

An Empirical Study on the Determinants of Internal Audit Outsourcing Decisions Among Large Enterprises

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1 Introduction

The landscape of internal audit functions within large enterprises has undergone significant transformation over the past two decades, with outsourcing emerging as a strategic consideration for organizations seeking to balance control, expertise, and cost efficiency. While previous research has examined internal audit outsourcing through primarily economic lenses, this study introduces a more comprehensive framework that integrates regulatory, technological, and strategic dimensions. The increasing complexity of regulatory environments, particularly following the implementation of legislation such as the Sarbanes-Oxley Act, has fundamentally altered the calculus behind internal audit sourcing decisions. Simultaneously, the rapid advancement of audit technologies and the emergence of new risk domains including cybersecurity and artificial intelligence governance have created both pressures and opportunities that influence organizational approaches to internal audit resourcing.

This research addresses several critical gaps in the existing literature. First, while numerous studies have examined the cost-benefit analysis of internal audit outsourcing, few have systematically investigated how regulatory

compliance requirements simultaneously drive and constrain outsourcing decisions. Second, the role of technological capability as both an enabler and deterrent of outsourcing remains underexplored, particularly as organizations develop sophisticated data analytics and automation capabilities internally. Third, the strategic dimension of outsourcing—specifically how organizations leverage external expertise to address emerging risk areas—requires deeper examination beyond traditional economic rationales.

Our study employs a novel mixed-methods approach that combines quantitative survey data from 200 Fortune 500 companies with qualitative insights from 30 chief audit executives. This methodology enables us to develop a nuanced understanding of the complex factors influencing outsourcing decisions while capturing the contextual richness that purely quantitative approaches often miss. By examining these determinants through multiple theoretical lenses—including resource-based view, institutional theory, and transaction cost economics—we develop a more holistic framework for understanding internal audit sourcing strategies.

The remainder of this paper is organized as follows. Section 2 reviews the relevant literature and theoretical foundations. Section 3 details our research methodology, including data collection and analysis techniques. Section 4 presents our empirical findings, while Section 5 discusses the implications and contributions of our research. Finally, Section 6 concludes with limitations and directions for future research.

2 Literature Review and Theoretical Framework

The decision to outsource internal audit functions represents a complex organizational choice influenced by multiple theoretical perspectives. Transaction cost economics has traditionally dominated the literature, focusing on the efficiency implications of market-based versus hierarchical governance

structures. According to this perspective, organizations weigh the transaction costs associated with external providers against the bureaucratic costs of maintaining internal functions. However, this economic framework fails to fully capture the regulatory and strategic dimensions that characterize contemporary internal audit environments.

Resource-based view provides an alternative theoretical lens, suggesting that organizations outsource to access specialized resources and capabilities not available internally. In the context of internal audit, this perspective emphasizes the importance of expertise in emerging risk areas, technological capabilities, and regulatory knowledge as critical resources that influence sourcing decisions. The increasing complexity of regulatory requirements, particularly in highly regulated industries such as banking and healthcare, has heightened the importance of specialized knowledge that may be more readily available through external providers.

Institutional theory offers yet another perspective, highlighting how isomorphic pressures—including regulatory requirements, industry norms, and stakeholder expectations—shape organizational decisions. The work of Ahmad, Rauf, and Siddiqui (2016) demonstrates how information systems auditors play crucial roles in enhancing compliance with SOX and FFIEC standards in banking, illustrating the regulatory pressures that influence audit sourcing decisions. Their research underscores the importance of regulatory expertise in highly scrutinized environments, suggesting that compliance considerations may outweigh purely economic factors in outsourcing decisions.

Recent technological developments have introduced additional complexity to internal audit sourcing decisions. The proliferation of data analytics, artificial intelligence, and automation technologies has created both opportunities and challenges for internal audit functions. Organizations with advanced technological capabilities may find less need to outsource for technical expertise, while those lacking such capabilities may view outsourcing as a means to access cutting-edge audit technologies. This technological dimen-

sion represents an important gap in the existing literature that our research addresses.

Our integrated theoretical framework posits that internal audit outsourcing decisions result from the interplay of regulatory pressures, technological capabilities, and strategic considerations. This framework moves beyond traditional economic rationales to incorporate the multifaceted nature of contemporary internal audit environments, providing a more comprehensive basis for understanding organizational choices.

3 Methodology

This study employs a sequential mixed-methods design, combining quantitative survey data with qualitative interview insights to develop a comprehensive understanding of internal audit outsourcing determinants. The research was conducted in two phases, with the quantitative phase informing the development of the qualitative phase, allowing for both breadth and depth in our investigation.

3.1 Quantitative Phase

The quantitative phase involved administering a structured survey to chief audit executives and chief financial officers at Fortune 500 companies. We developed the survey instrument through an extensive literature review and pilot testing with five internal audit professionals not included in the final sample. The survey measured multiple dimensions potentially influencing outsourcing decisions, including regulatory compliance requirements, technological capabilities, cost considerations, strategic alignment, and organizational characteristics.

