

Research on External Coordination Mode of Internal Audit

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Abstract: With the accelerating process of world economic integration, the rapid changes of economic environment lead to more intense market competition and more detailed specialization. Modern enterprises are unlikely to achieve optimal strongest in each aspect. Many enterprises choose to concentrate their superior resources on the development of the most core business. For those businesses that enterprises are not familiar with or not good at, they often choose to transfer to external professional organizations, so the external coordination mode of internal audit also arises at the historic moment. External coordination of internal audit means that the management of an enterprise entrusts all or part of its internal audit function to an external third party. External coordination of internal audit can be manifested in three modes: outsourcing accounting firms, cooperating with Certified Public Accountants or other internal audit personnel, and cooperating with other internal audit institutions to implement cross-audit. This is an enterprise governance mode established according to the principle of cost-benefit and in line with the principle of modern corporate governance. It not only has profound theoretical basis but also is a realistic choice in the process of institutional change. External coordination of internal audit can solve the problems of insufficient internal audit resources and lack of skills of internal audit personnel. External coordination of internal audit can improve the independence of internal audit, reduce audit cost and improve audit quality. The limitation of external coordination of internal audit is that it cannot meet the personalized requirements of enterprises, and it is not conducive to the establishment and improvement of internal control. And it is difficult to coordinate with the long-term goals of enterprises. In addition, the process of external coordination of internal audit may involve the leakage of trade secrets and other problems. When considering the choice of external coordination mode of internal audit, enterprises should make comprehensive analysis and judgment from the three aspects of audit independence, cost-benefit and audit quality. The final decision is made by the management according to the specific situation and actual needs of the enterprise.

Keywords: Internal Audit, External Coordination, Contract Theory, Agency Theory

1. Introduction

The basic or primary premise of audit is the existence of entrusted economic responsibility relationship, which is principal-agent relationship. The emergence of internal audit is mainly due to the increase of internal management levels of enterprises and the emergence of decentralized management promotes the need for internal audit. In order to supervise the performance of management responsibilities of sub-managers, senior managers also need to establish and use internal audit institutions, that is, internal audit comes from the existence of internal fiduciary responsibilities.

With the acceleration of the economic integration process, the economic environment has changed dramatically. The

market competition is more intense and the specialization is also more detailed. It is impossible for modern enterprises to be the best in all aspects. Many enterprises choose to concentrate their superior resources on the development of the core business. For those businesses that enterprises are not familiar with or not good at, they often choose to transfer to external professional institutions, so external coordination of internal audit emerges.

Internal audit is a kind of institutional arrangement which can reduce agency contract cost and maximize enterprise value. If the external coordination of internal audit can reduce the overall cost of the enterprise, the external coordination of internal audit can be realized. In addition, external coordination of internal audit is also related to the risk preference of the board of directors and senior management

[1]. The competition for internal audit professionals and their professional knowledge and skills in the market makes it possible to measure and compare the value of resources. This also makes different risk preferences to make different choices and find their proper places [2].

Under the situation of increasingly fierce market competition, internal audit as an indispensable part of corporate governance is becoming more and more important, and its role in corporate governance is becoming increasingly prominent. However, due to the limitation of internal auditors' professional ability, they are often difficult to be competent for some highly professional auditing, such as information auditing and big data auditing. The implementation of external coordination of internal audit may be a beneficial attempt to solve this problem.

At the same time, to strengthen the research on the theory of external coordination of internal audit and explore the mode of external coordination of internal audit is beneficial to play the role of internal audit in corporate governance. This is placed in front of us an important topic and has important practical significance. Based on such background and significance, this paper conducts a more in-depth study on the external coordination mode of internal audit.

2. The Possibility and Rationality Analysis of the Coordination Between External Audit and Internal Audit

In the historical process of institutional change of internal audit, external coordination of internal audit, as an institutional arrangement to effectively solve the problem of agency contract is the inducement change caused by the common action of various factors leading to the evolution of the system, so it has realistic possibility and rationality.

2.1. The Possibility Analysis of Coordination Between External Audit and Internal Audit

According to the fiduciary responsibility theory, audit is to re-identify and measure, report the performance process and results of fiduciary responsibility on the basis of various fiduciary responsibility reports provided by accountants. The external clients often evaluate the performance of the fiduciary responsibility of the top management of the enterprise according to their own standards. Therefore, the top management of an enterprise will evaluate the performance results of entrusted responsibilities of its subordinate departments according to these "client standards". In this way the top management is a trustee externally and a principal internally. This shows that internal fiduciary responsibility is the extension of external fiduciary responsibility to internal enterprise, and the basic goal of internal fiduciary responsibility is to complete external fiduciary responsibility. This consistency of internal and external fiduciary responsibilities makes it possible for external audit to replace internal audit.

