainty**

Another key components of transaction attributes is environmental uncertainty. Many researchers are unable to distinguish between behavioural uncertainty (i.e. difficulty in monitoring activities) and environmental uncertainty (such as variation in activity demand). While environmental uncertainty is focusing on the prior- period contractual cost, monitoring and enforcing costs (Vita, Tekaya & Wang, 2010). Environmental uncertainty comprises the cost involved in searching for information in the market and signifies an invaluable part of general transaction cost since it is impracticable to obtain needed information on all prices and products at any appropriate time (Thronin, Hoffman & Ford, 2009).

### **Cost of Auditing**

Another key factor associated with the TCE theory is frequency (Greenberg, Greenberg & Antonucci, 2008). The main driver of an organization decision to use markets (buy) versus hierarchies (make) is the transaction cost. Therefore, decisions on whether to rely on internal staff (employee) in carrying-out internal audit service or contract a service provider, outside the establishment is a function of cost. Williamson (1985) argued that transaction frequency is directly associated with the cost of transaction (i.e. more transactions implies higher cost). Frequency of internal audit function is realized in two ways (Everaert, Sarems & Rammel, 2006). Firstly, the periodicity of the internal audit activities is recognised as the frequency. Specifically, each of the internal audit tasks may be performed daily, weekly, monthly, queerly or annually. Secondly, frequency is also realized from the perspective of the size of the activity (Everaert, *et. al*, 2006). For instance, an establishment that performs processing of 100 invoices on weekly basis has a lower frequency of invoice entry than a firm that conducts processing of 1,000 invoices every week. The former organization will more likely to outsource their accounting and internal audit function to a professional accountant than the latter (Everaert, *et. al*. 2010).

### **Determinants of IAF Outsourcing**

Research studies that examined the major determinants of internal audit outsourcing are quite substantial but with contradictory positions. Some of these studies identify auditors independence, cost savings, professional or technical competence, firm and industry size, company policy, assets specificity, environmental uncertainty, frequency of audit, audit quality, perceived benefits, awareness, behavioural uncertainty and expertise knowledge (e.g. Inu & Abianga, 2015; Okpara, Ezirim & Mohammed, 2017; Barac & Motubatse, 2010; Tahajuddin & Kertali, 2018; Carey, Subramaniam & Ching, 2006, Jie, Nam, Mei, Khoon & Sheemon, 2013; Sharma & Subramaniam,

2005; Seetharaman, Moorthy & Saravanan, 2008, Amarajeewa, Dedunu & Bandara, 2017; Suleiman & Dandago, 2014, Sulanjaku & Todri, 2015; Lowe, Geiger & Pany, 1999; Plant, 2014; Papageorgiou, Padia & Yassen, 2013; Mubako, 2018; Tazilaha, Majid & Suffarn, 2019; Tto, Bun & Tran 2017, Isokssan & Lantz, 2015 and Scarlata, Garven, Vagner & Bahmanziari, 2019. Using Nigerian experience, Inu and Abianga (2015) examines the impact of internal audit outsourcing on auditor's independence. The study discovered that the perception of auditor's independence vary according to the nature of work undertaken. The perception of auditor's independence is high when the auditor that performs the external audit is different from those performing the IAF or a separate department within the same audit firm perform the IAF. Okpara, Ezirim and Mohammed (2017) evaluates the managerial factors influencing internal audit outsourcing decision among small and medium sized enterprises in Nigeria. The study discovered that significant relationship exist between professional competence, perceived cost savings and internal audit outsourcing. However no significant relationship exist between IAO and risk management consideration. In another study by Okpara *et.al* (2017), firm size and industry type significantly influences IAO decisions among MSMEs in Nigeria. Barac and Motubatse (2010) investigate the internal audit outsourcing practices in South Africa. The outcome of the study opine that company policies, lack of appropriate technical skills, perceived objectivity of the auditors, together with the cost implications are the major reasons why South African establishments outsourced the internal audit function. In examining the internal audit outsourcing among 304 publicly listed companies in Australia, Carey, Subraivaniam and Ching (2006) concluded that technical competence of the external service provider and the perceived cost savings are major factors influencing IAO in Australia. Jie, Nam, Mei, Khoon & Sheerman (2013) inspect the various determinants of IAO among SMEs in Malaysia. The conclusion of the study indicated that cost of the audit, environmental uncertainty, frequency of the audit assignment and asset specificity are major factors influencing IAO among Malaysian SMEs. The same position was established previously in Australia, when (Sherma & Subrananiam, 2005) investigated the outsourcing of internal audit services among the Australian firms. Findings of the investigation reveal that asset specificity firm size, perceived environmental uncertainty together with cost pressure are significant variables influencing IAO.

