

Evaluating The Factor Of Cost And Benefit Of Internal Audit

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Abstract

The financial and operational cost and benefits of internal auditing plays very vital role in the organizations. The main aim of this study is determine the importance and impact of both internal audit and internal audit outsourcing with in organizations. A 15 items perception of a financial and operational cost and benefit of internal audit usage survey was conduct to one organization of Oil and Gas Development Company Limited. The finding of the study shows that three variables were significant in the selection of internal audit but the two variables shows the negative results which indicate outsourcing is cheaper than in sourcing. A very common conclusion is that the internal facilities is more costly another choice to be used in outsourcing so that internal provider is less efficient than external providers as they developed the technological efficiencies, a study of this type would explain the factors dependable for the significance of in sourcing compare to outsourcing and to compare the cost and benefit of internal audit.

Key Words: Cost, Benefit, Internal Audit, OGDCL, Pakistan

1. Introduction

This research is being made on internal auditing in order to improve and make more worth able accountability, ethical and professional practices as well as effective risk management, improved quality of output and helping and guiding in decision making and monitoring the performance. Internal auditing is not just to tackle the financial matters only but it also helps in analyzing cost and benefits, utilizing resources and its implementation and effectiveness of the management

According to Institute of Internal Auditors New York:” *Internal audit is an independent, appraisal activity within an organization for the review of accounting, finance and other operations on the basis of service to the organization. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls.*” Internal auditing helps and organization accomplish its objective by bringing systematic, disciplined approach to evaluate and improve the effectiveness risk management, control and governance processes.

In past twenty years huge number of changes taken place and changed the faces of internal audit operating and managing activities. Other factors like environmental awareness and information technology explosions make huge impact on development of internal audit last but not least legislation play vital role in auditing. Legislation has played vital role in these changes

vital role in these changes, these changes makes stakeholders expect more from public treasure and significance perception of auditing. Internal auditors with in organizations get direct impact of these changes and influence of internal audit methodology and approaches. Internal audit as a function within organization increased more in profile then yester years. Pressure increased on public sector organizations because of restricted funding ensuring good value for money with in local government. External auditor has been taken credit for making accountability more ensured , in current years reports related to corporate governance highlighted the role and importance of internal auditor at forefront .Reports helps in identify the relevance of having secured control structure this is the best complimented by the presence of an internal audit body.

OGDCL came in to being in 1952 Pakistan Petroleum Limited (PPL) and Pakistan Oil Fields Limited (POL) carried out explores activities in the country. Giant gas field discovered at Sui in Baluchistan by PPL in 1952,the discovery was huge success in the country there was keen interest emerge for exploration ,Foreign companies shows interest in discovery made contracts and agreements with the government of Pakistan.

In 1950’s, foreign companies conduct geological and geo-physical surveys and 47 exploiters well drilled out. Small gas fields surfaces due to well exploiters drilling. Discoveries and exploration activities carried great interest and enthusiasm in mid 1950’s but in spite of that in late 50’s activities declined, there were no more interest shown for further exploration private and government companies were interested in making money earn more and more. In today’s time new discoveries are carried out by different private companies.

Many organizations familiar with internal audit view its value too narrowly. An astute use of in-house or outsourced

internal audit is to maximize its importance and its role in organization's internal audit plays its role as bottom-line defender. Internal audit identify cost containment opportunities and enforce current and emerging cost-containment policies and procedures organizations. Internal audit plays its tradition role as an independent reviewer of the organization's policies, procedures and internal controls. But there is so much more this function could and must help the organization thrive in today's environment. Auditing results can help in suggestions for strengthening and improving the current policies

That's not to say that an internal audit aimed at cost containment but it strictly focused on accounting issues and examining how money is handled throughout and organization. To the contrary, an internal audit also analyze systems and procedures to determine whether value is being achieved for the money spent and whether an organization's resources are being used most efficiently. For example, an internal

