

# THE OUTSOURCING OF INTERNAL AUDIT – IT IS A SOLUTION IN INCREASING THE QUALITY OF INTERNAL AUDIT?

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*Abstract. The dynamism of the economical environment where companies activate suppose for them a continuously search of solutions for improving over the control of activities developed. A solution is to adopt the internal audit function, and this offers answers to the questions which usually the manager of the company asks himself about how he or she and his collaborators could have a good and efficient control over the activities developed. For the positive results of the implementation of the internal audit function is necessary to be an independent function, without pressures or other influences which could stop the achieving the settled objectives. We will try to find in what measure the outsourcing of the internal audit function could determine the increasing of the quality of the internal audit, underling the advantages and disadvantages which could be generated, trying to issue few relevant conclusions.*

*Key words: internal audit, outsourcing,, independence, internal auditors*

In present, we are confronted with a very quickly evolution and spectacular of the internal audit function on the global plan and also in Romania, and this fact is due to the conscience more and more of the companies' management for the necessity and the importance of the internal audit in the company structure. In this way, even the managers of the small companies begin to be interested in advantages of the internal audit functions. In spite of the advantages of the internal audit, the managers ask themselves:

- *Which would be the effort (cost) supposed by the settling of this function of internal audit?*
- *Are justified these costs relative to the benefits obtained after the implementation of the internal audit function in the company?*

The settling of the internal audit function in the company supposes, from an administrative point of view, to hire a internal audit team coordinated by a responsible person for leading the team, assuring the necessary conditions for working (place, equipments, etc.) and of course the salary for the hired person. On the other side, we have to consider few essential aspects in implementation of the internal audit function in order that the results to be the best. So, the internal audit function must be characterized by independence and to be free of every pressure or influence which could stop the achieving the settled objectives. The professional internal audit standards underline the double importance of the internal audit independence:

- The independence of the department inside the company, which determines the situation of the internal audit at a higher level, simple said it is subordinated only to the top management
- The independence of the internal auditor will assure the objective character of the activities and the results of the internal audit.

The independence of the internal auditors is sustained for eliminating the practical very often founded, and that is the supraconcentrate activity of the internal auditor with different duties, which don't have to be in the area of activity of the internal auditor, like: defining of the procedures and methods of work, evaluating and supervising the employees of the company, administrative activities, effective financial control or different activities of inspecting. The result of the supraconcentrate activity for the internal auditor is the loosing the independence and the objectivity of the internal audit. It is obviously that the internal auditor can't evaluate objective a procedure defined by himself.

The efficiency and the rigorous work of the internal auditor are directly damaged if the independence and objectivity are affected, from this reasons are assessed few rules which must be respected:

- The internal auditor do not have any operational department subordinated;
- Possibility as internal auditor to have access at every moment to persons from every hierarchical level, at assets and information;
- The recommendations made by the internal auditor aren't compulsory for managers of the company.

Organizing the internal audit function and placing it in the direct subordination to the top management is not enough to assure the objectivity of this activity. For an objective activity, the internal auditor has to appreciate in a neutral mode, to be impartial and to be without preconceived ideas. It is obviously that the ideal in objectivity is very hard to achieved, existing all the time a marginal risk after the internal audit activity, named audit risk. The objectivity must be the scope what should be achieved and every internal auditor has to do all the efforts for touching this scope. The independence and the objectivity are some times contested by the internal auditors which are subordinated hierarchic. Trying to eliminate this kind of problems, there were developed new approaching for the internal audit function, on global plan and also for the national plan. This approaching was centered on the outsourcing totally or partially of the internal audit function.

So, was developed more ways of approaching<sup>387</sup>:

- Complete outsourcing of the internal audit function ,
- Partnerships with companies of audit with relevant experience in the internal audit (*co-sourcing*),
- Assuring the support for setting of the internal audit function (setup), and after this will be realized by a team hired inside the company.

If we look on the global plan of the internal audit activity we can see that this solution of outsourcing of the internal audit services has already some history and it is getting more and more space.

An example in this way is a study from 1999, made by two British specialists<sup>388</sup>, through this study they issued the assumption that the potential of outsourcing of the internal audit activity will growing in the next few years achieving 25% from the total of the internal audit services of the audit companies. Another study<sup>389</sup> recent made in 2006 with subjects 99 companies listed on the Australian Stock Exchange underline that at least 45.5% of the companies surveyed has outsourced totally or partially the internal audit function. These companies associate the outsourcing of the internal audit with a decreasing the costs, using a better consultant, with technical competence increased which characterize the external consultant.

Another study regarding the trends in the internal audit<sup>390</sup>, realized by the one of the big audit company from Big Four group (Ernest&Young Romania), underlines few interesting conclusions.