However, Seetharaman, Moorthy and Saravanan (2008) studied the association between the independence of auditors and outsourcing of internal audit. Using case study approach, the outcome of the research opined that having internal audit activities performed by the company's external auditor does not by itself appear to negatively affect financial statement users perception of auditor independence and other related decisions. Based on the Sri-Lankan experience, Amarajeewa, Dedunu and Bandara (2017) interrogated the major determinant affecting an outsourcing of IAF. The study obtained relevant data from management and operational level employee of finance companies which currently outsource their internal audit functions in Kandy urban area. Though correlation and multiple regression analysis, findings of the study posit that IAO as significantly influenced by internal audit quality, cost of the audit and the expertise knowledge of the auditor. Conversely, management support and the independency of the IAF are not affected by IAO. Using Nigerian deposit money bank as a premise, Suleiman and Dandago (2014) examines the extent of internal audit functions outsourcing among banks. Data were obtained from head of operations, branch managers, internal auditors and area managers of all the 22 DMBs in Nigeria as at July, 2013. The result of the study indicates that (i) establishing

accounting systems, (ii) evaluations of the system, (iii) verification of assets, (iv) recruitment of staff and other human resource management activities, (v) ensuring security of documents, and (vi) security of IT database are functions heavily outsourced by deposit banks in Nigeria. Sulanjaku and Todri (2015) inspect the perspectives of outsourcing of internal audit functions in Albania. Based on analytical review procedure, the study observed, that cost reduction are the major reason why Albanian businesses outsourced the internal control functions. The study by Lowe, Geiger and Pany (1999) examined the relationship between internal audit outsourcing and perceived external auditors independence. They discovered that auditor performance of management functions had a significant negative impact on user's perceptions of auditors' independence and financial statement reliability. However, separation of audit firm performing the outsourced internal audit from those that perform financial statement audit had a significant positive impact on financial statement users perception of auditors independence. Also using the South-African experience, Plant (2014) investigate the various internal audit outsourcing practices within the public sector of the economy. Relevant data were obtained from 32 Chief audit executives, 30 of the chairperson of the audit committee and 31 accounting officers from the 40 national departments. Inferential analysis of the data reveals that the respondents preferred in house IAFs to outsourced IAFs because of the perceived commitment to governance by in-house auditors. However, due to lack of technical expertise and shortage of competent internal auditors. IAFs are often outsourced to external audit service providers. Papageorgiou, Padia and Yassen (2013) evaluate the impact of decisions to outsource, the IAF in South Africa. The study adopted purposive sampling technique to obtain data from 80 South African organizations in both the private and the public sector of the economy. Relying on inferential statistics to analyse the data, the outcome shows no significant differences were observed between the private and public sectors with regards to the interactions with the external auditors and threats to independence. Major difference reveals that private companies prefers "Big4" accounting firm more often than the public sector. Through literature synthesis and future direction, Mubako (2018) explore a review of academic and professional literature associated with internal audit outsourcing from 1980 to 2018. The study discovered that as a result of the perceived cost, benefit and improved access to specialized internal auditing services, outsourcing decisions are widespread. However, there are mixed findings on the impact of outsourcing on quality, independence, availability of resources and cost. From the viewpoint of Malaysia, Tazilaha, Majid and Suffari (2019) examines the various factors influencing the decisions to outsource the internal audit function among the SMEs. They discovered that awareness of the internal audit function, perceived benefits associated with internal audit function and the perceived financial cost are the major determination of IAO among SMEs in Malaysia. In a related discourse, Tto, Bui and Tran (2017) interrogated the different factors influencing the decisions to outsource accounting functions in Vietnam. The outcome of the study shows that specificity of accounting significantly and positively influences accounting outsourcing. However, environmental uncertainty, frequency of accounting transactions and trust in service providers were not significant in influencing accounting outsourcing. Utilizing Common Body of Knowledge (CBOK) survey results data from the Institute of Internal Auditors Research Foundation (IIARF), Scarlata, Garven, Vaguer and Bahmanziari (2019) examine the extent of internal audit outsourcing among small organizations in Anglo-Culture countries (US, Canada, New Zealand, Australia, South Africa, the U.K., and Ireland). Descriptive analysis of the data found that significant association exist between organization financial health and IAO in small organization. Isaksson and Lantz (2015) investigated the association among outsourcing strategies

