



InsideNGO

Operational Excellence for Global Impact

Internal Audit: In-sourced, co-sourced or outsourced?

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Internal Audit Organizational Structure

Purpose of presentation: To illustrate some common internal audit models and describe pros and cons of each.

- Organizations utilize many models to conduct the internal audit function.
- Factors include organizational size, geographic dispersion, board and management structure/ preference and organizational maturity.

Takeaway: No one type is right for all!

Role of Internal Audit

- Varies by organization but typically includes:
 - Assessment of completeness, accuracy and validity of financial information;
 - Evaluation of key risks and adequacy of internal controls;
 - Compliance with laws and regulations including those of USAID, other government and non-government funders;
 - Compliance with the organization's policies and procedures;
 - Opportunities to identify and implement cost-savings and other efficiencies;
 - Relationship with the external auditors

Models for Internal Audit* Functions

1. In-sourced and centralized
2. In-sourced with field support
3. Co-sourced with a third party
4. Out-sourced
5. Local compliance function with dotted line to internal audit
6. Independent, local staffing within a country or region
7. Some combination of the above

* - Internal audit also referred to as I/A

1. In-sourced and Centralized

- For **large organizations** (corporations, multinationals)
- Somewhat similar to a multi-level, mid-sized CPA firm
- Can include its own I/A HR/ training function
- Advantages: Ability to employ cross-functional resources; high degree of staffing flexibility
- Disadvantage: **NOT** appropriate for most NGOs due to high costs

2. In-sourced in HQ with Regional Field Support

- HQ function supplemented with regional auditors
- Common for larger organizations requiring a significant overseas presence
 - FHI considering adding Nairobi-based internal auditor
- Advantages: Lower trans-oceanic travel costs, quick response time, no time zone issue, local language/ knowledge capability.
- Disadvantages: distance from HQ may provide quality assurance, independence challenges.

3. Co-sourced with a third party

- Somewhat flexible arrangement that combines internal & external audit resources
- Current FHI arrangement
- Advantage: some audit committee welcome “independent” audit involvement as quality control measure
- Disadvantages: Less in-house capacity building and possible communication issues

4. Outsourced

- Typically, one (or no) internal audit employee; majority is external resource, often focused more on financial than operational control
- Direct oversight of external auditors (if a dedicated in-house person); if not, direct reporting to senior management or BOD
- Advantages: direct oversight (if in-house internal audit director); “benchmarking/ best practices experience” obtained from multiple clients
- Disadvantages: Usually not full-time (limited time on client premises)

5. Local Employee with Internal Audit “Dotted Line”

- Permanent or long-term locally employed auditor within a country
- Appropriate for countries with extensive programs (e.g. FHI Nigeria)
- Advantages: permits broad knowledge of personnel, systems, customs and language; “close to the action”; lower personnel and travel costs;
- Disadvantages: possible independence issues with local management; supply of qualified personnel or multi-country expertise possibly limited; opportunities for in-country advancement may be restricted.

6. Independent, Local Employee

- Locally employed auditor within a country
- Used when compliance challenges known or anticipated
- Advantages: (similar to #5): permits extensive knowledge of personnel, systems, customs and language; and lower personnel/ travel costs
- Disadvantages: Reports locally instead of to independent audit function, reducing HQ control and subject to country office budgetary constraints; quality of personnel, consistency/ standardization of training/ quality control issue

Summary

Type	Pro	Con
1. In-sourced/ Centralized	Flexible resources such as staffing & training; excellent advancement opportunities	Usually <u>not feasible</u> for many <u>resource constrained NGOs</u>
2. In-sourced w/ field support	Lower <u>travel cost</u> , <u>quick response</u> time, no time zone issue, <u>local</u> language & knowledge <u>capability</u>	<u>Quality assurance</u> , possible <u>independence</u> challenges with 'cozy' field relationship
3. Co-sourced with third party	Some audit committee welcome " <u>independent</u> " audit involvement	<u>Less in-house capacity building</u> and possible <u>communication</u> issues
4. Out-sourced	Direct oversight (if internal audit director); " <u>best practices</u> " experience from multiple client exposure	Usually not full-time; <u>limited visibility</u> ; liaison/ communications with sr. management/BOD, <u>responsiveness & accountability</u> more difficult
5. Local with I/A "dotted line"	<u>Extensive knowledge</u> of personnel, systems, customs & language; lower personnel and travel costs;	Possible local management <u>independence</u> issues; <u>limited multi-country expertise</u> ; opportunities for <u>in-country advancement</u> may be restricted;
6. Independent, local staffing	Similar to #5, above.	<u>Limited HQ control</u> ; inconsistency in <u>personnel quality, uniform training & quality control</u>

Case Study

Project Concern International (PCI)
and
Gelman Rosenberg and Freedman

Background - Project Concern International

- \$30 million annual revenues
- 16 countries
- No internal audit department
- Internal audits started 6 years ago
 - Focus on improving local controls, local capacity
- In 2010, Board interested in reducing annual external audit fee
 - Internal audit focus now on meeting testing needs of annual external auditor

Traits	Co-Sourcing	Outsourcing
Goal	Improve local controls, local capacity	Reduce audit fee: perform substantive testing
Reporting	Disclose both material and immaterial items to management	Disclose violations of audit objectives to external auditors and management
Staffing	1 from Gelman, 1 from PCI	Two from Gelman
Independence	Gelman hired by PCI; supervises PCI employee	Gelman hired by PCI but taking instructions from external audit firm
HQ Staff Involvement	Extensive	Minimal
Impact on HQ/Field Relationship	Personal contact, ongoing dialogue on issues revealed	Minimal