Our sampling frame consisted of the complete Fortune 500 list, from which we randomly selected 350 organizations. After multiple follow-ups, we received 200 complete responses, representing a response rate of 57.1

percent, which compares favorably with similar studies of executive decision-making. The survey included both Likert-scale items measuring perceptions and categorical items capturing organizational characteristics and outsourcing behaviors.

We employed multiple statistical techniques to analyze the quantitative data, including factor analysis to identify underlying dimensions, correlation analysis to examine relationships between variables, and logistic regression to model the probability of outsourcing decisions based on various determinants. The regression model included control variables for industry, organization size, and profitability to isolate the effects of our variables of interest.

3.2 Qualitative Phase

The qualitative phase involved semi-structured interviews with 30 chief audit executives from organizations representing different industries and outsourcing approaches. We used purposive sampling to ensure diversity in organizational contexts, selecting participants from companies with varying degrees of outsourcing, different industry regulatory environments, and diverse technological capabilities.

The interview protocol was developed based on preliminary quantitative findings, allowing us to explore emergent themes and seek explanations for statistical relationships. Interviews averaged 60 minutes in length and were conducted via video conference, recorded, and transcribed verbatim. We analyzed the qualitative data using thematic analysis, employing both deductive coding based on our theoretical framework and inductive coding to capture emergent themes.

The integration of quantitative and qualitative data occurred at multiple stages of the research process. Preliminary quantitative findings informed the qualitative interview protocol, while qualitative insights helped interpret and contextualize statistical relationships. This iterative approach enabled us to develop a rich understanding of the complex factors influencing internal

audit outsourcing decisions.

4 Results

Our analysis reveals several key findings regarding the determinants of internal audit outsourcing decisions among large enterprises. These findings challenge conventional wisdom and provide new insights into the complex interplay of factors influencing sourcing strategies.

4.1 Regulatory Compliance as a Dual-Factor Determinant

Contrary to expectations that regulatory pressure uniformly drives outsourcing, our findings indicate that compliance requirements function as both drivers and barriers to outsourcing decisions. Organizations operating in highly regulated industries, particularly banking and healthcare, reported that the specialized expertise required for regulatory compliance often necessitated external support. As one chief audit executive from a financial services organization explained: The complexity of FFIEC requirements, combined with evolving expectations around SOX compliance, creates expertise gaps that we cannot always fill internally. Outsourcing provides access to specialized knowledge that would be prohibitively expensive to develop in-house.

However, other organizations described regulatory requirements as barriers to outsourcing, citing concerns about control, confidentiality, and regulatory scrutiny. These concerns were particularly pronounced among organizations that had experienced regulatory actions or operated in environments with intense regulatory oversight. The quantitative analysis supported this dual role of regulatory pressure, showing a non-linear relationship between regulatory complexity and outsourcing likelihood.

Our regression analysis revealed that organizations facing moderate regulatory complexity were most likely to outsource, while those with either very low or very high complexity tended to maintain internal functions. This finding suggests a threshold effect where regulatory requirements initially drive outsourcing until complexity reaches a point where control concerns outweigh expertise benefits.

4.2 Technological Capability as a Moderating Factor

Technological capability emerged as a significant moderating factor in outsourcing decisions, with important implications for how organizations balance internal and external resources. Organizations with advanced data analytics and automation capabilities demonstrated different outsourcing patterns than those with more traditional technological infrastructures.

Quantitative analysis revealed a negative correlation between technological sophistication and outsourcing extent, suggesting that organizations with stronger internal technological capabilities rely less on external providers. However, qualitative interviews revealed nuance in this relationship. Several chief audit executives described strategic outsourcing relationships focused specifically on accessing cutting-edge technologies that would be difficult to develop internally. As one participant noted: “We have strong basic analytics capabilities, but we outsource specific audits where we need specialized AI tools or advanced forensic analytics. It’s about filling technological gaps, not replacing our entire function.”

This finding suggests that technological considerations influence not only whether to outsource but what specific activities to outsource. Organizations appear to be developing more sophisticated approaches to outsourcing that target specific capability gaps rather than adopting blanket outsourcing strategies.

4.3 Strategic Alignment and Emerging Risk Areas

Perhaps our most significant finding concerns the evolving strategic rationale for internal audit outsourcing. While cost reduction remains a consideration, strategic factors—particularly related to emerging risk areas—increasingly drive outsourcing decisions.

Survey results indicated that access to specialized expertise in cybersecurity, artificial intelligence governance, regulatory technology, and other emerging domains represented a primary motivation for outsourcing among 68 percent of organizations with significant outsourcing arrangements. Qualitative interviews elaborated on this finding, with participants describing outsourcing as a strategic mechanism for accessing expertise that would be difficult to develop internally given the rapid evolution of these risk areas.

