

Determining the Right Internal Audit Model for Your Company

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Internal audit departments continue to experience challenges related to an expanding audit universe, changes in laws and regulations, greater technology risks, and increased budget pressures. Executive management and audit committees should periodically review their company's risk profile and determine if their current internal audit model is optimal for the company and significant stakeholders. Whether in-house, outsourced, or somewhere in between, the internal audit department model should be based on the defining characteristics of the company as well as the specific applicability and potential benefits and challenges associated with each operating model.

Laid out in the Crowe Horwath LLP white paper "[A New Decade, A New Internal Audit Model](#)" were the four principles of the new internal audit model:

1. [Assurance](#)
2. [Performance improvement](#)
3. [Compliance](#)
4. [Risk identification](#)

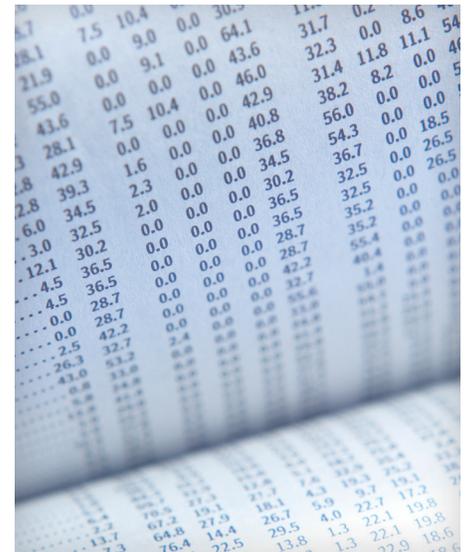
Each of these principles influences a company's determination of which internal audit operating model is optimal.

Members of executive management and audit committees generally believe that internal audit departments have the requisite skills to cover the basic risks; however, members often are less confident that internal audit personnel have the skills to cover areas of operations and strategic risk. Nevertheless, the expectations of executive management and audit committees seem to be expanding and internal audit departments are being asked to spend more time on areas of operational and strategic risk.

Increasingly, internal audit departments are being held responsible for implementing enterprise risk management (ERM) programs and coordinating ERM activities with primary business functions in the organization.

Many internal audit departments are struggling with recruiting, training, and retaining talent; maintaining knowledge and technology; and operating with a larger global footprint in an expanding risk universe.

The many challenges internal audit departments face today, coupled with the administrative costs associated with maintaining an internal audit department, have caused many companies to re-evaluate their internal audit operating model. With the right model, the internal audit function can meet the increased expectations, fulfill its audit plan, and ultimately accomplish its mission.



Determining the Appropriate Internal Audit Operating Model

A company's decision to establish or maintain an in-house internal audit department or enter into a cosourcing or an outsourcing relationship is generally determined by a number of qualitative factors. Exhibit 1 highlights the qualitative factors that management and audit committees should consider in conjunction with this evaluation.

Exhibit 1: Qualitative Factors to Consider

Key Characteristics of the Company	In-House	Cosourced												Outsourced
		●	●	●	●	●	●	●	●	●	●	●	●	
Is internal audit a core competency for the company?	Yes	●	●	●	●	●	●	●	●	●	●	●	●	No
Is the internal audit department a source of future talent for the company?	Yes	●	●	●	●	●	●	●	●	●	●	●	●	No
How complex are the company's information systems?	Low	●	●	●	●	●	●	●	●	●	●	●	●	High
How geographically dispersed are the company's locations around the globe?	Few Locations	●	●	●	●	●	●	●	●	●	●	●	●	Many Locations
How centralized or decentralized is the company's organizational structure?	Centralized	●	●	●	●	●	●	●	●	●	●	●	●	Decentralized
How complex are the company's business processes?	Simple	●	●	●	●	●	●	●	●	●	●	●	●	Complex
How regulated is the company's industry?	Low	●	●	●	●	●	●	●	●	●	●	●	●	High
How many acquisitions is the company planning in the near term?	Few	●	●	●	●	●	●	●	●	●	●	●	●	Many

Source: Crowe analysis

Overview of the Internal Audit Operating Models

Organizations need to consider the particular characteristics, specific applicability, and potential benefits and challenges of each of the internal audit operating models. Exhibit 2 provides a detailed overview of each of the models.

