

Engaging Third Parties for Internal Audit Activities

MANAGEMENT



Fast Fact

Strategies for Successful Relationships



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Executive Summary

One of the biggest challenges chief audit executives (CAEs) face is having enough staff to meet demands and obtaining the right skills to complete their audit plans. To meet this challenge, many CAEs engage third parties for some of their internal audit activity. This report will help internal audit practitioners, managers, and audit committees to more effectively manage these relationships.

You will learn:

- The kinds of organizations that use third parties for internal audit activity
- The future expectations for third-party use
- The services third parties generally provide
- Best ways to engage, supervise, and maintain third-party relationships

Lessons learned were obtained from a variety of CAEs, service providers, and audit committee members worldwide. In addition, the report describes differences between global regions and industries, using results from the CBOK 2015 Global Internal Audit Practitioner Survey, the largest ongoing study of internal audit professionals in the world.

Section 1: Who Uses Third Parties for Internal Audit Activity?

As business partners in their organizations, CAEs must ensure that their internal audit departments have the capacity and skills to fulfill their roles. Many CAEs use third-party services to meet their long-term or short-term needs. To create a snapshot of current practice in this area,

the CBOK 2015 practitioner survey asked CAEs the following question:

In the previous calendar year, were some of your organization's internal audit activities provided by a third party (either internal or external to your organization)?

Findings for Global Regions

A global average of 38% of CAEs say they use third parties for internal audit activity, with North America having a notably higher rate than other regions (see **exhibit 1**). More than half of North American CAEs report using third parties, compared to a range of 27% to 43% for CAEs in other regions of the world.

Findings for Organization Types

Another important difference can be seen by looking at different organization types. Public sector and privately held organizations were less likely to use third parties for internal audit activity than the financial sector, publicly traded organizations, and not-for-profits (see **exhibit 2**).

(It should be noted that 47% of not-for-profit survey respondents were from North America.)

Internal Audit Budget Sufficiency

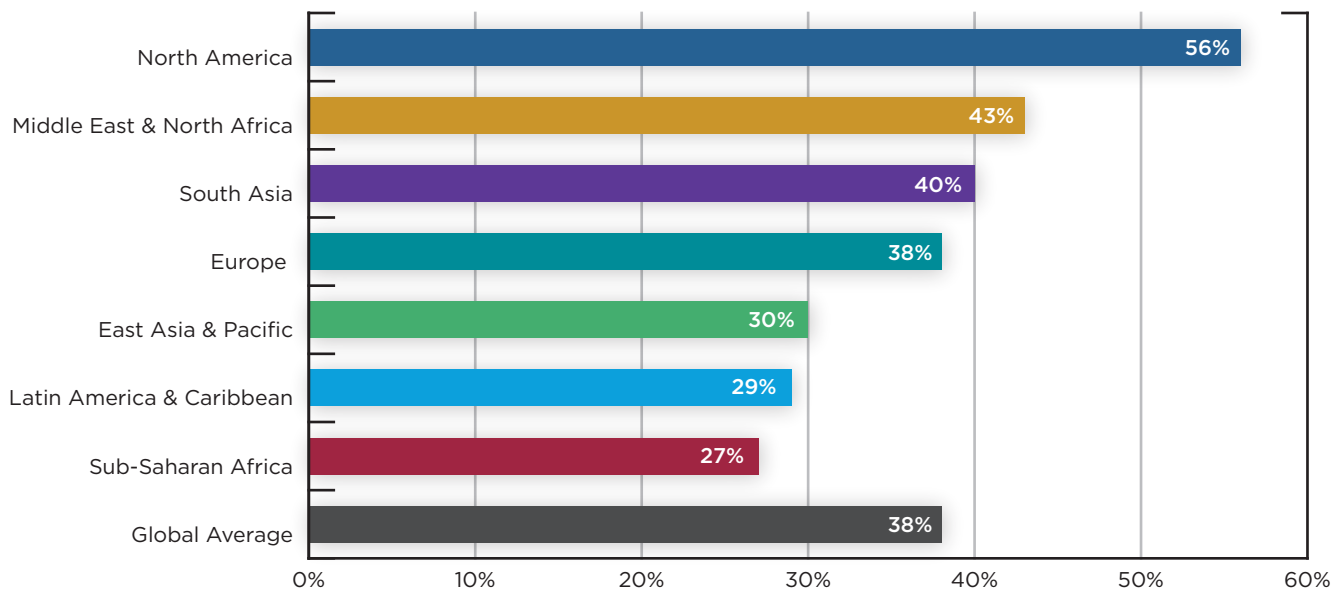
CAEs who perceive their budget to be “not at all sufficient” report substantially lower use of third parties (see **exhibit 3**). In other words, insufficient budgets are associated with lower use of third parties for internal audit activity.