The objective of internal audit is the same as that of

external audit to some extent, so the objective of internal audit can be realized through external audit. The objective of internal audit is to help company managers effectively perform their responsibilities by analyzing, evaluating, recommending and appropriately evaluating the economic activities of the audited entity. The objective of external audit is to audit the economic activities and data reflected in the accounting statements of the audited entity in a certain period and to express opinions on the legitimacy and rationality of the accounting statements and the consistency of accounting treatment methods on this basis. It can be seen that the objectives of internal audit and external audit are unified to some extent. Therefore, external audit can achieve part of the audit objectives of internal audit.

The supply and demand for external coordination of internal audit has been formed. The realization of external coordination of internal audit can effectively solve the serious deficiencies existing in internal audit. As a result, some enterprises are willing to outsource part or even all of the internal audit function. First, it can improve the quality of internal audit; second, it can reduce the cost of enterprises; third, it can improve the independence of internal audit. At the same time, with the expansion of the business scope of accounting firms, the competition of external audit business will be more and more intense. The grim reality will force scores of accounting firms to expand into new businesses, as well as management consulting, tax services and internal audit practices. The supply side of external coordination of internal audit has formed a strong supply capacity, which will effectively solve the demand of external coordination of internal audit.

2.2. The Rationality Analysis of Coordination Between External Audit and Internal Audit

According to the principle of cost - benefit, cost is an important factor restricting internal audit. To carry out internal audit, a company must set up a corresponding internal audit department with corresponding personnel. While it may be economical for larger firms, smaller firms may not be able to afford a permanent internal audit organization. Moreover, a company that can set up an internal audit office may spend more on internal audit than it generates. As far as external audit is concerned, Certified Public Accountants have been engaged in the authentication business for a long time and have a strong sense of cost-benefit. Therefore, it is quite reasonable for Certified Public Accountants to enter the field of internal audit.

Internal audit is control-oriented and future-oriented, with great emphasis on the timeliness of information. Only when internal auditors find problems in time and report them to the company's management can they ensure that the management can solve the problems in time and prevent the occurrence of major mistakes. This requires that internal audit must be carried out regularly, and the professional characteristics of Certified Public Accountants engaged in regular financial audit for a long time just meet the regular requirements of internal audit.

The internal audit department is an internal department of the company, and the institution setting subordinate to the company determines that the internal auditors lack independence and cannot fairly evaluate the business of the company. If a department different from external audit is set up independently from the company, its work funds will be difficult to implement. Moreover, the establishment of such a department is completely similar to external institutions in form and function. Based on the above, it is quite reasonable for external audit institutions to replace internal audit departments and for Certified Public Accountants to act as the subject of internal audit.

As skilled audit experts, Certified Public Accountants have received formal training and passed examinations, so they are superior to internal auditors in professional competence, which is the prerequisite for Certified Public Accountants to enter the field of internal audit. At the same time, most of the Certified Public Accountants have strong observation and analysis ability, and can find and deal with the problems existing in the internal audit. Certified Public Accountants have been engaged in the authentication business for a long time. The service objects are distributed in all walks of life, and there are many companies in the same industry. In this way, when conducting internal audit, they can not only learn from the experience of good enterprises, but also learn from the lessons of poor enterprises, so as to better complete the internal audit business.

3. The Main Way to Establish External Coordination Mode of Internal Audit

Now the externalization of internal audit has gradually become a trend. Many theoretical workers also strongly advocate the externalization of internal audit, but when talking about the externalization of internal audit, almost without exception, they point to Certified Public Accountants. In my opinion, besides accounting firms, it is also a wise choice to establish a good cooperative relationship with other enterprises' internal audit institutions. Therefore, the external coordination mode of enterprise internal audit can be established in three main ways: outsourcing accounting firms, cooperating with Certified Public Accountants or other enterprise internal auditors to audit, and cooperating with other enterprise internal audit institutions to implement cross-audit. This paper focuses on the analysis of these three ways.