Exhibit 2: Comparing and Contrasting the Internal Audit Models

In-House Model	Cosourced Model	Outsourced Model
Overview		
<ul style="list-style-type: none"> The internal audit department consists only of company employees. The internal audit department is responsible for the risk assessment, planning, and execution of the internal audit plan and for reporting the internal audit results. The company acquires and maintains the methodology, technology, and knowledge infrastructure. 	<ul style="list-style-type: none"> The internal audit department consists of a combination of company employees and personnel from a third-party provider. The internal audit department is responsible for risk assessment and planning and uses people from both groups to execute the internal audit plan and report the internal audit results. Both the company and the third party supply the methodology, technology, and knowledge infrastructure. 	<ul style="list-style-type: none"> The internal audit department consists only of employees from a third-party provider, some of whom could be former members of the company's internal audit function. The third-party provider assists management with developing a risk assessment and audit plan and is responsible for executing the internal audit plan and reporting the internal audit results. The third-party provider uses its methodology, technology, and knowledge infrastructure for the company.

Exhibit 2: Comparing and Contrasting the Internal Audit Models (continued)

In-House Model	Cosourced Model	Outsourced Model
Characteristics		
<p>Staffing</p> <ul style="list-style-type: none"> The internal audit department manages all aspects of recruiting, training, and performance management. <p>Methodology</p> <ul style="list-style-type: none"> The internal audit department develops and maintains the company's internal audit methodology. <p>Technology</p> <ul style="list-style-type: none"> The internal audit department develops or purchases, implements, and maintains its technology platform and audit software. <p>Knowledge Resources</p> <ul style="list-style-type: none"> The internal audit department uses publicly available content, informal networks, or professional organizations to obtain knowledge, benchmarking data, and leading practices. 	<p>Staffing</p> <ul style="list-style-type: none"> The internal staff is supplemented by third-party resources to meet defined resource needs (to fill resource gaps, cover foreign locations, or provide specific skills, for example). <p>Methodology and Technology</p> <ul style="list-style-type: none"> The internal audit department develops an internal audit methodology and technology platform or takes advantage of the methodology and technology investments of the third-party provider. <p>Knowledge Resources</p> <ul style="list-style-type: none"> The third-party provider supplies knowledge of other companies, benchmarking data, and leading practices. 	<p>Staffing</p> <ul style="list-style-type: none"> The third-party provider is responsible for all staffing and personnel matters (such as recruiting, retention, and training). <p>Methodology, Knowledge, and Technology</p> <ul style="list-style-type: none"> The third-party provider's investments in methodology, knowledge, and technology are available to the company.
Applicability		
<ul style="list-style-type: none"> The model is generally driven by corporate culture considerations or a priority placed on using the internal audit department as a source of future talent to the business. 	<ul style="list-style-type: none"> The model is a solution for elevating the capabilities of the internal audit department. Internal audit is a variable cost of this moderately flexible staffing model. 	<ul style="list-style-type: none"> The model is a turnkey solution with full and immediate access to the company's global personnel, subject-matter experts, methodology, and technology. Internal audit is a variable cost of this fully flexible staffing model. The model is the quickest route to transformational change.
Potential Benefits		
<ul style="list-style-type: none"> Company personnel are generally more receptive to internal auditors who are employees. The company has a potential source of future management talent. Institutional knowledge is maintained. Internal auditors are under direct control and 100 percent dedicated to the company. 	<ul style="list-style-type: none"> The model is a moderate route to transformational change. The staffing model is partially flexible. The internal audit department is a partially variable cost. The company has immediate access to the third-party provider's investments in methodology, technology, knowledge, benchmarking data, and best practices. The company has immediate access to subject-matter experts or resources in specific geographies. There is a two-way knowledge transfer between the internal auditors and the third-party provider. The company continues to have a potential source of future management talent. Institutional knowledge is maintained. Travel-related costs are reduced. 	<ul style="list-style-type: none"> The model is the quickest route to transformational change. The staffing model is fully flexible. The internal audit department is a variable cost. The company has immediate access to the third-party provider's investments in methodology, technology, knowledge, benchmarking data, and best practices. The company has immediate access to subject-matter experts or resources in specific geographies. The third-party provider is responsible for training, recruiting, and career development. Travel-related costs are reduced.

