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Is Your Organization Benefiting From the Most Effective Model for Internal Audit?

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Whether in-house or outsourced, or a blend of the two, the choice of the best operating model for internal audit is far from a one-size-fits-all decision.

Executive management and audit committees may decide to weigh the options based on a variety of factors. A re-evaluation might be prompted after an acquisition, the appointment of a CEO or a new leader of the audit committee, or due to perceptions of low quality and high cost. No particular model is intrinsically superior, and the decision to switch models varies by company and targeted objectives.

Senior executives and boards sometimes lack confidence in the capabilities of current internal audit staff, who may be proficient at conducting regulatory compliance matters, but not experienced or knowledgeable enough to help identify operational and strategic risks.

Many internal audit departments struggle with recruiting, training, and retaining top talent, along with adequately helping to manage risks in operations with a global footprint. In addition, internal audit groups continue to face regulatory change as well as technology innovation, with businesses being powered increasingly by digital technologies – such as analytics and cloud computing – that can boost performance and introduce new risks.

Discussing Which Model Best Suits Your Organization

The decision to maintain the function in-house, or adopt a cosourcing or an outsourcing relationship, is generally determined by qualitative factors that management and audit committees need to weigh carefully.

Advances in automation and collaborative technologies have enabled wider access to outside service providers, not only for internal audit but for a wide range of functions deemed noncore or nonstrategic to the organization.

Exhibit 1 shows some key questions to consider, with the answers pointing to the applicability of one or more of the models. Exhibit 2 takes a high-level view of key differences between the three models.

Exhibit 1: Key questions to discuss when contemplating a change

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

Exhibit 2: Comparison of high-level characteristics

In-House

- Internal audit consists of company employees only.
- Internal audit is responsible for assessing risk, planning, executing the internal audit plan, and reporting results.
- Company acquires and maintains the methodology, technology, and knowledge infrastructure.

Cosourcing

- Internal audit consists of a combination of company employees and personnel from a third-party service provider.
- Internal audit is responsible for risk assessment and planning, and uses people from both groups to execute the internal audit plan and to report results.
- Both the company and the third party supply methodology, technology, and knowledge infrastructure.

Outsourcing

- Internal audit consists of employees only from the third-party provider, which might include former members of the company's internal audit function.
- The third party assists management with developing the risk assessment and audit plan and is responsible for executing the plan and reporting the results.
- The third party applies its own methodology, technology, and knowledge infrastructure.

Understanding How Responsibilities Vary by Model

Staffing, methodology, knowledge, and technology resources are managed differently in the three models.

- In the in-house model, the company manages all aspects of recruiting, training, and performance management. It develops and maintains its own internal audit methodology, as well as technology platform and audit software. For benchmarking data and leading practices, in-house groups look to publicly available content, informal networks, and professional organizations. Some of the challenges can include fixed costs, the difficulty of recruiting and retaining high-quality internal auditors, and finding a quicker, more flexible way to transform internal audit for greater relevance to the business. Maintaining internal audit in-house also can become a source of future talent to the business.
- In the cosourced model, a third-party service provider supplements internal resources to fill resource gaps, cover foreign locations, and provide specialized skills. Internal audit becomes a more variable cost in this moderately flexible staffing model. The in-house group may develop its methodology and technology platform, or take advantage of what the third party offers. The cosourcing partner frequently supplies knowledge of other companies, benchmarking data, and leading practices. Activities between the in-house and cosourced internal auditors, of course, require coordination. Cultural change management may be needed.
- In the outsourced model, the third-party service provider takes responsibility for all staffing and personnel matters such as recruiting, retention, and training. The client organization is able to take advantage of the service provider's investments in methodology, technology, and knowledge resources. The provider's internal auditors are not under direct control, nor are they 100 percent dedicated to the client organization. While gaining quick access to outside talent, an organization potentially loses a source of future management talent, along with institutional knowledge, by contracting with an outside provider of managed services. Of the three choices, this variable-cost model provides the fastest route to transforming the function.

Exhibit 3: Compare the benefits of each model

In-House	Cosourcing	Outsourcing
• Company personnel are generally more receptive to internal auditors who are employees. • Company has a potential source of future management talent. • Institutional knowledge is maintained. • Internal auditors are under direct control and 100% dedicated to the company.	• Staffing model is moderately flexible, and the cost of internal audit is partially variable. • Company gains immediate access to investments by the third-party provider in methodology, technology, benchmarking data, best practices, and subject matter resources in specific geographies. • Two-way transfer of knowledge between internal auditors and the third party. • Company maintains institutional knowledge and a source of future management talent. • Travel-related costs decline. • A moderately paced route to transformational change.	• Staffing is highly flexible, and internal audit is a variable cost. • Company gains immediate access to the third-party provider's investments in methodology, technology, knowledge, benchmarking data, and best practices. • Company also gains access to subject matter experts in specific geographies. • The third party is responsible for training, recruiting, and career development. • Travel-related costs decline. • Quickest route to transformational change.