and their impact on financial performance of small manufacturing firms in Sweden. Data were obtained from 400 small firms with employees less than 50. The result of the multiple regression established no relationship between outsourcing strategies and financial performance.

### **Justification for the Study**

Generally, previous literatures provides mixed findings with regards to the decisions to outsource the internal audit function of an establishment to an outside service provider. Mubako (2018) opine that there are mixed outcome on the impact of internal audit outsourcing (IAO) in relation to quality, cost, independence and availability of resources. Scholars argued that major determinants of IAO includes: firm size, industry size, cost savings, professional competence but excludes risk management consideration (Okpara, Ezirim & Mohammed, 2017); company policies, perceived objectivity and appropriate skills (Barac & Motubatse) technical competence and perceived cost savings (Carey, Subramanian & Ching, 2006); asset specificity, environmental uncertainty, frequency, cost pressure and firm size (Tto, Bui & Tran, 2017; Jie *et al*,2013; Sharma & Subramanian, 2005); auditors independence (Seetharaman *et al*,2008; Lowe, *et al*,1999); internal audit quality, expertise knowledge, higher quality service and lower administrative cost (Amarajeewa, *et al*,2017; Sulanjaku & Todri, 2015); awareness, perceived benefit and perceived cost (Tazilaha, *et al*, 2019); financial performance (Isaksson & Lantz, 2015); and also audit committee involvement together with organizational financial health (Scarlata, *et al*,2019). This study therefore hope to expand the frontier of knowledge by adopting quantitative measures in investigating major determinants of IAO among micro, small and medium sized enterprises (MSMEs) in Nigeria

### **METHODOLOGY**

The study adopted survey research design. Survey method was used to collect primary data from the respondents. Several researchers supported this approach based on argument that people's intention is better measured via survey study and that causal or predictive relationships are better tested with survey (Bryman & Bell, 2001; (Ogunbameru & Ogunbameru, 2010; Sanders, Lewis & Thormhill., 2009).The study focused on Micro, Small and Medium Sized Enterprises (MSMEs) registered with SMEDAN in Lagos State. A sample size of 170) respondents were purposively selected based on the willingness to complete the data. The study used quantitative approach by measuring respondents' view on a graduated scale for statistical analysis in order to have a reasonable accurate measurement of the constructs rather than using observation. An adapted structured questionnaire was applied to collect the relevant data for this study. The questionnaire was sectionalized to reflect demographic information, independent and dependent variables. Responses were rated using the five-point Likert scale. Internal consistency measured using Cronbach alpha reliability test, with the aid of SPSS version 24. Given the result, it is concluded that the instrument is reliable and capable of producing consistent results. The data collected from the 145 copies thoroughly filled and returned, giving a response rate of about 85% were analyzed using descriptive and inferential statistics and consequently draw conclusions.