Audit can evaluate the supply chain for cost effective management by ensuring that preferred vendors only are being used. Furthermore, internal audit's review can determine whether contracts are ripe for renegotiations or can identify improvement in the RFP"(request for proposal) process so an organization receives the most competitive vendor bids .Internal auditing can assess actual spending versus standard supply lists and order quantities to identify bottom line sapping deviations from organization's economic ideal. In today's tough economic times, organizations are quick to get back to those core values that made them successful in the past. They tighten their belts and scrutinize every activity. But as the economy improves and companies flourish. Internal audits can provide critical ongoing monitoring to help ensure those hard-won cost benefits which do not disappear in brighter times. There are pros and cons of outsourcing internal audit in an organization. Most of the companies are not willing to prefer outsourcing of internal audit because it impact directly to the external auditors and impair the quality of the firms internal control structure. Such concerns were echoed by the recently enacted according to" *Sarbanes-Oxley Act, which proscribes outsourcing of any internal audit functions to the external auditor*". According to" *in USA, Canada and Australia outsourcing is very common practice approved by the research*". Traditionally on core areas of outsourcing is management of HR, legal taxation is more widely spread in the internal audit and increase in internal is a very wider. In 1990 it is becoming more popular, according to" *Corbett (1998in USA they buy services as in the house and 85%can do this*". Giving authentic the decision of outsourcing will motivate the accounting professionalize to improve the quality of the product which is the evidence of the transactional approach. The research problem of this study is to find out the factors dependable for significance of in sourcing compared to out sourcing. Research set two aims to in order to know the research problem: To explain the factors dependable for significance of in sourcing compared to out sourcing, to compare cost and benefit of internal audit.

2. Auditing Structure

2.1 cost savings

To develop and effective and affectionate internal audit in which a business is expanding in width and scope is very difficult. (Widener and Selto, 1999; Johnson, 2003).the again the definition of internal audit revised by the Institute of Internal Auditors (IIA) in 1999 insurances of internal audit have the vision to its tradition by adding the two words management of risk and governance in this way the scope of internal audit is. The selection of qualified staff, recruiting and finding of staff is now more difficult as well as expensive too (Martin and Lavine, 2000).

In terms of the activities of internal audit the external will give more benefit as they merged the work of their sub ordinate through the time development and saving the technique of cost in performing the activities of internal audit just because they are aware of the economies of scale. As we know that the external provider is a form of auditing, activities of core business, in developing the basic technological efficiencies so there should be greater investment. A very unique view about the outsourcing is that it is very low another choice of internal facilities. It is argued that internal provider is less effective than the external provider know the economies of scale and would much aware of the development of technologies efficiency (Lowe *et al.*, 1999).as external providers know the economies of scale it lower the price and result is in that the external provider will give high competence rates than in internal providers. The findings of research through the areas of technology of information (Loh and Venkataraman, 1992; Wholey *et al.*, 2001) management of HR (Lever, 1997) and function of in house(Maltz, 1994)confirms that the high price of resources of internal is the main factor to select the outsource.

2.2. Firm Size

In an organization the size usually determine the frequency any extent of its activities. The suggestion of the transaction cost concludes that the transaction cost only approaches when the company is very large. The social relationship between the clients and the service providers which is focused on the theories of power of political and

alternative and trust in the basic factor between the clients and the provider of service.

As institute of internal auditors (IIA, 2001) defines that it is the not a dependable, activity of insurance that improves and add the operations in an organization. It brings about the changed in

Discipline, control and to be systematic in an organization to achieve it's objectives and it also shows the improvement in risk management, process of governance and control. The companies which are smaller in size have less opportunity to fund the resources and fund due to the lack of economies of scale. The indirectly cousin conclude by Anderson *et al.* (1993) for the scale of economies who suggest that maximum cost of monitoring the activities within organization either it is external or internal decreases with the firm size. So the smaller companies have more opportunity to indulge in the internal auditing at more level of scale of economies which is provided by the external providers. When the smaller companies cam operating the outsourcing so that it set up at high internal department and avail the benefit from the external providers to gain the access to the methodology of internal audit of that time. Although the big companies also avail the benefit from the external providers because big companies have a greater chance to gain from the economies of from in internal facility and the external providers profit in this way in declined due to the firm size increases.