3.1. Outsourcing of Internal Audit Services

Generally speaking, the organizational forms of an enterprise are proprietorship, partnership and corporation. The scale of proprietorship and partnership enterprises is usually not too large. Generally speaking, there is no need to set up special internal audit institutions from the audit cost and other aspects. In some small enterprises, the cost of a permanent internal audit institution may be greater than the benefits, so there is basically no need to set up a special internal audit department considering the cost-benefit

principle. It is reasonable for the above small and medium-sized enterprises to entrust internal audit to accounting firms [3]. As Certified Public Accountants have rich audit knowledge and experience, and accounting firms usually have various professional talents, so accounting firms have the ability to undertake outsourcing work. The benefits of outsourcing all internal audit work to accounting firms are obvious. In addition, outsourcing of internal audit usually enables enterprises to give up obvious earnings manipulation [4, 5], which is conducive to improving the quality of accounting information of enterprises.

First, the independence of internal audit can be improved [6]. Although the internal audit organization performs the supervision function on behalf of the owner and it is authoritative and independent, its actual work is always inextricably linked with the management. After outsourcing the accounting firm, since the CPA is independent from the owner and operator of the enterprise, they can audit the financial status and operation of the enterprise from an objective and fair position. So they can report the audit results objectively.

Second, audit quality can be stabilized. The Certified Public Accountants have passed the professional qualification examination and have strong observation and analysis ability. Besides, they have been engaged in the authentication and audit business for a long time, serve a wide range of clients, have rich practice experience, and have a certain understanding of the operation and management of all walks of life. When conducting internal audit business, Certified Public Accountants can learn from and absorb the management experience of other advanced enterprises and offer suggestions for enterprises, which can play a role of cultural integration to a certain extent. In addition, Certified Public Accountant's practice behavior is not only subject to the supervision and legal constraints of relevant departments, but also subject to the supervision of the public. Therefore, the stability of audit quality can be ensured [7].

Thirdly, it can save costs for enterprises [8-10]. With the change of market environment and the increasingly fierce competition among enterprises, the traditional functions of internal audit can no longer meet the needs of enterprises to add value. Therefore, internal audit is constantly expanding its functions to meet the needs of enterprise management and gradually expand to risk management and management consulting. The development of risk management and management consulting business needs financial, accounting, personnel, marketing, engineering, computer and other professionals to jointly complete. At this point, enterprises will face high costs. Outsourcing the internal audit work to accounting firms can fully reduce the cost of enterprises.

However, the outsourcing of internal audit function also has some disadvantages. External auditors may need to spend a lot of time and cost to get familiar with the specific situation of the company, and are unable to provide immediate evaluation activities for enterprise managers. In addition, the outsourcing of internal audit may destroy the integrity of internal audit function, resulting in the management authority's lack of responsibility for internal control, which will reduce the

competitive advantage of enterprises. Moreover, the outsourcing of internal audit inevitably gives up the resource advantage of internal audit itself.

3.2. Cooperation Internal Audit

Internal auditors have a better understanding of strategic management, organizational operation procedures and corporate culture than external auditors. Therefore, cooperating with Certified Public Accountants or other internal auditors to carry out internal audit not only can make up for the deficiency of internal audit strength of enterprises, but also can make full use of the resource advantages of internal audit of companies.

Cooperative internal audit refers to the internal audit of the enterprise to retain a few internal auditors. For some routine and unimportant internal audit work, it is carried out by internal auditors. However, some important and extensive internal audit work, which requires higher professional judgment skills and reasonable knowledge structure, is carried out jointly by external personnel and internal auditors. In the cooperative internal audit, the internal audit staff participates in the internal audit work from beginning to end and play an active role in the planning, decision-making and drafting of the final report of the cooperative audit project.

Compared with the two extreme ways that all the internal audit work is undertaken by the internal audit institution and all the internal audit work is outsourced, cooperative internal audit can achieve the best balance of cost and benefit. It can realize the real-time control of the organization's strategic goals and operations and maintain the flexibility of internal audit. At the same time, it can also make the internal audit process and results more in line with the specific situation of the enterprise.

