OUTSOURCING OR CO-SOURCING OF
OF
INTERNAL AUDIT FUNCTION

The Institute of Internal Auditors Malaysia

MALAYSIAN INSTITUTE OF ACCOUNTANTS

Disclaimer Statement

This publication contains general information only and MIA shall not, by means of this publication be construed as rendering any professional advice in relation to any matter contained in this publication. This document shall not be used as a basis for any decision or action that may or may not affect your business. Before making any decision or taking any action that may or may not affect your business, you are advised to consult an independent professional advisor.

Whilst every reasonable care has been taken in preparing/compiling this document, MIA makes no representations or warranties of whatsoever nature (either expressly or impliedly) in respect of this publication including but not limited to the accuracy, suitability, reliability or completeness of the information contained in this publication.

Please take notice that under no circumstances will MIA, its Council members, directors and employees be liable to any person or business entity for any direct or indirect losses, costs or damages howsoever arising including due to the use of and reliance of any information contained in this publication.

INTRODUCTION

The Institute of Internal Auditors Malaysia (IIA Malaysia) and Malaysian Institute of Accountants (MIA) conducted a preliminary study on **Outsourcing or Co-sourcing of Internal Audit (IA) Function**. This study was conducted among the Malaysian companies where most of the respondents were members of IIA Malaysia and MIA. As required by the Listing Requirement of Bursa Malaysia Securities Berhad, many companies have established IA functions either as an in-house, outsourced or co-sourced function. This survey focuses on outsourced or co-sourced IA functions. There was a total of 114 respondents that completed the survey used for this study. The respondents were from non-public listed companies, the Main Market and Ace Market.

BACKGROUND OF THE STUDY

The business environment is becoming more challenging with technological advancements and more sophisticated tools to support the expansion and growth of the businesses. The expansions and growth are also challenged by key business issues that include risk, talent, innovation and sustainability. It is very crucial to have the internal auditors to assess and evaluate the effectiveness of the operational activities of the organisation especially in the areas of Governance, Risk management and Controls (GRC).

Setting up an effective IA Function is also one of the challenges faced by the Board Audit Committee (BAC). However, we expect that most in-house IA functions in Malaysia are matured especially with the guidance of IIA Malaysia and its *standards (IPPF - International Standards for the Professional Practice of Internal Auditing)*. Therefore, this survey only focused on outsourcing or co-sourcing of IA functions. The survey was conducted to determine the importance and impact of outsourcing or co-sourcing of IA functions within organizations. The survey was also expected to provide insights on the reasons why organisations choose to opt for outsourcing or co-sourcing of the IA function.

Outsourcing of IA Function

Outsourcing: A partnership between a client and an outside vendor, both sharing a common vision to effectively, efficiently and accurately accomplish an agreed-upon process for the benefits of both parties in a way of doing business effectively. Where the IA function is outsourced, there will be an independent internal audit service provider who will conduct the internal audit services.

Co-sourcing of IA Function

Co-sourcing: A combining of services from within and outside a business to achieve the same goal. This means a business arrangement in which work is performed by both internal staff and the external service provider. Where an organization lacks some expertise in certain areas, i.e.,

IT Audit, Risk Management and Special Review, they tend to engage or co-source those areas with an external service provider.

FINDINGS

- ***Annual budget of IA function*** - 35% of the respondents indicated that their annual budget of the IA function is less than RM50K, while 21% reported a budget of RM101K – RM499K and 20% with a budget of RM50K – RM100K. On average, the annual budget of IA function is less than RM500K.

- ***Number of IA Staff***- Most of the respondents fall into the category of 0-10, number of IA staff. The result indicates that the IA team of outsourced or co-sourced IA function is relatively small (less than 10). For organisations who co-sourced their IA function, there may not be enough resources in the IA team, whereas for outsourced IA function, it may be sufficient enough as it is fully outsourced to the external service providers to perform the audits.

- ***Specialty Areas of Co-sourced IA functions***- Risk Management is the top ranking (34%) of the specialty areas, followed by the IT Audit (27%), Governance Reviews (24%) and Special Reviews (15%). This may reflect that the in-house IA function's existing resources are either not sufficient enough to support these areas or lack the required skills to perform audits in these areas.

- ***Reasons for Outsourcing or Co-sourcing the IA function*** - The main reasons identified by the respondents in this survey for outsourcing or co-sourcing the IA functions are as follows:
  - ➢ The need for specialised technical expertise
  - ➢ Cost efficiency
  - ➢ To improve the quality of the audit
  - ➢ Difficulty in recruiting competent staff

These reasons indicate that the specific skill sets required for specialty areas is deemed to be one of the crucial reason for the IA function to be outsourced or co-sourced. Furthermore, the growing role of IA encompassing Governance, Risk Management and Controls (GRC), require qualified staff in those areas to conduct the audits.

- ***Criteria used to evaluate potential outsourced or co-sourced service provider***
  The survey respondents have identified four criteria used to assess the external service providers which are as follows:
  - ➢ The firm's experience in providing the kind of IA services required;
  - ➢ The reputation of the firm;
  - ➢ An evaluation of the audit team's knowledge; and
  - ➢ The costs involved and whether they are likely to escalate if dependency is increased

- ***Requirements and Deliverables in the contract*** - A written agreement or contract is very essential for outsourcing or co-sourcing of IA functions. In this survey, the top four requirements and deliverables identified are as follow:
  - ➢ Key deliverables
  - ➢ Assignment of responsibility on the audit plan
  - ➢ Expected timelines for audits
  - ➢ Agreement on the structure and process of outsourcing

- ***The Board/ Management's three primary expectations of IA function -*** There were more than 10 options given to the respondents to identify three primary expectations of the Board or Management of their IA function. Listed below are the top four of primary expectations selected by the respondents:
  - ➢ Assessment and reporting of internal control deficiencies;
  - ➢ Process/ Control improvement recommendations;
  - ➢ Identification of irregularities or non-compliance; and
  - ➢ Assessment and reporting of key business risks

CONCLUSION

It is recognised that many co-sourcing or outsourcing arrangements with external service providers have been effective in helping organisations obtain internal audit services that contribute to management's controls objectives. However, there must be safeguards by the Board to ensure that the internal audit function is performed efficiently and effectively in conformance to the International Professional Practices Framework (Standards).

Standard 2070 – ***External Service Provider and Organisational Responsibility for Internal Auditing*** states, "*When an external service provider serves as the internal audit activity, the provider must make the organisation aware that the organisation has the responsibility for maintaining an effective internal audit activi*ty". The Standard further explains that "*this responsibility is demonstrated through the quality assurance and improvement programme which assesses conformance with the Definition of Internal Auditing, the Code of Ethics and the Standards*".