Section 2: How Much Work Do Third Parties Perform?

We've examined how many organizations use third parties to support or enhance the internal audit activity. Now let's look at the extent to which these organizations rely on third parties. Survey respondents who indicated that they use third parties for internal audit activity were asked:

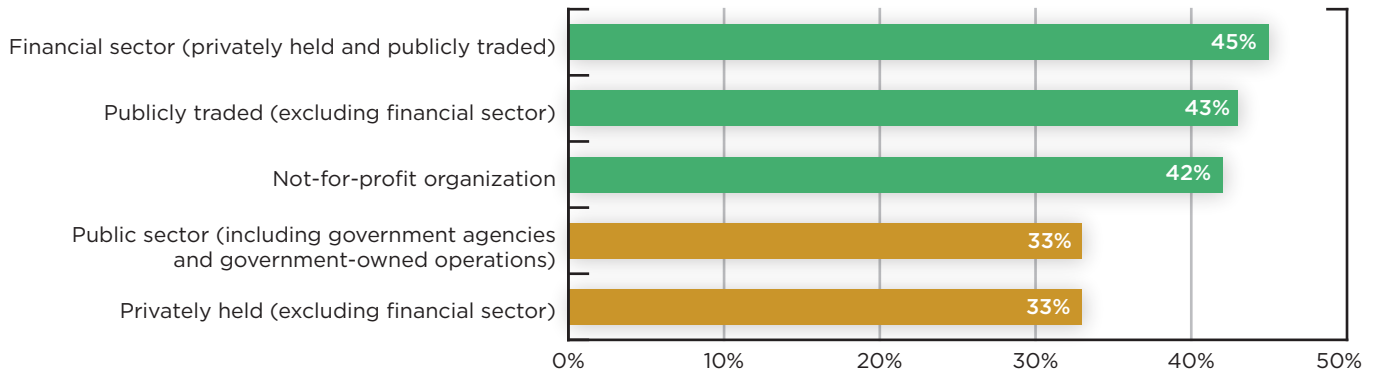
What percentage of your organization's internal audit activities were performed by a third party in the past calendar year?

Exhibit 1 Use of Third Parties for Internal Audit Activity



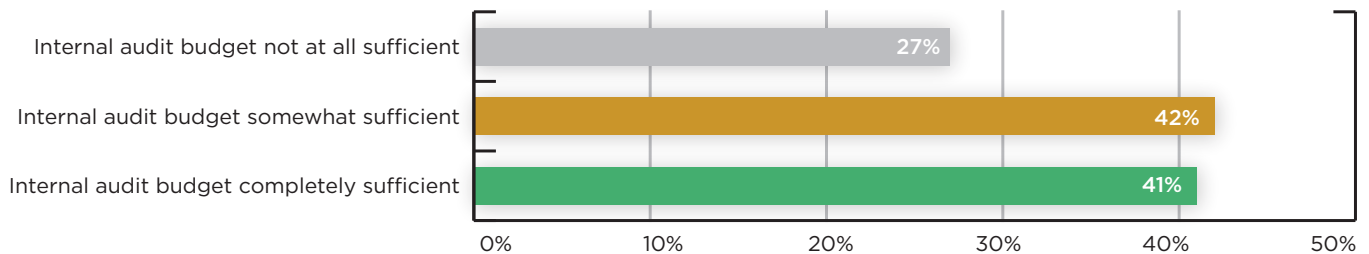
Note: Q31: In the previous calendar year, were some of your organization's internal audit activities provided by a third party (either internal or external to your organization)? CAEs only. $n = 3,125$.