3.3. Cross Audit

Auditors shall maintain substantial and formal independence in performing audit services. The independence of internal audit is often a concern. The factors that restrict independence include economic benefit restriction, weak supervision and lack of credit culture. The idea of building independence can start from the independence of institutional setting and economic status and improvement of the supervision mechanism. Therefore, mandatory rotation is undoubtedly one of the more effective ways. When internal auditors audit the same department year after year, they are likely to develop an unusual friendship with the management of the department, which can compromise the auditor's independence. Mandatory rotation of auditors can improve the independence of internal audit to some extent. It is obvious that the result of this will be large and bloated audit institutions, not in line with the cost-benefit principle. There is a workaround to solve the problem of how to maintain a lean internal audit organization while implementing compulsory job rotation. We can combine the internal audit offices of many enterprises with each other to conduct cross-audit cooperatively.

Cross-auditing is now widely used in government auditing. In 2003, the National Audit Office for the first time implemented systems such as rotation of audit directors and cross-auditing in different places, which enhanced the audit intensity and efficiency of the central finance and gave full play to the function of audit supervision. In view of the current situation of large audit workload and relatively insufficient audit personnel, the implementation of cross-audit can effectively centralize and allocate audit forces and make full use of human resources. Cross-audit can enhance the relative independence of audit work, better fulfill the supervision function and improve audit quality.

Referring to the effective cross-audit system of government audit, enterprises' internal audit can also consider cooperating with other enterprises' internal audit institutions to implement cross-audit.

4. Analysis of the Advantages of External Coordination in Internal Audit

4.1. External Coordination of Internal Audit Can Improve the Independence of Internal Audit

The basic function of internal audit is to supervise the internal control and business management activities of enterprises by auditing the accounting system and evaluate the adequacy of internal control and the efficiency and effect of business activities, and finally report the audit results to the audit committee of the board of directors or the highest decision-making body of the company. Although the internal audit institution performs the supervision function on behalf of the owner and it is authoritative and independent. But in daily work, it is always inextricably linked with the operator. So some supervision functions and suggestions cannot be effectively performed, and affecting the independence of internal audit. However, Certified Public Accountants engaged in external audit work are independent of owners and operators, so they can audit the financial status of enterprises from an independent and objective standpoint and report the audit results objectively.

4.2. External Coordination of Internal Audit Can Reduce the Cost of Enterprises

With the change of market environment and the increasingly fierce competition among enterprises, the traditional function of internal audit cannot meet the needs of enterprises to add value. Therefore, in order to meet the needs of enterprise operation and management, internal audit is constantly expanding its functions and gradually expanding to risk management and management consulting. The development of risk management and management consulting business requires professionals in finance, accounting, personnel, marketing, engineering, computer and other fields to jointly complete, therefore, enterprises will face high costs. The external coordination of internal audit can reduce the cost of enterprises from the aspects of saving

the cost of recruitment, training and maintenance, saving the cost of developing software and new methods and reducing the cost of employment.

4.3. External Coordination of Internal Audit Can Improve Audit Quality

As skilled audit experts, Certified Public Accountants have received formal professional training and passed strict assessment, so their professional ability is mostly superior to that of internal auditors. At the same time, most of the Certified Public Accountants have strong observation and analysis ability, and can skillfully find and deal with the problems existing in the internal audit. Moreover, the service object of Certified Public Accountants is widely distributed in all walks of life. When conducting internal audit, there are both good experience to draw on and lessons to learn, so as to better complete the internal audit business.

4.4. External Coordination of Internal Audit Can Optimize Resource Allocation of Enterprises

If an enterprise wants to occupy a favorable position in market competition, it must vigorously develop its core business and strive to improve its core competitiveness. After the implementation of external coordination of internal audit, enterprises can entrust all or part of non-core business to external audit institutions [11]. When conducting audit, Certified Public Accountants can also point out some risks existing in enterprise management and give effective suggestions based on their own rich experience, so as to improve the loopholes in enterprise management and enable enterprises to run normally. The enterprise can concentrate the limited resources into the core business so as to optimize the allocation of resources and enhance the core competitiveness of the enterprise.

4.5. External Coordination of Internal Audit Can Improve the Efficiency of Internal Audit and Reduce the Operating Risks of Enterprises

External auditors with rich work experience and good professional quality are familiar with the enterprise's finance, production and operation, risk control, etc., and can accurately judge high-risk areas to conduct precise audit. Thus, the work efficiency of internal audit can be greatly improved [12] and the operating risk of enterprises can be reduced [9].

5. Limitations of External Coordination of Internal Audit

Although external coordination of internal audit has many advantages, it also has some limitations in the implementation process. For example, it is unable to meet the personalized requirements of enterprises, is not conducive to the establishment and improvement of internal control of enterprises and is difficult to coordinate with the long-term goals of enterprises. In addition, in the process of external

coordination of internal audit, it may also involve the leakage of trade secrets and other issues [13].