## RESULTS AND DISCUSSION OF FINDINGS

Table 4.1: Distribution of Firms on the Factors Influencing the Outsourcing of Internal Audit Function

Factors	SD	D	N	A	SA	X	SD
Asset Specificity			--				
There is an insufficient in-house technological know-how	23(15.9%)	35(24.1%)	38(26.2%)	38(26.2%)	11(7.6%)	2.84	1.19
Employment contract with internal auditor includes performance incentives designed for retention purposes (e.g. promotion opportunities)	13(9.0%)	27(18.6%)	43(29.7%)	52(35.9%)	10(6.8%)	3.12	1.07
Training in asset specificity skills for internal auditor represents a significant investment	7(4.8%)	30(20.7%)	30(20.7%)	59(40.7%)	19(13.1%)	3.35	1.09
It would be hard for an industry experienced and suitably qualified auditor to work in internal audit function without additional asset specificity training	12(8.3%)	49(33.8%)	22(15.2%)	45(31.0%)	16(11.7%)	3.03	1.20
Working in internal audit department acquires specialized knowledge, skills and abilities that could not be transferable to another company (i.e. asset specific skills)	20(13.8%)	48(33.1%)	24(16.6%)	35(24.1%)	18(12.4%)	2.87	1.26
Environmental Uncertainty							
Vendor has precisely written rules and procedures for the performance of outsourced internal audit	7(4.8%)	9(6.2%)	38(26.2%)	82(56.6%)	9(6.2%)	3.53	0.89
Standard of performance (in terms of quantity, quality and timeliness of output) for the outsourced internal audit is clearly specified in the contract	3(2.1%)	9(6.2%)	24(16.6%)	83(57.1%)	26(18.0%)	3.80	0.86
Vendor uses standardized operating procedures	7(4.8%)	13(9.0%)	26(17.9%)	75(51.7%)	24(16.6%)	3.64	1.01

The analysis in Table 4.1 showed the factors that influence the outsourcing of internal audit function by MSMEs to include assets specificity, environmental uncertainty, and cost of auditing. According to the analysis under assets specificity, majority (40%) of the MSMEs with a mean value of 2.84 disagreed that there is insufficient in-house technological know-how; about 42% of the MSMEs with a moderate mean value of 3.12 agreed that employment contract with internal auditor includes performance incentives designed for retention purposes (e.g. promotion opportunities); about 53% of the MSMEs with a moderate mean value of 3.35 agreed that the training in asset specificity and skills for internal auditor represents a significant investment; about 42% of the firms with a moderate mean value of 3.03 agreed that it would be hard for an industry

experienced and suitably qualified outsider to work in internal audit function without additional asset specificity training; and 48.5% of the firms with a low mean value of 2.87 disagreed that staff

to execute the outsourced internal audit							
Dealing with the vendor implied changes for the overall functioning of your firm e.g. in terms of adaptation of internal processes	8(5.5%)	42(29.0%)	38(26.2%)	43(29.7%)	14(9.7%)	3.06	1.08
Dealing with the vendors implied changes for the employees of your firm e.g. in terms of required skills and training needed	11(7.6%)	28(19.3%)	25(17.2%)	68(46.9%)	13(9.0%)	3.28	1.10
Cost of Auditing							
The continuing costs of the arrangement are appropriately accounted for in arriving at the initial decision to outsource	4(2.8%)	16(11.0%)	45(31.0%)	66(45.5%)	14(9.7%)	3.43	0.88
Cost of outsourcing will be lower than the cost of using permanent full-time employees to maintain internal auditing	20(13.8%)	30(20.7%)	20(13.8%)	51(35.2%)	24(16.5%)	3.17	1.31
The outsourcing agreement truly capture*	12(8.1%)	11(2.1%)	10(7.0%)	60(41.4%)	16(11.0%)	1.20	1.14
Reduction of the cost of acquiring relevant resources to carry out the business process	9(6.2%)	29(20.0%)	34(23.4%)	60(41.4%)	13(9.0%)	3.24	1.06
Cost of financial statement audit can be reduced if the serviced are provided by third	25(17.2%)	45(31.0%)	21(14.5%)	42(29.0%)	12(8.3%)	2.77	1.24