Exhibit 2 Use of Third Parties for Internal Audit Activity (Compared to Organization Type)



Note: Q31: In the previous calendar year, were some of your organization's internal audit activities provided by a third party (either internal or external to your organization)? CAEs only. $n = 3,126$.

Exhibit 3 Use of Third Parties for Internal Audit Activity (Compared to Budget Sufficiency)



Note: Q31: In the previous calendar year, were some of your organization's internal audit activities provided by a third party (either internal or external to your organization)? Compared to Q28: In your opinion, how sufficient is the funding for your internal audit department relative to the extent of its audit responsibilities? CAEs only for both questions. $n = 3,046$.

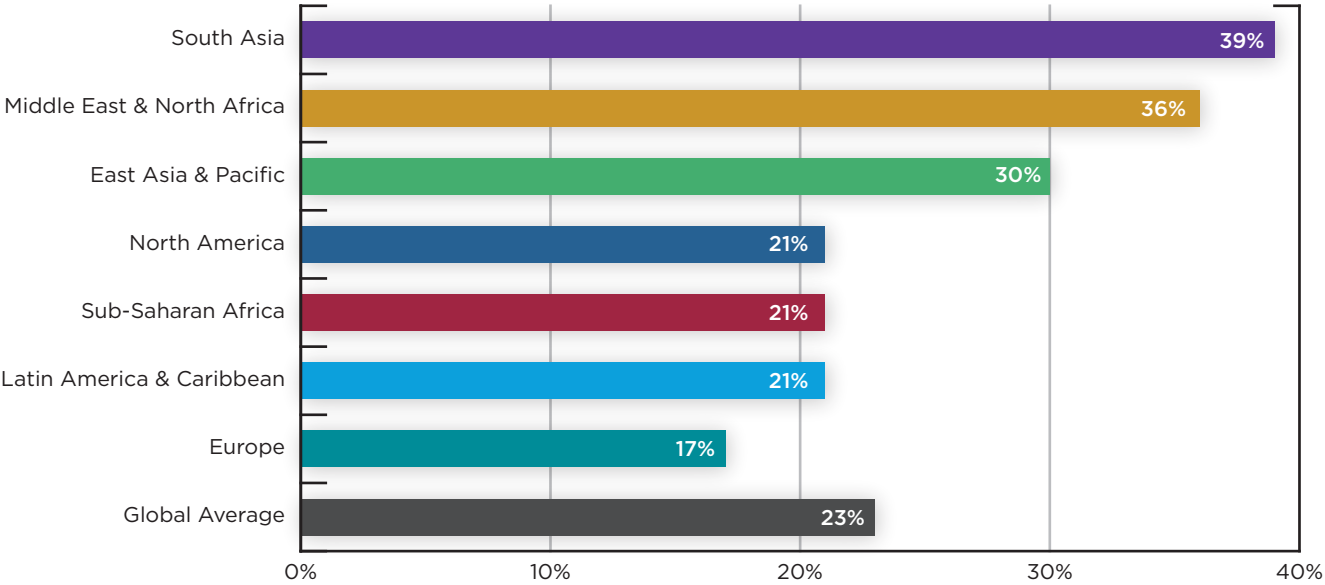
On average, these organizations use third parties for about 23% of their internal audit activity (see **exhibit 4**). The highest percentage of activity is in South Asia and Middle East & North Africa (both with more than 35%). The lowest is in Europe (17%). When responses are compared between different organization types, it can be seen that the financial sector is lower than the global average for amount of activity performed by the third parties (see **exhibit 5**).

Section 3: What Are Expectations for Future Use of Third Parties?