Exhibit 2: Comparing and Contrasting the Internal Audit Models (continued)

In-House Model	Cosourced Model	Outsourced Model
Potential Challenges		
<ul style="list-style-type: none"> ■ The model is the slowest route to transformational change. ■ The staffing model is the least flexible. ■ The internal audit department is a fixed cost. ■ Company access to subject-matter experts is restricted. ■ Growing costs are associated with investments in methodology, technology, knowledge, and training. ■ Recruiting and retaining high-quality internal auditors might be difficult. ■ Travel-related costs are higher. 	<ul style="list-style-type: none"> ■ Activities between the in-house and cosourced internal auditors require coordination. ■ The two audit teams require cultural integration. ■ The model is a cultural change for the company. 	<ul style="list-style-type: none"> ■ The company no longer has a potential source of future management talent. ■ There is a potential loss of institutional knowledge. ■ The internal auditors are not under direct control or 100 percent dedicated to the company. ■ Company personnel might consider the internal auditors to be outsiders. ■ The model is a cultural change for the company.

Source: Crowe analysis

Internal Audit Operating Models and Reporting Structures

An internal audit department’s structure and reporting relationships depend on the operating model that management and the audit committee have determined is appropriate for the organization. One size does not fit all, and similar companies can have very different operating models. In addition, the operating model should be flexible to adapt to changes within the organization and its business. The following provides an overview of the three most common internal audit operating models and reporting structures.