working in internal audit department do not acquire specialized knowledge, skills and abilities that would not be transferable to another company (i.e. asset specific skills). Thus, asset specificity positively and moderately influences outsourcing of internal audit function by MSMEs. The analysis further revealed under environmental uncertainty that majority (62%) of the MSMEs with a slightly high mean value of 3.53 agreed that the vendor has precisely written rules and procedures for the performance of outsourced internal audit; above 85% of the MSMEs with a high mean value of 3.80 agreed that the standard of performance (in terms of quantity, quality and timeliness of output) for the outsourced internal audit is clearly specified in the contract; 67% of the firms with a high mean value of 3.64 affirmed that the vendor uses standardized operating procedure to execute the outsourced internal audit; 39.4% of the MSMEs with a moderate mean value of 3.06 agreed that dealing with the vendor implied changes for the overall functioning of their firms, in terms of adaptation of internal processes; and about 55% of the MSMEs with a moderate mean value of 3.28 agreed that dealing with the vendors implied changes for the employees of their firms, in terms of required skills and training needed. Therefore, environmental uncertainty positively and highly influences outsourcing of internal audit function by MSMEs.

Concerning cost of auditing, about 54% of the MSMEs with a moderate mean value of 3.43 agreed that the continuing costs of the arrangement are appropriately accounted for in arriving at the initial decision to outsource; 51% of the firms with a moderate mean value of 3.17 agreed that cost of outsourcing will be lower than the cost of using permanent full-time employees to maintain internal auditing; about 49% of the MSMEs with a moderate mean value of 3.20 agreed that the outsourcing agreement truly captures all costs; about 50% of the MSMEs a moderate mean value

of 3.24 agreed that reduction of the cost of acquiring relevant resources to carry out the business process influence outsourcing of internal audit function. However, 37% of the MSMEs with a low mean value of 2.77 agreed that cost of financial statement audit can be reduced if the serviced are provided by third parties. Therefore, cost of auditing positively and moderately influences outsourcing of internal audit function by MSMEs. This result is in line with prior research (Everaet et al., 2010; Spekle et al., 2007; Wildener and Selto 1999). Which found that asset specificity was the most important determinant of transaction cost and a significant driver for the outsourcing of internal audit. ~ This finding is also consistent with presiding studies of other service functions (i.e Information Technology) where asset specificity was involved as a critical driver in outsourcing decision (Nelson et al., 1996; Poppo & Zenger, 1998; Aubert et al, 2004; Barthelemy & Geyer, 2005; Alvarez-Suescun, 2010).

Contrary to TCE model, environmental uncertainty was not associated with internal audit function outsourcing. In fact, the evidence on the impact of environmental uncertainty seems to contradict the insights of Transaction Cost Economic theory. This result is similar to pervious research (Widener & Selto 1999; Everaet *et al*, 2010) which found that environmental uncertainty was not associated with outsourcing of audit and accounting activities. This finding contradict a few studies (Wang 2002; Lamminmaki 2007; Dibbern & Heimzl 2006, 2009) which found a negative relationship between environmental uncertainty and outsourcing of service functions (e.g. Information System, Food and Beverage, General maintenance). However, those result may not be appropriate for internal audit function outsourcing because if the audit practices are not too specific to the MSMEs, such functions might be provided by the professional accountant or auditor.