The CBOK 2015 practitioner survey also explored future use of third parties by asking CAEs:

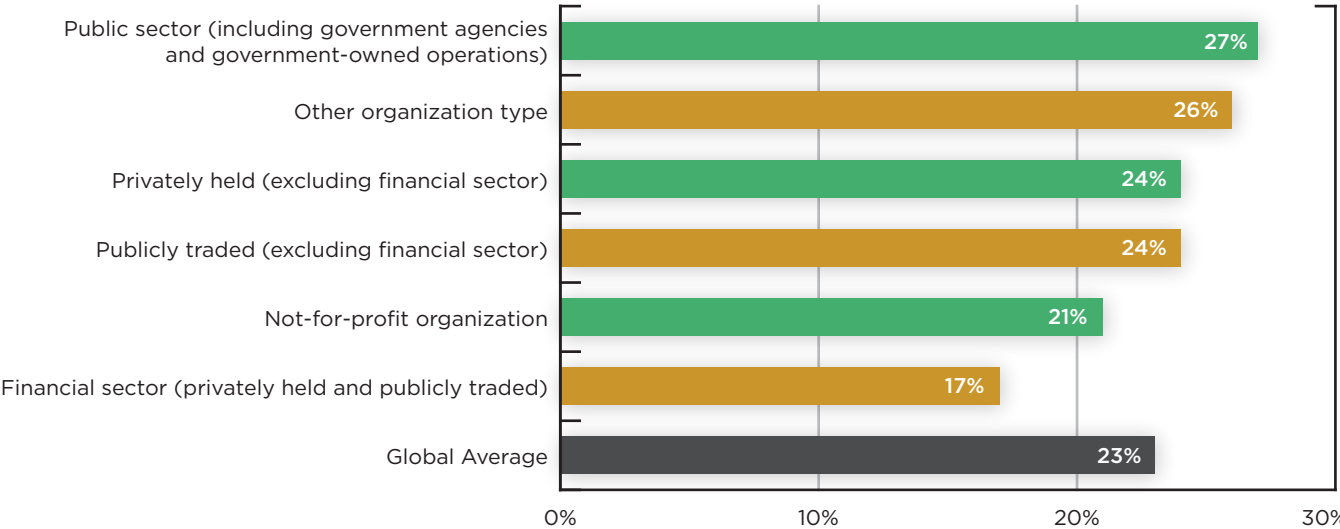
How do you anticipate that your budget for third-party internal audit resources (either internal or external to your organization) will change in the next year?

Exhibit 4 Average Percentage of Activity Performed by Third Parties (Among Those Who Use Third Parties)



Note: Q31a: What percentage of your organization’s internal audit activities were performed by a third party in the past calendar year? This question was only answered by respondents who indicated earlier that they use third-party services for internal audit activity. n = 1,122.

Exhibit 5 Average Percentage of Activity Performed by Third Parties (Among Those Who Use Third Parties) Compared to Organization Type



Note: Q31a: What percentage of your organization’s internal audit activities were performed by a third party in the past calendar year? This question was only answered by respondents who indicated earlier that they use third-party services for internal audit activity. n = 1,136.

Among survey respondents, the regions that are the most likely to expect an increase in their third-party budgets next year are South Asia and Middle East & North Africa (see **exhibit 6**). These regions also have the highest percentage of internal audit activities performed by third parties (compare **exhibit 4** to **exhibit 6**).

Exhibit 6 also shows that while Sub-Saharan Africa has a substantial percentage who expect an increase in their third-party budgets (42%), it also has the highest percentage who expect a decrease (20%). Finally, for the rest of the world, the majority of respondents expect their third-party budgets to stay the same.

Findings for Internal Audit Department Size

The size of an internal audit department has an interesting relationship to the use of third parties. **Exhibit 7** compares use of third parties in the current year to expected increase in third-party budget for next year. Among survey respondents, 32% of the smallest departments report using third parties, compared to a range of 41% to 56% for medium to large groups. Their future expected use of third parties

follows a similar path. However, in contrast, the largest internal audit departments report *very low* use of third parties currently (only 28%) but expect more use in the future (37%).