2.3 Corporate Strategy

Another factor which affects the outsourcing decision is the corporate strategy that focused on core competences of the business. The period of the management that focused on core competences gained the high fame and importance during 1990's with the high management profile (see Prahalad and Hamel, 1990; Stalk *et al.*, 1992).in this way the non core activities is removed by the fully support of outsourcing and the development of the firm is around the precious and the activities that are producing the high revenues (see Kralovetz, 1996; Lever, 1997). Corbett (1998) to explain the definition of outsourcing the following quote.

Outsourcing is:

. . . Not a valuable thing but it is a relationship and basic competence of the organization and it is the objective outline.

In an organization it is at every section. And it is tool of management which is a basic tool and reshaped of business. What is new in an organization about the size, future and volume due to which the organization can be entered in long term services contracts for the activities which is performed traditionally.

For monitoring the structure of an organization and performance of internal audit function has provide the support mechanism rather it create a core competence that give a gained at competition (Shapoff, 1999). Rittenberg and Covaleski (2001) external provider have usually use this pin point to relate the internal activities to the insurance services. An extra conclusion is that the firm is emphasizes more to the external activities because it give more experienced to managed the outsourced risk so greater the number of activities of outsourcing the management becomes more confident in utilizing the external providers (Klass *et al.*, 2001).so it is concluded that nontraditional services of internal audit is higher than that of the activities with low out sourcing activity.

2.4 Internal Audit Function:

The trade way commission in 1987 plays a vital role in the control over the firm environment and the corporate strategy governance. The internal accounting controls have both internal auditing function and audited committee. The audit committees have the members that are linked with the management that significantly determines the non-dependence of audit committee and its objective which include the function of internal audit (Wallace and Kreutzfeldt 1991). Trade way commission describes the relation between the internal audit and audit committee Scarborough *et al.* (1998) find that audit committee is consist of alone directors which are likely to have:

- a) Have the urgent meeting with the chief auditors.
- b) Review and result of internal audit.

Rittenberg *et al.* (1999) find that the internal audit department is not kike to successfully to outsource were those who were prominently in the system of governance of the firms.

2.5 Management Support:

To be effective internal audit function there must be full support to the senior's members of an organization. Line management support in this way very complex. The employees of management are positive behavior toward the internal audit. So, in this way it strength its role. Internal audit has focus on the business activities and produce the result at a high risk of area, be relevant and the result should give due to the needs and expectation. Internal audit process should be review as monitoring not of the previous matter but able to access it against some target. The internal audit key point that it has an improvement in a continuous manner. It prefers the line and audit committee to

be work in a balanced condition and promoting the continuous improvement in an organization there should be aid and powerful sponsor of the internal audit.

2.6 Technical Competence:

Characteristics of technical competence include qualified skills and experienced of designing the system and management of risk. So, it is conclude that the firm such as public accounting have the courage to developed a comparative advantage over the internal providers because they have the experienced and the specialized people who are more educated(see Barr and Chang, 1993;Aldhizer and Cashell, 1996; Anderson, 1996; Kralovetz, 1996; Powell, 1997)so it is argued that the theory of competition resources advantages suggests that the firms which shows the competitive advantage has easy to copy which yield a good market place and there by dominant performance (Hunt, 1995).

An alternative suggestion which is collected in recent years has gained less importance is that the internal provider is more competent as compared to the external provider. Powell (1997) suggests that junior staff employment and public accounting firms might promise the quality of in house. Barr and Chang (1993)result is provider of external have also have a depth of clients knowledge as same as the internal auditors. It is viewed that internal auditors are more famous from the system of control in the and better ability to see the changes in the external provider business (Cardillo, 1994; IIA, 1994; Kravovetz, 1996). The area of business has believe on that outsource conclude that the information, tax activities has a courage to decide the outsource (Dunbar and Philips, 2001; Beaumont and Costa, 2002). Now the suggestion of external providers is that the technical competence to influence to outsource.