## CONCLUSION AND RECOMMENDATIONS

The study showed that outsourcing of internal audit functions is a very important way of improving the operations and efficiency of MSMEs. Internal audit function is a value added and core function which can assist any firm towards taking decisions that will ensure objectives are achieved in terms of MSMEs' growth. Generally, results of the research showed that MSMEs in Lagos State outsourced internal audit functions to a large extent (between 70 to 80 percent), and the outsourcing of internal audit functions was mainly influenced by such factors as asset specificity, environmental uncertainty, and cost of auditing. Internal audit outsourcing promotes independence of audit in small and medium-scale companies. Based on the findings of the study, the owners-managers should ensure that the internal audit functions of their companies are outsourced to external auditors in order to achieve audit independence and high audit quality at a reduced cost of auditing. There should be written rules and procedures for the performance of outsourced internal audit. They should also ensure that timeliness of the audit reports are clearly specified in the contract. By identifying the broader range of services currently provided by professional accountants to MSMEs and the benefits attached to these services brings into focus the broader range of choices available to MSMEs owner- manager. The result of this research would support the development of market for some internal audit services since the study examine the MSMEs demand for outsourcing. This produces knowledge that will help MSME owner-manager in their sourcing (e.g. make or buy) decisions concerning the principal progresses of the MSMEs. It may be necessary to investigate further other factors that may also influence outsourcing of internal

audit function apart from those already identified in addition it will be interesting to know the impact of internal audit outsourcing on the performances of MSMEs in Lagos State.

## REFERENCE

- Abbot, L. J., Parkers, S. Peters, G. F & Raina D. V. (2007). Corporate governance, audit quality and the Sarbanes-Oxley Act: Evidence from Internal Audit Outsourcing *The Accounting Review* 82(4) 803-835
- Abdul-Halim, H. B. A. (2009). Outsourcing the HR functions: the role of strategies and HR performance. Unpublished PhD Thesis, Faculty of Business and Accountancy, University of Malaya, Kuala Lumpur.
- Adeniji, A. A (2019). *Auditing and Assurance Services*. (3<sup>rd</sup> Edition) Lagos: Value Analysis Publishers.
- Adeniji, A. A (2016). *Tax Audit and Investigation*. (1<sup>st</sup> Edition) Lagos: Value Analysis Publishers
- Adeniyi, S. I., & Mieseigha, E.G (2013). Audit tenure: An assessment of its effects on audit quality in Nigeria. *International Journal of Academic research in Accounting, Finance and Management Sciences*, 3(3) 275-283
- Ale-Ebrahim, N., Ahmed, S., & Taha, Z (2010). Critical factors for new product developments in SMEs virtual team. *African Journal of Business Management*, 4(11), 2247-2257.
- Al-Chahadah, A., Soda, M.Z & Al-Omari, R. (2018). The impact of the internal audit on the quality of accounting information. *International Journal of Economics and finance* 10(9), 157-167
- Al-Shail, A. M & Turki, T. A. (2017). A theoretical discussion of internal audit effectiveness in Kuwait Industrial SMEs. *International Journal of Academic Research in Accounting, Finance and Management Sciences*, 7(1) 107-116
- Altwayry, A. (2017). Internal audit quality evaluation and reliance decision external auditor perception. *International Journals of Economics & Management Science* 6(5), 1-13
- Amarajeew, H.G., Dedunu, H. H & Bandara, A. A. (2017). The determinants affecting an outsourcing of internal audit function. Finance companies special reference to Kandy Urban Area. *IOSR Journal of Business and management (IOSR-JMB)* 19 (5), 125- 131
- Barac, K& Motulbatse, K. N (2010). Internal audit outsourcing practices in South Africa. *African Journal of Business Management*, 3 (13), 968-979
- Baezam, O.A. (2018). Factors influencing the effectiveness of internal audit on organizational performances. *International Journal of Advance Engineering, Management and Science (IJAEMS)*, 4(4), 219-226
- Dibbern, J., & A. Heinzl, (2009) Selective outsourcing of information systems in small and mediumsized enterprises. In R. Hirschheim, A.Heinzl, & J. Dibbern (Eds.), *Information systems outsourcing. Enduring themes, new perspectives and global challenges* 57- 82. Berlin: Springer.
- Dionco - Adetayo E. (2011). *Guide to Business Research and Thesis Writing*. Ibadan: Ramed Publications Limited.
- Elmuti, D. (2003). The perceived impact of outsourcing on organizational performance. *Mid-American Journal of Business*, 18, 33-41.
- Espino-Rodríguez, T. F., & Padron-Robaina, V (2004). Outsourcing and its impact on operational objectives and performance: a study of hotels in the Canary Islands *Hospitality Management*, 23(287-306).
- Espino-Rodríguez, T. F., & Padron-Robaina, V. (2005). A resource-based view of outsourcing

