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Sourcing for the Internal Audit Function

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For such a critical function, internal audit is too often regarded as simply a box to tick on management's list of operational things to do. In actuality, the Singapore Code of Corporate Governance requires companies to establish an effective internal audit function that is adequately resourced and independent of the activities it audits (Principle 13).

A more pressing call is how a company should approach its internal audit options to best fit its corporate structure and requirements. Essentially, there are three primary options: in-house, outsourced, or co-sourced.

IN-HOUSE

In-house internal audits rely solely on company resources, staff and expertise.

For smaller companies, this option may simply not reap the necessary cost efficiencies available to larger players which can invest in the dedicated development of an internal audit department.

However, the benefits of the in-house option certainly include the internal familiarity with the company's business, and the strength of better networks and working relationships within the company.

Additionally, internal auditors can be groomed or they can be rotated to other departments, expanding their internal control knowledge throughout the organisation. The presence of such auditors also creates awareness of the crucial role internal audit plays in a company's operations.

OUTSOURCED

Here, a company may delegate its internal audit function to an external service provider, usually one of the public accounting firms other than its external auditor.

A company may opt to go this route because of a lack of qualified internal resources and technical or specialty knowledge required, or just because the size of the organisation is simply too small to sustain an in-house team. Outsourcing may then be both cost effective and provide for necessary independence.

One negative aspect of outsourcing is that the depth of the internal audit may be less thorough as the outsourced team is usually with the client for a shorter period.

The Institute of Internal Auditors offers a valuable caveat for companies that choose to outsource: oversight and responsibility for the internal audit activity cannot be outsourced. An in-house liaison, preferably an executive or senior management employee, should be responsible for "managing" the internal audit activity.

CO-SOURCED

Co-sourcing involves in-house internal auditors being the primary resource for executing the company's internal audit plan while engaging an external service provider, particularly in a specialised area, to provide the necessary support or to boost cost efficiency.

Co-sourcing can create a synergy that complements the strength of an in-house internal audit team and enables it to tap the broad capabilities available from an external service provider.

It also allows an internal audit department to pursue value added services that it otherwise could not do itself because of a lack of resources, time or capabilities.

A 2013 survey conducted by the Singapore Accountancy Commission and consultancy firm KPMG indicates that 44 per cent of chief audit executives view co-sourcing as the most cost-efficient means of obtaining a diverse range of skill sets that may not be fully utilised in an in-house context.

MULTI-PRONGED APPROACH

The decision on the most appropriate option for a company relies on factors such as company size, structure, resources and management culture.

Some companies move on to different options as their organisations evolve or grow. One example of a large organisation that creatively worked out an effective solution for its internal audit needs is the Ministry of Health Holdings (MOHH), the holding company of the various public healthcare entities.

In 2010, after an extensive internal review and consultation and given its size, MOHH consolidated its internal audit function across the entire group.

Internal auditors from its subsidiaries which had in-house teams were transferred to a central internal audit department within the holding company. In effect, the subsidiaries which previously had their own internal audit function then "outsourced" this function to the head office.

At the same time, the internal audit department at the head office also "co-sourced" specific functions, such as a whistle-blowing hotline, to external specialist service providers.

MOHH found that the economies of scale of a central department provided for better management of and career progression for its large pool of internal audit staff. At the same time, it achieved a higher level of independence of its internal auditors relative to the individual subsidiaries. Its use of specialist outsourced service providers also complemented and supplemented its internal resources.

MOHH went further to create synergies and alignment at the board level by having the audit committee chairmen of its subsidiaries be members of the audit committee of the holding company.

In the final analysis, each company has to decide which option best serves its business practice. There is no clear-cut right or wrong answer.

However it is organised or executed, the internal audit function should be designed to be effective for its purposes and comply not just with the letter and form of regulations, but also the spirit and substance of it. ■