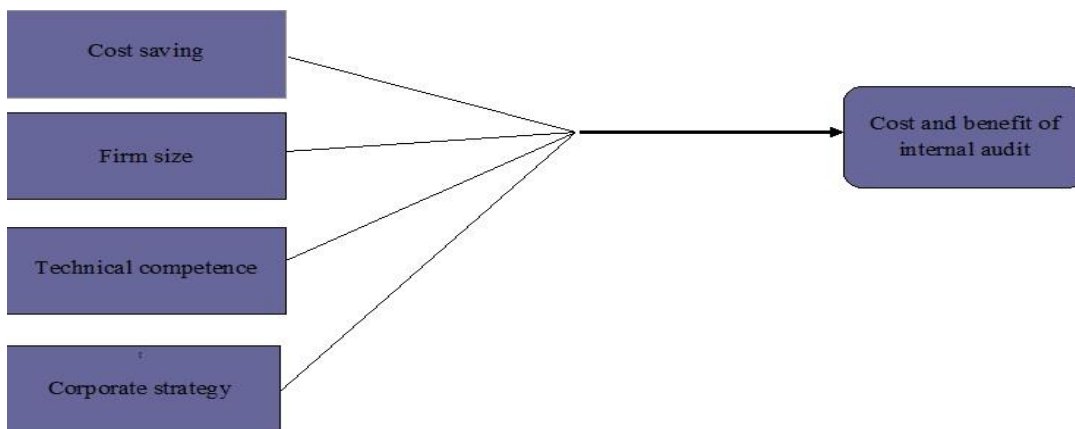


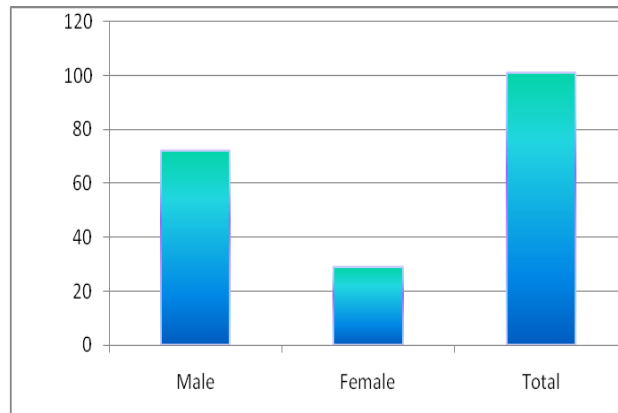
Figure 1. Theoretical Framework

3. Methodology

According to Klass (2001). This study is descriptive in nature, as several other studies conducted on the same theme in different countries. And this research replicates the same theme in Pakistani context. OGDCL target population consists of 10,635 employees working in different branches and head office. Sample size was 150, but only 101 complete questionnaires was received from the company OGDCL in order to know the factors of financial and operational cost and benefit of internal audit. The sampling technique was convenient due to OGDCL not provided the sampling frame work. The data was collected through a survey and questionnaire administered personally to the employees of OGDCL. The items are based on 5 points likert scale whereas 1) strongly agree, 2) agree, 3) no option, 4) disagree and 5) strongly disagree. And the secondary data was collected from more than twenty published research papers in reputed journals. Descriptive statistics, correlation and one sample T test applied in order to know the impact of selected variables to the cost and benefit of internal audit and statistical package for social sciences used for analysis the data.'

4. Data Analysis

4.1. Demographic Analysis



Gender (Figure. 2)

Gender (Table. 1)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	72	71.3	71.3	71.3
	Female	29	28.7	28.7	100.0
	Total	101	100.0	100.0	

Discussion:

The gender table & figure 1 of the respondent shows; 72 respondents is male which makes up 71.3% of the sample size and 29 respondents are female which makes up 28.7% of the sample size. This table shows a distinct ratio of male and female employee's response because of lesser ratio of female faculty in the organization.

Experienced: (Table 2)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1(1-5)	34	33.7	33.7	33.7
	2(6-10)	33	32.7	32.7	66.3
	3(Above-10)	34	33.7	33.7	100.0
	Total	101	100.0	100.0	

Discussion:

The above table shows that in category 1 the employees has the experienced from 1-5 years and it shows the 33.7%

of experienced in an organization. The category 2 shows that that the employees have the experienced of 6-10 years and it shows 32.2% of experienced in an organization. The category 3 shows the experienced of above 10 years and it is 34% in an organization.