Comparing the Reporting Structures

Here is a quick overview of reporting structures for internal audit, and how they vary by operating model:

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 (Exhibit 4). In some cases, organizations may return to this model after trying outsourcing or cosourcing due to the preferences expressed by a newly appointed business leader for having the function kept in-house.

In a cosourced internal audit department, the CAE typically 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 the person the CAE designates, and internal auditors are employees of the company and the cosourced provider. In-house and cosourced internal audit teams can be integrated or maintained separately (Exhibit 5).

In the outsourced model, 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 6).

Exhibit 4: In-house organizational chart

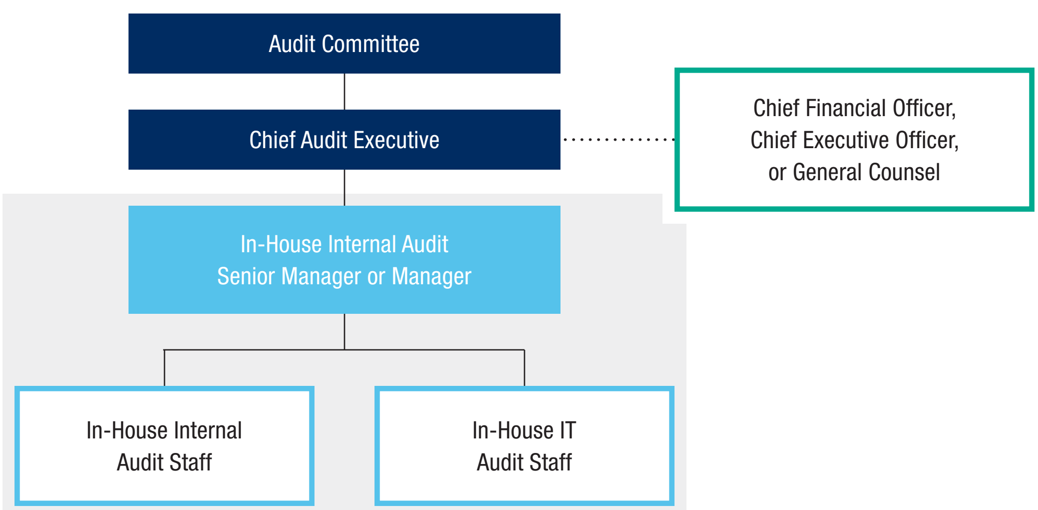


Exhibit 5: Cosourced organizational chart

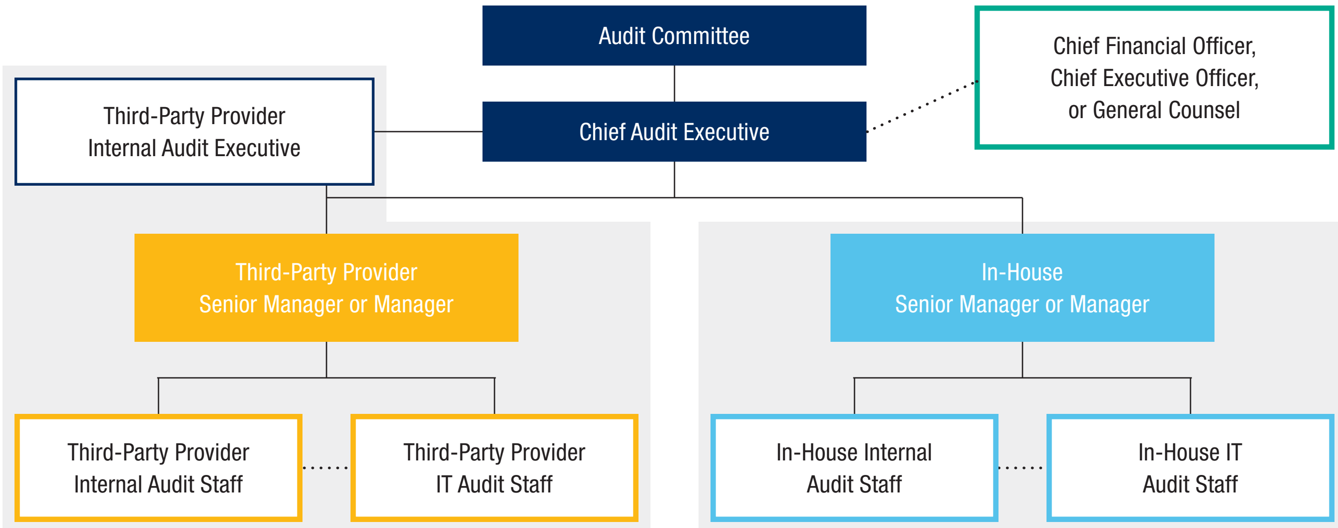
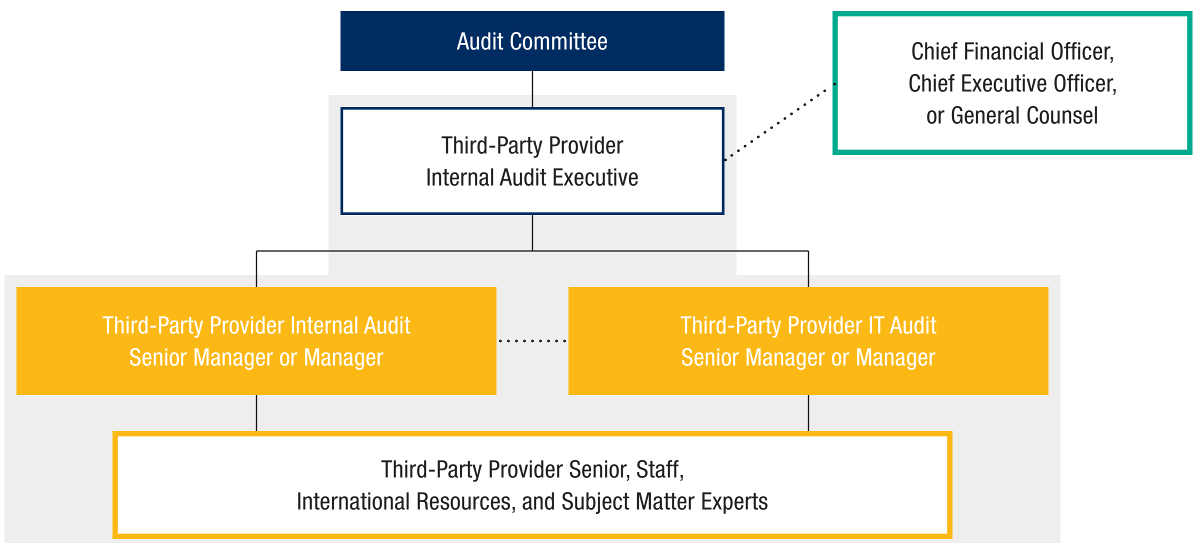


Exhibit 6: Outsourced organizational chart



Examples of Why Companies Switch Models

The following are examples of companies (made anonymous to protect client names) that have experienced challenges related to their internal audit function.

- **Manufacturing company.** Spun off from its parent, this organization needed to develop its own internal audit function. Business leaders decided to outsource the function. The third party provided a robust risk assessment methodology for selecting internal audit processes and locations. Data analytics were used to monitor internal controls, and the third party provided reports and recommendations that identified root causes of problems. Specialists in information technology and forensic audits were called in as needed.