- and its implications for organizational performance in the hotel sector. *Tourism Management*, 26, 707-721.
- Espino-Rodriguez, T. F., & Padron-Robaina V. (2006). A review of outsourcing from the resource-based view of the firm. *International Journal of Management Reviews*, 8(1), 49-70.
- Feyitimi, O., Nasieku, T & Muturi, W. (2016). Relationship between outsourcing accounting tasks and financial performance of small and medium enterprises in Nigeria. Strategic relatedness factors using the partial least square approach. *European Journal of Business Economics and Accounting*, 4(2)51-66
- Geda, T. (2018). The role of internal audit practice to promote good governance in public institution of Ethiopia: The case of Jimina Zone. *Global Journal of management and Business Research* 18 (2), 40-56
- Geiger, M.A., Lowe, D. J & Kurt, J. P. (2002). Appearance are important: Outsourced internal audit services and the perception of audit independence. *The CPA Journal*, 72 (4) 462-479
- Grabimann, E & Hofer, D. (2014). Impact factors on the development of internal auditing in the 21<sup>st</sup> century. *ACRN Journal of Finance and Risk Perspectives* 3(3)67-80
- Hamzah, N., Aman, A R., Maelah, Auzair, S. M, & Amiruddin, R (2010). Outsourcing decision processes: A case study of a Malaysian firm. *African Journal of Business Management*, 4(15), 3307-3314.
- Jonathan, G. E. (2014). Small, Medium Enterprises as catalyst for industry. *8<sup>th</sup> Annual Micro, Small and Medium Enterprises (MSMEs) Conference*
- Inua, O.I & Abianga, E. U (2015). The effect of the internal audit outsourcing on auditors independence: The Nigerian experience *Research, Journal of Finance and Accounting* 6(10), 36-44
- Iqbal, Z. & Dad, A.M. (2013). Outsourcing: A review of trends, winners & losers and future directions. *International Journal of Business and Social Science*, 4(8)91-107
- Isaksson, A & Lantz, B. (2015). Outsourcing strategies and their impact on financial performance in small manufacturing firms in Sweden. *International Journal of Business and Finance Research*, 9(4) 11-20
- Kontogergis, G (2018). The role of internal audit function on corporate governance and management. *International Journal of Accounting and Financial Reporting*, 8(4) 100-114
- Lamminmaki, D. (2007). Outsourcing in Australian Hotels: A Transaction Cost Economics perspective. *Journal of Hospitality & Tourism Research* 31, 73-110.
- Mahdavi, S. M. S., Ayedh, A. M. A & Khairi, K. F. (2018). Effectiveness of internal audit *International Journal of science and Research (IJSR)* 7 (1) 1797-1803
- McIvor, R. (2000). A practical framework for understanding the outsourcing process. *Supply Chain Management: An International Journal*, 5 (1), 22-36
- McIvor, R. (2009). How the transaction cost and resource-based theories of the firm inform outsourcing evaluation. *Journal of Operations Management*, 27, 45-63.
- Mubako, G. (2018). Internal audit outsourcing: A literature synthesis and future directions. *Australian Accounting Review* 00(00) 1-14
- Ndukwe, O. D. (2016). Perspectives on the internal audit function. *Igbinedion University Journal of Accounting* 1(1)76-86
- Nurdion, P. B & Gamayuni, R. R. (2018). The effect of internal auditor competency on internal audit quality and its implication on the accountability of local government *European research studies Journal* 21(4)426-434