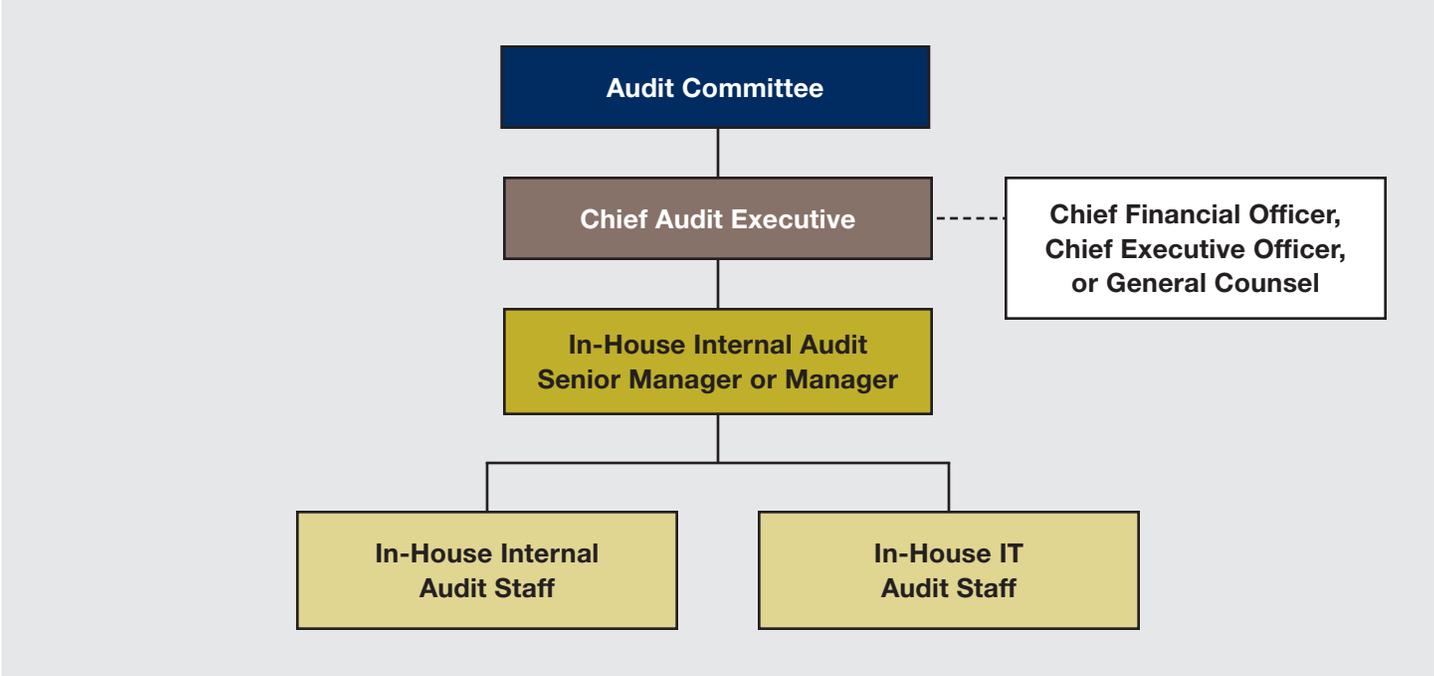
In-House Internal Audit Department

In an in-house internal audit department, the chief audit executive (CAE) typically reports directly to the audit committee and reports administratively to the CFO, CEO, or general counsel. All of the internal auditors are employees of the company. (See Exhibit 3.)

Cosourced Internal Audit Department

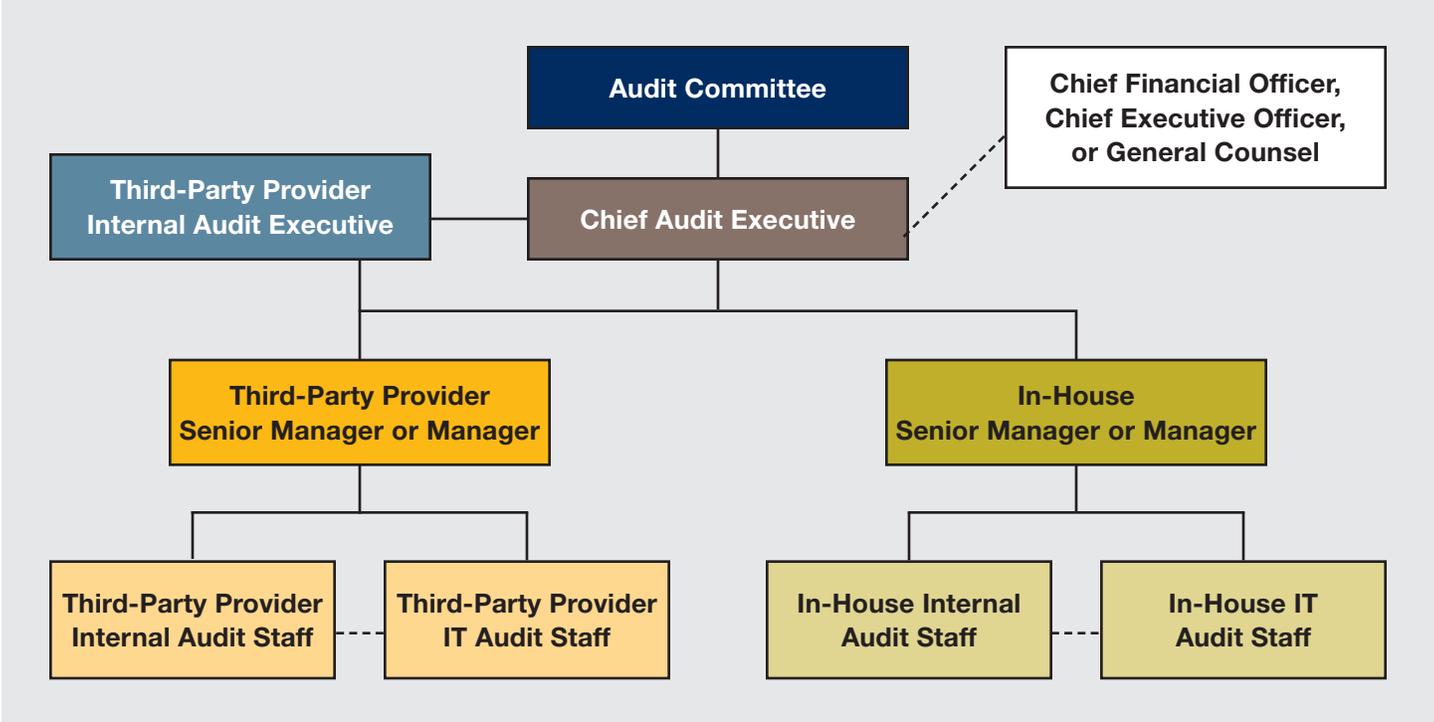
Typically in a cosourced internal audit department, the CAE reports directly to the audit committee and administratively to the CFO, CEO, or general counsel. The cosourced internal audit provider reports directly to the CAE or a person the CAE designates, and the internal auditors are employees of the company and the cosourced provider. The in-house and cosourced internal audit teams can be either integrated or maintained separately. (See Exhibit 4.)