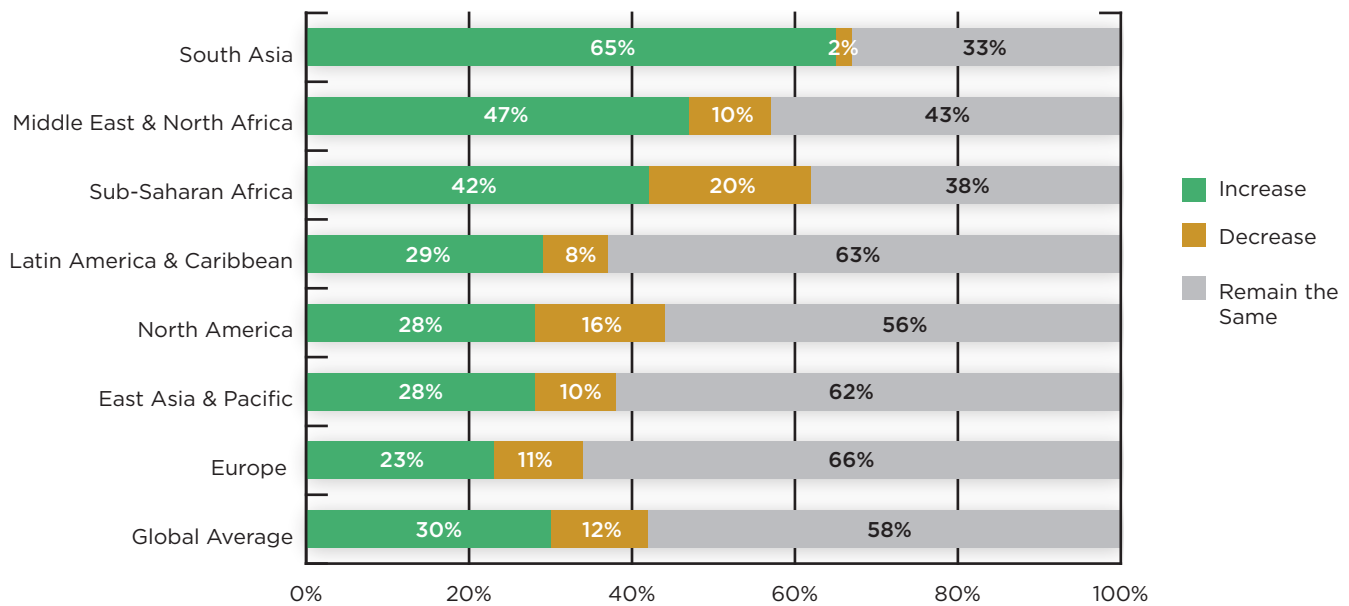
Section 4: What Types of Services Are Provided by Third Parties?

Third-party services are commonly used to:

- Provide specialty skills not available in the internal audit department
- Solve staff shortages
- Supplement staff on an ongoing basis
- Cover remote business locations
- Perform special projects