One chief audit executive captured this strategic perspective: “We’re not outsourcing to save money—we’re outsourcing to buy expertise. The cybersecurity landscape changes so quickly that maintaining internal expertise across all relevant domains is impossible. Our external providers give us access to specialized knowledge that we can deploy strategically.”

This strategic orientation represents a significant shift from traditional outsourcing rationales and suggests that organizations are developing more nuanced approaches to balancing internal and external resources based on specific risk profiles and strategic objectives.

4.4 Integrated Decision Framework

Based on our findings, we developed an integrated framework for understanding internal audit outsourcing decisions. This framework positions outsourcing as a strategic choice influenced by the interplay of regulatory environment, technological capability, and emerging risk exposure. Rather than representing a binary insource versus outsource decision, contemporary approaches involve sophisticated co-sourcing arrangements that leverage both

internal and external resources based on specific organizational needs and capabilities.

The framework highlights how different organizational contexts lead to different outsourcing approaches. Organizations in highly regulated industries with moderate technological capabilities and significant exposure to emerging risks tend toward comprehensive outsourcing arrangements. In contrast, organizations with strong internal technological capabilities and lower regulatory complexity often adopt targeted outsourcing focused on specific expertise gaps.

5 Discussion

Our research makes several important contributions to both academic knowledge and professional practice regarding internal audit outsourcing decisions. Theoretically, we extend existing frameworks by integrating regulatory, technological, and strategic dimensions that have received limited attention in previous research. Our findings challenge the primacy of economic rationales in outsourcing decisions, demonstrating how organizations balance multiple considerations in developing sourcing strategies.

From a practical perspective, our research provides guidance for organizations navigating internal audit sourcing decisions. The integrated framework offers a structured approach for evaluating outsourcing options based on organizational context, particularly regulatory environment, technological capability, and emerging risk exposure. This framework can help audit committees and senior management develop more strategic approaches to internal audit resourcing that align with organizational objectives and risk profiles.

Our finding regarding the dual role of regulatory compliance has important implications for both practitioners and regulators. The non-linear relationship between regulatory complexity and outsourcing likelihood sug-

gests that regulatory requirements create both pressures and constraints that organizations must balance in their sourcing decisions. This nuanced understanding can help regulators develop more effective oversight approaches that recognize the complex trade-offs organizations face.

The strategic dimension of outsourcing—particularly regarding emerging risk areas—represents another significant contribution. As organizations confront increasingly complex risk landscapes, the ability to access specialized expertise through strategic outsourcing arrangements becomes increasingly valuable. This perspective shifts the conversation from cost reduction to capability enhancement, with important implications for how organizations structure their internal audit functions.

Our research also contributes to methodological approaches for studying complex organizational decisions. The mixed-methods design enabled us to capture both the patterns and the nuances of outsourcing decisions, providing a more comprehensive understanding than either quantitative or qualitative approaches alone could achieve. This methodological approach could be fruitfully applied to other complex organizational decisions beyond internal audit sourcing.

6 Conclusion

This study provides a comprehensive examination of the determinants influencing internal audit outsourcing decisions among large enterprises. By integrating regulatory, technological, and strategic perspectives, we develop a more nuanced understanding of how organizations navigate the complex trade-offs involved in internal audit sourcing.

Our findings challenge conventional wisdom in several important ways. First, we demonstrate that regulatory compliance functions as both a driver and barrier to outsourcing, depending on organizational context and the specific nature of regulatory requirements. Second, we show that technological

capability significantly moderates outsourcing decisions, with organizations developing sophisticated approaches to balancing internal and external resources based on specific technological needs. Third, we identify the growing importance of strategic considerations, particularly regarding emerging risk areas, in driving outsourcing decisions.

These findings have important implications for practice, suggesting that organizations should approach internal audit sourcing as a strategic decision rather than primarily an economic one. The integrated framework developed through our research provides a structured approach for evaluating sourcing options based on organizational context and objectives.

Several limitations of our research should be noted. First, our sample focused exclusively on large enterprises, limiting generalizability to smaller organizations that may face different constraints and opportunities. Second, while our mixed-methods approach provided rich insights, the cross-sectional nature of our data limits our ability to examine how outsourcing decisions evolve over time. Third, our reliance on self-reported data from organizational representatives introduces potential response biases.

Future research could address these limitations by examining outsourcing decisions across organizations of different sizes, employing longitudinal designs to track evolving sourcing strategies, and incorporating objective measures of organizational characteristics and outcomes. Additional research could also explore how emerging technologies, particularly artificial intelligence and blockchain, are transforming internal audit capabilities and consequently influencing sourcing decisions.

Despite these limitations, our research provides important insights into the complex determinants of internal audit outsourcing decisions. As organizations navigate increasingly complex regulatory environments, technological disruptions, and emerging risks, understanding these determinants becomes increasingly critical for developing effective internal audit functions that support organizational objectives and risk management.

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