Exhibit 3: Internal Audit Organizational Chart – In-House Model



Source: Crowe analysis

Exhibit 4: Internal Audit Organizational Chart – Cosourced Model

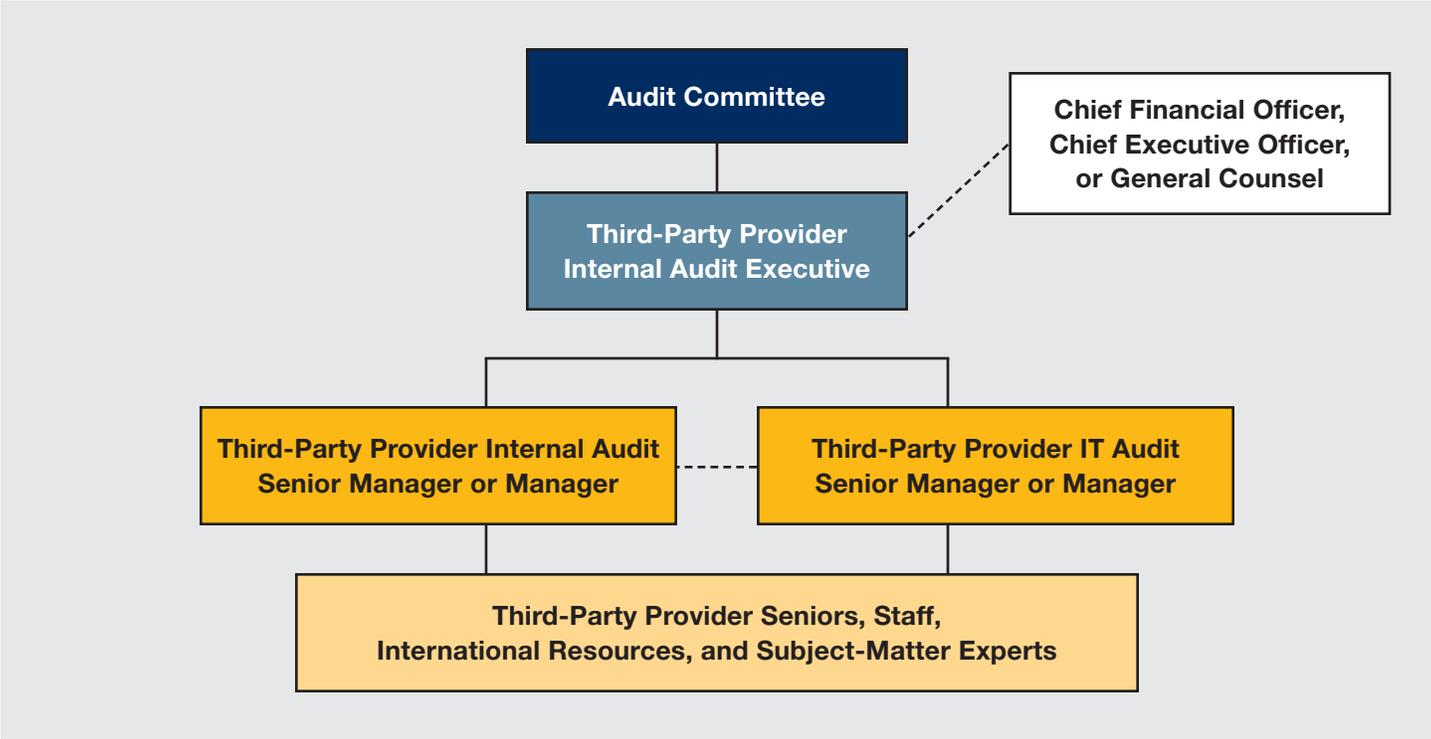


Source: Crowe analysis

Outsourced Internal Audit Department

In an outsourced internal audit department, an executive-level resource from the third-party service provider assumes the CAE role. The CAE typically reports directly to the audit committee and administratively to the CFO, CEO, or general counsel. The internal auditors are employees of the third-party service provider.

Exhibit 5: Internal Audit Organizational Chart – Outsourced Model



Source: Crowe analysis

Conclusion

Internal audit departments should continue to monitor industry trends, the current regulatory environment, and their organization’s plans for business change. This will enable internal audit departments to assess their existing capabilities, predict their future requirements, and adapt their operating models appropriately.

Appendix: Internal Audit Case Studies

The following are disguised examples of real-life companies that experienced various challenges related to their internal audit function. As a result, their executive management and audit committees decided to outsource or cosource their respective internal audit functions.

Exhibit 6: Outsourcing and Cosourcing Case Studies

Fortune 100 Global Food Company		Fortune 1000 Manufacturing Company	
Outsourcing	Internal Audit Challenges <ul style="list-style-type: none"> The internal audit department was consistently unable to complete its internal audit plan. The internal audit department was not well respected in the organization. The executive leadership team had low confidence in the audit work. Audit recommendations were not adding value. Audit reports were not issued in a timely manner. 	Outsourcing	Internal Audit Challenges <ul style="list-style-type: none"> The company had been spun off from its parent and needed to develop an internal audit department. The previous internal audit department had not identified the root cause associated with internal audit issues.
	Solution <ul style="list-style-type: none"> Outsource the internal audit department to a third-party service provider. 		Solution <ul style="list-style-type: none"> Outsource the internal audit department to a third-party service provider.
	Results <ul style="list-style-type: none"> Significantly improved methodology and execution. Better audit cycle timing and relevant audit reporting. Enhanced credibility with executive management and other key stakeholders. 		Results <ul style="list-style-type: none"> Robust risk assessment methodology for selecting internal audit processes and locations. Use of data analytics to periodically monitor key internal controls. Use of IT and forensic audit specialists on engagements. Internal audit reports with recommendations focused on the root cause.
Outsourcing	Internal Audit Challenges <ul style="list-style-type: none"> The internal audit department was not meeting the needs of executive management and the audit committee. Executive management wanted to improve the quality of the internal audit work and reduce overall internal audit costs. 	Cosourcing	Internal Audit Challenges <ul style="list-style-type: none"> The company had a changing risk profile that was shifting more of the internal audit work to international locations. The internal audit department staff did not have the necessary foreign language skills or understanding of business practices in specific geographies.
	Solution <ul style="list-style-type: none"> Outsource the internal audit department to a third-party service provider. 		Solution <ul style="list-style-type: none"> Cosource the internal audit department with a third-party service provider.
	Results <ul style="list-style-type: none"> Significant improvement in internal audit deliverables. 20 percent reduction in overall internal audit costs. Ability to integrate specialists into internal audits. Improved risk assessment and risk coverage. 		Results <ul style="list-style-type: none"> An internal audit partner that could provide international resources to support the company's domestic internal auditors. Significantly lower travel expenses.

Source: Crowe analysis



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