4.2 Overall Descriptive Statistics

Mean & SD. (Table. 2)

Variables	N	Min.	Max.	Mean	Std. Deviation
Cost saving	101	1.0	3.3	1.696	.4740
Firm size	101	1.0	4.0	2.290	.7995
Technical competence	101	1.3	3.7	2.078	.5020
Corporate strategy	101	1.0	3.3	2.023	.4429
Cost & Benefit of Internal Audit	101	1.0	2.7	1.736	.3474

Discussion:

This descriptive analysis shows the analysis of 101 employee’s response for different variables. The score of the variable ranged from 1 to 5 which are based on the scale. The factors also ranked on the basis of the mean(1-lowest rank , 5-highest rank).Cost and saving has the mean score 1.696 from the employees it mean that the employees preference to cost and saving and ranked it to the 1st which mean the employees is strongly agree. Firm size the second variable shows the mean score 2.290 from the employees it mean that employees rarely agree on this and a lot the ranked 5th which mean the employees is agree on it. Technical competence the third variable has the mean score of 2.078 from the employees it mean that the employees agree on it and give the ranked 4th which means the employees is agree on it. Corporate strategy the fourth variable shows the mean of 2.023 and give the ranked of 3rd which means the employees is agree on it. Cost and benefit of internal audit shows the mean of 1.736 which mean the employees is strongly agree on it by giving the ranked position 2nd.in descriptive analysis all the variable shows positive results.

4.3 Correlation Analysis

Relationship of variables (Table. 3)

Variables	Cost Saving	Firm Size	Technical Competence	Corporate Strategy	Cost & Benefit of Internal Audit
Cost Saving	1	.643**	.430**	.497**	.790**
Firm Size	.643**	1	.553**	.460**	.731**
Technical Competence	.430**	.553**	1	.494**	.406*
Corporate strategy	.497**	.460**	.494**	1	.626**
Cost & Benefit of Internal Audit	.790**	.731**	.406*	.626**	1

* Correlation is significant at the 0.05 level (2-tailed).

Discussion:

The entire five variables are highly correlated in the selection of internal audit. Cost and saving, firm size, technical competence, corporate strategy and cost and benefit of internal audit are also contribute in the selecting the preferred sourcing. Now in this ways the correlation analysis is giving the positive results in obtaining the required result.

4.4. Inferential Analysis:

One-Sample Test. (Table 4b)

Variables	Test Value = 2					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Cost saving	-6.438	100	.000	-.3036	-.397	-.210
Firm size	3.651	100	.000	.2904	.133	.448
Technical competence	1.553	100	.124	.0776	-.022	.177
Corporate strategy	.524	100	.601	.0231	-.064	.111
Cost & Benefit of IA	-7.637	100	.000	-.2640	-.333	-.195

Discussion:

The above test is carried out through by T-test one sample variable analysis. The three variables are significant in the selection of internal audit but the two variables shows the negative results because the external providers will more benefit an organization as they know the economies of scale. A very common conclusion is that the internal facilities is more costly another choice to be used in outsourcing so that internal provider is less efficient than external providers as they developed the technological efficiencies. As we know the reasons of cost and saving shows the negative results. Cost and benefit of internal audit also shows the negative result so the reasons behind it is that cost only provide the beneficial to the external providers as they the circumstances of economies and from the report we conclude that only 45% of the decision of outsourcing lead to the dismissal of any internal audit staff.

5. Conclusion

This study conducted through the survey of 101 employees of the organization (OGDCL), the users already had their inclination based on different factors and attributes of internal audit some gave more preferences to internal audit because internal audit have full support to the seniors management of the organization. therefore it is quite possible estimates of variables are affected the cost and benefit or internal audit cost having ,firm size , technical competence, corporate strategy and cost and benefit of internal audit are the major variables in selecting the factors dependable for in sourcing compared to outsourcing both sourcing have their own significance in an organization. Hence the study shows the significance portion of employees over in sourcing than out sourcing.

Future Research

There are plenty of room for further research and this present study could be a channel for researcher to carry out research by considering a large sample size and more than one firms and also different industries. Moreover, the other way could be the cross border comparison of the evaluation technique of cost of internal audit and measures for minimizing them and optimizing the benefit from savings.

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