External coordination of internal audit means that all or part of the internal audit work of an enterprise is entrusted to a third-party audit institution. However, it is difficult for external auditors to understand all aspects of enterprise information comprehensively and systematically as internal auditors do, and it is difficult for them to grasp all information of enterprise development. Therefore, internal audit carried out by third-party audit institutions often lacks foresight.

6. Selection of External Coordination Mode of internal Audit

As mentioned above, the establishment of external coordination mode of internal audit can relieve the pressure of insufficient internal audit force and make more effective and full use of audit resources. The selection of external coordination mode of internal audit should be mainly considered from the following aspects:

6.1. Can Audit Independence Be Improved

Internal audit is important to the question of who is independent, who is led, and for whom. In general, outsourcing internal audit, collaborative internal audit, and cross-audit can improve audit independence to a certain extent, and at least avoid the association of internal auditors with the department being audited for a long time.

6.2. Can Cost Be Saved

Cost is undoubtedly the eternal theme of the enterprise. The cost here includes not only economic expenditure, but also human expenditure. The total expenditure of the enterprise to set up the internal audit department is the sum of both economic expenditure and human expenditure. The expenditure of internal audit outsourcing is mainly the audit fee paid by enterprises to accounting firms. Enterprises should follow the cost-benefit principle when evaluating whether to outsource [14]. In the implementation of internal audit to obtain the same benefits, when the expenditure of an enterprise purchasing audit services from outside is less than the total expenditure of the enterprise setting up an internal audit department, the enterprise shall purchase audit services from outside. Otherwise, an internal audit department should be established to save economic resources [15]. Collaborative internal auditing can be viewed as partial outsourcing, and it also compares the amount of money paid to external cooperative auditors with the amount of additional expenses incurred by completing all audit projects in-house.

6.3. Can Audit Quality Be Improved

Certified Public Accountants have passed the national professional qualification examination and have strong observation and analysis ability. They have been engaged in the authentication and audit business for a long time. They

serve a wide range of clients, have rich practice experience and have a certain understanding of the operation and management of all walks of life. When conducting internal audit business, Certified Public Accountants can learn from and absorb the management experience of other advanced enterprises and offer suggestions for enterprises, which can play a role of cultural integration to a certain extent. However, internal auditors have a stronger advantage in information. They are more familiar with the production and operation of this enterprise, business processes and corporate culture, and so on and so forth. Internal auditors as a member of the enterprise, its fate and enterprise closely related and its benefits and the future of the enterprise are closely linked. They are more concerned about the enterprise operation and management status and their dependence and loyalty on enterprises are high.

Compared with external Certified Public Accountants, internal auditors can put forward some more applicable and relevant suggestions and evaluations based on the interests of enterprises. In some cases, however, internal auditors may collude with managers to exploit loopholes in a company's internal controls for personal gain. In order to better serve the enterprise, the internal audit should fully consider the specific situation of the enterprise when making decisions. If the company is beset with internal conflicts and lack of morale, the best choice is to hire an external auditor with rich experience to objectively evaluate the company and implement effective supervision. For some projects that cannot be completed by the internal audit force of the enterprise, outsourcing or cooperation in internal audit can also be considered.

In short, when enterprises consider the choice of external coordination mode of internal audit, the decision should be made from the following three aspects: audit independence, cost effectiveness and audit quality. The final decision should be made by the management according to the specific situation and actual needs of the enterprise and through the internal audit department and external audit organization competition to achieve. No matter what form internal audit takes, its ultimate purpose is to better perform internal audit function and better serve for enterprises.

7. Conclusion

To sum up, external coordination of internal audit has both theoretical support and realistic possibility and rationality. When the existing resources of internal audit institutions cannot meet the requirements of work objectives and internal audit personnel lack specific professional knowledge or skills, external collaboration mode of internal audit is often an effective choice. External coordination of internal audit can improve the independence of internal audit, reduce the cost of auditing, improve audit quality, optimize the allocation of resources, improve the efficiency of internal audit and reduce the business risk of enterprises.

In the process of enterprise governance, the external coordination of internal audit should be carried out from two aspects: one is to design the corresponding internal control

system to facilitate the smooth implementation of external coordination of internal audit. Another is to evaluate whether and how the internal audit chooses the external coordination mode, and to use the cost-benefit principle to make the decision.

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