So, they conclude that 62% from the companies use the outsourcing in different forms, appreciating that the outsourcing of the internal audit is not a universal solution, but because of the recent economical collapses, a higher and higher number of Audit Committees claim independent revisions of the internal audit function or they use co-sourcing (using specialized resources for covering key risks for the function). The trend is to use external consultants for assuring the support or for the adviser. Also, there are used advisors for punctual needs, where the experience of the internal employee is not enough (partnership and co-sourcing). Transfer of knowledge to the internal auditor's team of the company is one of the reasons of this approaching.

The same study analyzing the possible reasons which are the base for the outsourcing of the internal audit function, and the conclusion of the study is principal causes:

- It is assured the immediately access to the best practices;
- It is significant improved the cost efficiency;
- It is increased the assurance level of the risks with the same expenses or with less expenses;

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<sup>1</sup> Deloitte&Touche, (2006), *The value of internal audit is undeniable*, July, available on-line at [www.deloitte.com](http://www.deloitte.com)

<sup>388</sup> Rittenberg, L.E. & Covaleski M., (1999), *Outsourcing the Internal Audit Function: The British Government Experience with Market Testing*, International Journal of Auditing, Volume 3 Issue 3 Page 225-235, November

<sup>389</sup> Carey, P., Subramaniam, N., Ching, C.W., (2006), *Internal audit outsourcing in Australia*, Accounting & Finance Journal Volume 46 Issue 1 Page 11-30, March

<sup>390</sup> Horlaci C. (2003), *The outsourcing of internal audit function*, november, available on-line at [www.ey.com](http://www.ey.com)

- It is assured the unlimited access to specialists in this domain;
- It is assured the access to the investment in the methodology, human resources and technology.

The expectations of the manager (which is client in this situation) regarding this outsourcing of the internal audit function is represented by:

- The growing of the internal audit contribution to touching the strategically objectives of the company;
- The external consultant has relevant experience in the internal audit activity;
- Specialized resources, adequate to the existent needs;
- Flexible approaching, client orientated;
- Instruments and techniques for performing work;
- The bigger benefits regarding fewer costs.

In the next lines, we will synthesize in a table the principals advantages and disadvantages which are implied by the outsourcing of the internal audit, because is absolutely necessary in taking the decision of the total or partial outsourcing of this function, to know the positive and negative aspects which appears when is adopted such a solution:

<b>The outsourcing of the internal audit (outsourcing)</b>	
<b>The advantages of the outsourcing</b>	<b>The disadvantages outsourcing</b>
<ul style="list-style-type: none"> <li>• From the point of view of the specialization, using the outsourcing can facilitate creation of the team with very good skills in the audited domain, having in this way assured the access to the best practices in the domain at a high competence;</li> <li>• The level of the objectivity can be higher comparative with the objectivity of the internal auditors hired by the company, because they (external consultants) didn't interact on the long term with the employees of the company;</li> <li>• Depending by the notorieties and the specialty of the contracted audit team, the audit team could have a significant support from the management of the company;</li> <li>• Eliminating the costs generated by the recruiting the internal auditors and the training needed for the audit team;</li> <li>• Eliminating the costs supposed by the investment in the methodology and technology;</li> <li>• Concerning of the management for the base processes;</li> <li>• A higher flexibility in allocating resources.</li> </ul>	<ul style="list-style-type: none"> <li>• The external consultant didn't know as an internal auditor the environment and the culture of the company as well as an internal auditor hired knows, and this can make harder the access to a series of relevant information, because the internal audit hired know where and what to search; (in combating these disadvantages some specialists like Blackmore J.<sup>391</sup> appreciates that in spite of the large experience of the hired internal auditor regarding the specificity of the company's activity, the external auditors can compensate or even to exceed by the relevant experience of the internal auditors from the specialized audit companies).</li> <li>• The internal auditor hired by the audit company (external consultant), being out of the company, can be accepted with some reticence by the audited departments, being in this way harder to develop collaborating relations which could be helpful in the investigations, being generated sometime cultural or organizational conflicts;</li> <li>• The availability of the outsourced internal auditor is not all the time, and every moment.</li> </ul>

**Table no.1 „The advantages and the disadvantages of the outsourcing of the internal audit”**

Analyzing the advantages and disadvantages that could be generated by the outsourcing of the internal audit function, we try to lay down few conclusions:

- The outsourcing of the internal audit is a solution which has no absolutely guarantee in every situation, for a higher efficiency than the internal auditor hired;

<sup>391</sup> Ernest&Young, (2005), *The merits of outsourcing your internal audit function*, December, available on-line at [www.ey.com](http://www.ey.com)

- We consider that the advantages for this solution is bigger in the case of small and medium companies, rather than the bigger companies regarding the relation expenses (costs)-benefits;
- In the process of choosing this option we must consider few essential factors like: external and internal environment where the company activates, the dimension of the company, domain of activity, the management experience.

### **References:**

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