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

Presented by
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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.

- Some 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 of
    - USAID, other government/non-government funders;
    - Host jurisdictions; and
    - The NGO or other organizational requirements
  - 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 (somewhat decentralized)

3. Co-sourced or responsibility shared with a third party

4. Out-sourced – largely independent of in-house internal audit

5. Local in-country compliance function
   - Connected to internal audit or
   - Independent, reporting to an in-country COP or region

6. Some combination of the above

* - Internal audit also referred to as I/A in this presentation
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 Field Support

- HQ function supplemented with regional auditors

- Common for larger organizations requiring a significant overseas presence
  - Example: FHI Kenya

Advantages:
- Lower trans-oceanic travel costs;
- Quick response time;
- Minimal time zone communications issue;
- Local language/ custom knowledge.

Disadvantages:
- Possible independence challenges;
- Distance from HQ I/A may impact quality assurance.
3. Co-sourced with a Third Party(ies)

- Somewhat flexible arrangement combining internal & external audit resources

- Examples:
  - Project Concern International (“PCI”) / Gelman, Rosenberg & Freedman
  - FHI/ Ernst & Young

- Advantage:
  - Some BODs/ audit committee welcome “independent” audit involvement as quality assurance measure

- Disadvantages:
  - Less in-house capacity building
  - Possible “chain-of command” communication issues
4. Outsourced

- Typically, one (or no) internal audit employee
  - Staff is external resource

- Differing models for oversight of external auditors
  - A dedicated in-house NGO audit director
  - If not, direct reporting to senior management or BOD

- Advantages:
  - If liaison is an in-house CAE* = direct I/A oversight
  - Otherwise “benchmarking/ best practices” data from multiple clients

- Disadvantages:
  - Usually not full-time (limited visibility as a deterrent)
  - Due to cost often focused on financial more than operational control

* - CAE – chief audit executive
5. Local Report to Internal Audit or CO

- **Locally employed auditor within a CO**
  - Can be “solid line” or “dotted-line” to internal audit

- Appropriate where extensive programs/compliance challenges exist
  - Example: Nigeria

- **Advantages:**
  - Broad knowledge of personnel, systems, customs & language; “close to the action”;
  - Lower personnel and travel costs.

- **Disadvantages:**
  - Possible independence issues (including budgetary)
  - May limit supply of qualified personnel or multi-country expertise
  - Standardization across organization can be difficult
  - Opportunities for in-country advancement may be restricted.
<table>
<thead>
<tr>
<th>Type</th>
<th>Pro</th>
<th>Con</th>
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<tbody>
<tr>
<td>1. In-sourced/ Centralized</td>
<td><strong>Flexible</strong> staffing &amp; training; Advancement opportunities.</td>
<td>Usually not feasible for many resource constrained NGOs.</td>
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<tr>
<td>2. In-sourced w/ Field Support</td>
<td>Lower travel cost; quick response; No time zone communication issue; Local language/ knowledge capability.</td>
<td>Possible independence challenges with “cozy” field relationship; Distance from HQ complicates QA.</td>
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<td>3. Co-sourced w/ Third Party</td>
<td>Some audit committees welcome “independent” auditor involvement.</td>
<td>Less in-house capacity building; Possible communication issues.</td>
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<td>4. Outsourced</td>
<td>Direct in-house liaison oversight (if internal audit director); “Best practices” experience obtained from multiple clients.</td>
<td>Usually not full-time with financial focus; Limited visibility; Communications with management/BOD; Responsiveness/ accountability might be more difficult.</td>
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<td>5. Local w/ Reporting to I/A or CO/Region</td>
<td>Extensive knowledge of personnel, systems, customs &amp; language; Lower costs.</td>
<td>Local management independence issues; Limited multi-country expertise; Reduction in HQ control &amp; uniformity; In-country advancement may be restricted.</td>
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**Summary**
Group Exercise
### Group Exercise

**Varying Organizational Scenarios**

<table>
<thead>
<tr>
<th>Org.</th>
<th>Revenue (millions)</th>
<th>Revenue Trend</th>
<th>No. COs</th>
<th>HQ/ Field Employees</th>
<th>Int. Audit Size</th>
<th>Global P&amp;P Uniformity</th>
<th>Other Info.</th>
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<tbody>
<tr>
<td>#1</td>
<td>$15</td>
<td>Flat</td>
<td>8</td>
<td>25/ 300</td>
<td>None</td>
<td>Almost None</td>
<td>No regulatory issues; “desk reviews” done</td>
</tr>
<tr>
<td>#2</td>
<td>$45</td>
<td>Slight Growth (+1.5%)</td>
<td>12</td>
<td>75/ 700</td>
<td>3</td>
<td>Fair and improving</td>
<td>Signif. foreign lang challenge</td>
</tr>
<tr>
<td>#3</td>
<td>$75</td>
<td>Rapid Growth (+6%)</td>
<td>11</td>
<td>185/ 900</td>
<td>5 FTEs outsourced</td>
<td>Varies by region from weak to acceptable</td>
<td>New COO; no in-house Gen. Counsel</td>
</tr>
<tr>
<td>#4</td>
<td>$160</td>
<td>Declining (-2%)</td>
<td>42</td>
<td>475/ 1,400</td>
<td>10</td>
<td>Strong; uses COSO model</td>
<td>Few int. or ext. audit findings 2008-2010</td>
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Questions?