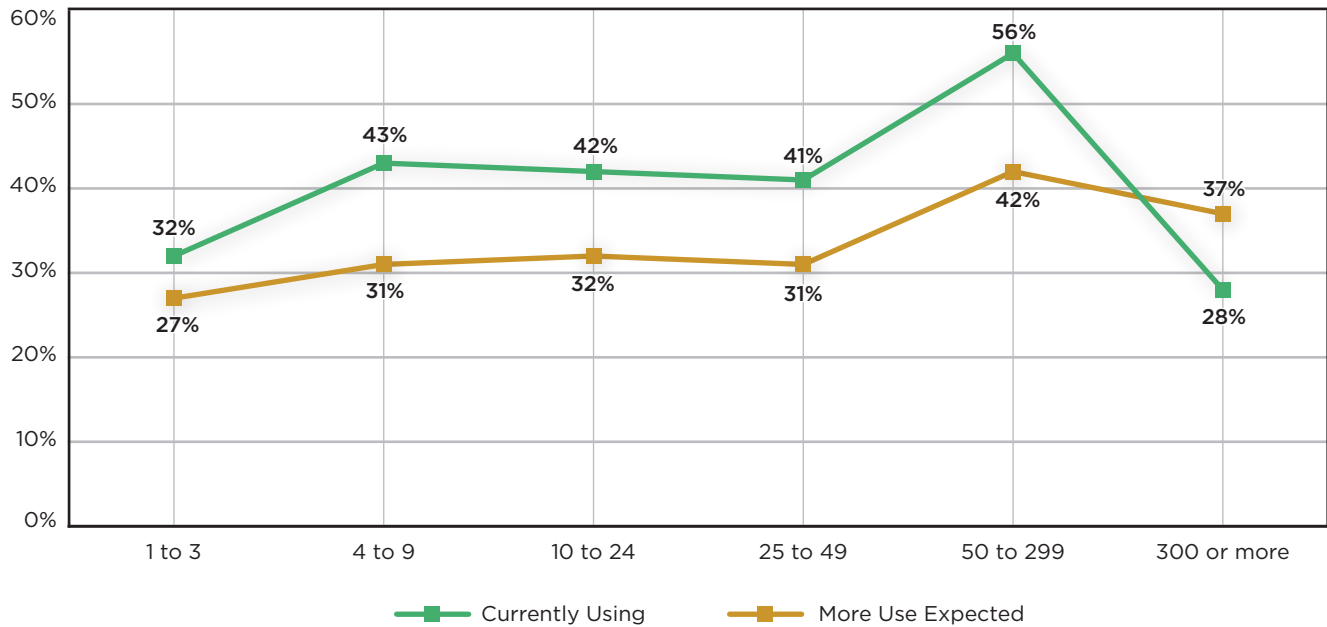
The type of usage differs according to the characteristics of the organization. To illustrate, let's compare third-party use between a Swiss financial services organization and a Middle East oil company:

Exhibit 6 Expected Change in Budget for Use of Third Parties by Internal Audit in the Next Year



Note: Q32: How do you anticipate that your budget for third-party internal audit resources (either internal or external to your organization) will change in the next year? CAEs only. n = 2,319.

Exhibit 7 Current Activity and Expected Increase in Third-Party Use by Internal Audit (Compared to Internal Audit Department Size)



Note: Q31: In the previous calendar year, were some of your organization’s internal audit activities provided by a third party (either internal or external to your organization)? CAEs only. Compared to Q32: How do you anticipate that your budget for third-party internal audit resources (either internal or external to your organization) will change in the next year? CAEs only. n = 3,052 for Q31. n = 2,289 for Q32.

Intertrust Group

Klaas Westerling, group head of internal audit and risk at Intertrust Group (Geneva, Switzerland) has one audit manager and one staff auditor. Because he has a small staff, he uses third parties for a large portion of his activity. Internal service providers assist with about 40% of the assurance and consulting engagements in the audit plan. (For example, employees from the finance department cover the finance areas within the scope of an audit.) He also engages external third parties approximately once each year to complete another 10% of the audit plan.

Emirates National Oil Company

Aley Raza, who is chief ethics and compliance officer and director of internal audits at Emirates National Oil Company (ENOC) (United Arab Emirates), has two managers and 16 staff members. Because he

has a larger staff. He does not need as much support from internal service providers; however, he needs third parties to provide language skills and other specialized oil and gas industry expertise. He uses Big Four audit firms or other service providers to complete approximately 10% of the audit plan.

A Note about Complete Outsourcing

In some cases, an organization may not be able to hire fulltime internal auditors in-house, so it will outsource all of its internal audit activity. In these cases, The IIA maintains that “oversight and responsibility for the internal audit activity cannot be outsourced.” In other words, an individual who is internal to the company should retain responsibility and oversight of the internal audit activity, even if all of the work is performed by a third party. (See The IIA Position Paper, The Role of Internal Auditing in Resourcing the Internal Audit Activity, January 2009.)

Section 5: What Are Best Practices for Relationships with Third Parties?

Ensuring successful management of third-party relationships is of utmost importance. While third parties may interface with management and/or the audit committee, the CAE is ultimately responsible for third-party effectiveness. Therefore, CAEs must 1) have a sufficient understanding of the objectives the service provider will fulfill, 2) communicate and sufficiently document these

objectives during the engagement process, and 3) provide adequate supervision to the service provider to ensure the objectives are met.