- Obert, S & Munyunguma, I. M (2014). Internal audit perception and their impact on performance of the internal audit function. *IOSR of Business and management (IOSR-JBM)* 16(5) 81-85
- Okodo, B. A., Aliu, M. M., & Yahaya, A. O. (2019). Assessing the reliability of the internal audit functions: The issues *Journal of contemporary Research in Business Economics and Finance* 1(1) 46-55
- Okpara, E., Ezirim, C. B & Mohammed, U. (2017). Managerial factors influencing internal audit outsourcing decisions of small and medium size enterprises in Nigeria. *International Journal of Business, Accounting and Finance* 11 (2) 1-24
- Okpara, E., Ezirim, C. B & Mohammed, U. (2017). Firm size, industry type and internal audit outsourcing in Nigeria: Evidence from SMEs. *International Journal of Business, Accounting and Finance* 11(1) 13-34
- Omolaye, K. E & Jacob, R. B. (2017). The role of internal auditing in enhancing good corporate governance practice in an organization. *International Journal of Accounting Research* 6(1) 1-08
- Papingeorgious, E., Padia, N & Yaseen, Y. (2013). Impact of decisions to outsource the internal audit function in South Africa *Journal of Economics and Financial Sciences JEF* 6 (3) 593-610
- Plant, K. (2014). Internal audit outsourcing practices in the South African public sector. *Africa Journal of public Affairs* 7 (3) 73-87
- Pinto, J., Pereira, A. C., Imoniana, T. O & Petin, S. (2014). Role of internal audit in managerial practice in organization. *African Journal of Business management* 8 (2) 68-79
- Regoliosi, C, & Martino, C. (2019). A study of the interactions between internal audit functions and external auditors in Italy *Corporate ownership & control* 16 (2) 38- 48
- Rajee, F. S & Akinlabi, B. H. (2013). Outsourcing services as a strategic tool for organizational performance: An exploratory study of Nigeria food, Beverages and Tobacco industry. *Journal of management policies and practice* 1(1) 01-20
- Scarlata, A. N., Garven, S., Vegner, B., & Bahmanziari, T. (2019). Internal audit outsourcing in small organizations: An exploratory studies *Journal of small business strategy*. 29(2) 44-57
- Seetharaman, A., Moorthy, M. K., & Suravann, A. S. (2008). Outsourcing of internal audit and independence of auditors. *Corporate, Board, role duties & composition* 4 (2) 40-49
- Selim, G. & Yiannakas, A. (2000). Outsourcing the internal audit function: A survey of the UK public and private sectors. *International journal of auditing*. 1(4) 213-223
- Sulanjaku, M & Tatri, A. (2015). The extent of internal audit functions outsourcing of internal audit function in Albania. *Academic Journal of Interdisciplinary studies* 4 (3) 395-399
- Sharma, D. S & Subramaniam, N. (2005). Outsourcing of internal audit services in Australian firms: *Some preliminary evidence* 1(1) 33-52
- Tahajuddin, S & Kertali, M. (2018). The effect of internal audit characteristics on the effectiveness of internal auditors. *European journal of Accounting, auditing and financial research* 6(7) 54-69
- Tazilaha, M. A., Majid, M & Suffari, N. F. (2019). Effect of outsourcing internal audit functions among small & medium enterprises. *International journal of business and technology management* 1(1) 28-34

- Thiouin, M. F., Hoffman, J. J, & Ford, E. W. (2009). IT outsourcing and firm-level performance: A transaction cost perspective. *Information & Management*, 46, 463-469.
- Tto, L., Bui, T. N & Tran, M. D. (2017). Factors influencing the intention of accounting outsourcing: The case of Vietnam. *Research journal of Economics* 1 (2) 1-7
- Vita, G. D., Tekaya, A & Wang, C. L. (2010). Asset specificity's impact on outsourcing relationship performance: A disaggregated analysis by buyer-supplier asset specificity dimensions. *Journal of Business Research*, 63 657-666.
- Williamson, O. E. (1991). Comparative economic organization: The analysis of discrete structural alternatives. *Administrative Science Quarterly*, 36(2), 269-296.
- Zhang, J., & Gao, S. (2012). How do SMEs build internal audit capabilities? A grounded theory approach. *World Review of Business Research* 2(1), 98 - 108.
- Zohari, T, (2008). Iranian government globalization policy impacts on SMEs and the corresponding effect on Iranian-Swedish trade.