Project Concern Int'l Risk Matrix

	Responsibility to evaluate	Country 1	Country 2	Country 3	Country 4	Country 5
Factors of Risk--Acceptable Risk (program driven)						
Program Size (MTDC): Large (over \$2m) 1, medium (\$1-2m) 3, small (under \$1m) 5		1	1	3	1	5
Recent program growth: High 1, medium 3, low 5		5	1	3	5	5
Federal funds: High % 1, medium % 3, low % 5		1	1	1	1	1
High levels of Cash in Bank: High Cash 1 (\$500k), medium (\$500-\$200k), low 5 (under \$200k)		5	5	3	5	5
United Nations funds inc. WFP: High % 1, medium % 3, low % 5		5	5	5	5	5
Microcredit programs: Yes and large 1, yes and small 3, no 5		5	5	5	5	5
Asset fungibility (lots of cash transactions): High 1, medium 3, low 5		3	3	5	3	5
Cost-reimbursement programs, Over \$500k 1, under \$500k but over \$100k 3, under \$100k or none 5		3	5	5	3	5
Large in-kind match requirement: high 1, medium to small 3, none 5		1	1	5	1	5
Downsizing: Definite and known 1, likely 3, unlikely 5		3	5	5	3	5
Does this country have Disaster Relief Funding? Over \$100K =1, None=5		5	5	5	5	5
Does this country have a high level of civil unrest or terrorist activity? Substantial 1, sporadic 3, no 5		5	5	5	3	3
Is there interaction with govt officials in decision-making roles and therefore risk of /Foreign Corrupt Practices Act violations? Yes and large 1, yes and small 3, no 5		3	5	5	3	5
Position on 2009 Corruption Perceptions Index: Use actual score.		3.3	3.3	5.6	2.7	3.4

	Responsibility to evaluate	Country 1	Country 2	Country 3	Country 4	Country 5
Factors of Risk--Unacceptable Risk (performance driven)						
Late processing: High 1, medium 3, low 5		3	1	3	5	5
Variance from MDRT: Material or frequent 1, immaterial or isolated 3, rarely 5		1	3	3	5	5
Grant overruns: Material or frequent 1, immaterial or isolated 3, rarely 5		5	5	5	5	5
Difficult balance sheet reconciliations: Material or frequent 1, immaterial or isolated 3, rarely 5		3	1	5	5	5
Large advance account balances: high 1 (\$20k, medium 3 (\$20-\$10k), low 5 (under \$10k)		1	5	5	5	5
Large advance account flow through: high 1 (\$300k), medium (\$300-\$100k), low 5 (under \$100k)		1	5	3	3	5
Advances are not being cleared on a timely basis: High 1, low 5		3	1	3	5	5
Does country use SAM, if applicable: No 1, partially 3, Yes 5	IO OPS	5	5	5	5	1
ACCPAC primary system: No 1, Yes 5		5	5	5	5	5
OPS risk assessment: High 1, medium 3, low 5	IO OPS	2	3	4	4	5
Appropriate response to change and improvement	IO OPS	2	3	3	3	3
Recent turnover in key management: Yes 1, no 5		5	5	5	5	5
High level of non-management turnover: Yes 1, no 5	IO OPS	1	1	5	5	5
Employee Satisfaction Survey Results, High 5, low 1	IO HR			PENDING		PENDING
Last 2 yrs mishandling of program income: Large 1, medium to small 3, none 5		5	5	5	5	5
Last 2 yrs audit findings: Material 1, immaterial 3, none 5		1	5	5	5	5
Last 2 yrs fraud: Collusion or repeated 1, individual or isolated 3, none 5		1	5	5	5	5
Last 2 yrs legal or tax problems: Yes and at least \$10k 1, yes and under \$10k 3, no 5		1	5	5	5	5

	Responsibility to evaluate	Country 1	Country 2	Country 3	Country 4	Country 5
Factors of Confidence						
Finance staff depth: High 5, medium 3, low 1		3	1	5	5	5
Financial depth of CD: High 5, medium 3, low 1		3	2	4	3	5
Collaboration between CD and CFD: Good 5, OK 3, poor 1		1	2	5	5	5
Collaboration between Finance and Programs: Good 5, OK 3, poor 1	CFO, COO	3	1	5	5	3
Internal control knowledge based upon annual IC evaluation		PENDING			PENDING	
Local statutory audit performed annually: Yes, 5, no 1		1	1	1	5	1
Monthly support packages quality: High 5, medium 3, low 1		3	1	5	5	5
Score						
Total Score		107.3	121.3	159.6	153.7	165.4
Maximum Score Possible (36 X 5)+7.5		187.5	187.5	187.5	187.5	187.5
Percentage Achieved		57%	65%	85%	82%	88%
Risk Count						
Low Risk Country	>85%			Yes		Yes
Medium Risk Country Needing attention to High Risk Areas	65%-85%				Yes	
High Risk Country Requires Audit or Field Visit	<65%	Yes	Yes			
Prior Quarter Score						
Total Score		92.8	114.8	129.8	117.6	138.1
Maximum Score Possible (27 X 5)+7.5		152.3	152.3	152.3	152.3	152.3
Percentage Achieved		61%	75%	85%	77%	91%
Risk Count						
Low Risk Country	>85%			Yes		Yes
Medium Risk Country Needing attention to High Risk Areas	65%-85%		Yes		Yes	
High Risk Country Requires Audit or Field Visit	<65%	Yes				

Questions?