- **Global products company.** The company's changing risk profile necessitated a change in internal audit model at international locations. Because in-house staff lacked foreign language fluency as well as understanding of business practices in specific geographies, company leaders opted for cosourcing. The third-party provider supplied international resources to support domestic internal auditors, which improved global coverage and competency while reducing travel expenses.
- **Professional services company.** The internal audit department was falling short of executive management and audit committee expectations. Business leaders wanted to improve the quality of the work and reduce costs. The company decided to outsource to a third party, which was able to reduce overall costs for internal audit by 20 percent. Specialists were integrated into the process, thereby improving risk assessments and coverage. Management continued the outsourcing arrangement due to perceived improvements in internal-audit deliverables.
- **Food company.** The internal audit department was consistently unable to complete its internal audit plan, and executive leaders had low confidence in the audit work. The function was outsourced to a third party, which provided time-tested methodology and timely execution of the audit plan. A more efficient audit cycle, coupled with relevant reports, enhanced the leaders' appreciation of the function among executive management and other key stakeholders.

Conclusion

There is much to be gained when an organization periodically evaluates internal audit performance as well as its internal audit operating model. Industry trends, changing regulations, and an organization's changing strategy can alter which model might be more advantageous. In some cases, a different model may result in higher-quality work and greater efficiency at reduced cost. Implementing the best model enables internal audit to fulfill its mission and provide highly relevant insight to executives and audit committees.

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