Exhibit 8 shows the most important questions that need to be answered when engaging in third-party relationships. This list is based on insights from interviews conducted with a variety of CAEs, third-party service providers, and audit committee members.

Exhibit 8 Key Questions to Ask About Third-Party Internal Audit Services

Pre-Engagement Considerations	
1.	What are your objectives for engaging the third party?
2.	What type of relationship with the third party will best meet your objectives?
3.	What are the financial constraints (e.g., budget) that could affect the scope of services provided by your third party?
4.	What level of expertise is needed to achieve your objectives?
Identifying the Service Provider and Signing the Engagement Letter	
5.	Have you conducted an effective and open proposal process?
6.	Are the objectives and performance metrics clearly outlined and agreed upon by all relevant parties?
Supervising the Service Provider Activity	
7.	What level of supervision is necessary to ensure effective and efficient work by the third party?
8.	How will you ensure the third party is meeting or has met your expectations (related to the metrics in the engagement letter)?
9.	Are there opportunities for knowledge transfer between the provider and internal audit staff?
Maintaining a (Current and Long-Term) Relationship with the Service Provider	
10.	Have you effectively communicated the engagement structure, objective, protocol, and rationale for use of the third party to: <ul style="list-style-type: none"> <input type="checkbox"/> Internal audit management and staff? <input type="checkbox"/> Service provider management? <input type="checkbox"/> Organizational management and executives? <input type="checkbox"/> The audit committee? <input type="checkbox"/> The board of directors?
11.	Is the third party aware of and able to meet your short-term and long-term needs?

More Lessons Learned

When it comes to engaging third parties for internal audit activity, experience is an effective teacher. Here are four recommendations from internal audit leaders who offer insight from their careers.

1. Proactively evaluate the need for third parties.

Stakeholders expect CAEs to continuously evaluate whether they need to engage third parties, says David Landsittel, former chair of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and corporate audit committee chair. “Audit committees value the business acumen and soft skills that CAEs possess. The CAE should be proactive in developing these skills within his or her team, addressing emerging business needs, and delivering value through the use of third parties in areas where skills do not currently exist.”

2. Set clear performance expectations in the third-party agreement.

You can greatly improve your relationship with third-party providers by establishing clear performance expectations, says Tania Stegemann, audit executive manager, CIMIC Group Ltd. (Melbourne, Australia). “In one of my previous roles as audit quality manager, we revised our approach to engaging third parties after a long-term relationship with a provider, to which we fully outsourced internal audit, no longer met our expectations. In the revised approach, we developed a strict protocol for how the work would be conducted, and key performance indicators focused on quality, timeliness, and value-added activities. We noticed significant improvement in our relationship with the subsequent provider and included these indicators in the new contractual agreement.”

3. Agree on responsibility for remediation and follow-up.

A particularly important aspect of the service provider agreement is a common understanding of which party is responsible for remediation and follow-up, says Dick Anderson, retired PricewaterhouseCoopers partner and former CAE for a global bank. “It is critical that both the CAE and the third-party service provider have an understanding of the remediation and follow-up process for issues noted in the third party’s report. Whether the client (e.g., CAE) or the third party is responsible should be agreed upon and included in the engagement letter to minimize conflicts between the client and the third party.”

CAEs should be prepared to reengage the third-party service provider for remediation and follow-up if needed, says Joe Bell, chief audit officer, Ohio School Employees Retirement System. “If the nature of the underlying task extends beyond the skills of existing audit staff and the relationship between the company and the third party is short-term, it may be necessary to reengage the service provider to conduct a post-implementation review.”

4. Take advantage of knowledge transfer.

Third-party service providers can be a welcome source of new ideas or knowledge, says Justin Pawlowski, audit manager, KPMG (Germany). “One important benefit of engaging a third party is potential knowledge transfer from the third party to the internal audit staff. Engagements where the third party and internal audit staff work collaboratively on one team often facilitate this transfer of knowledge.”

In particular, third-party service providers may be able to provide an important perspective on emerging risks, says Brian Christensen, executive vice president of global internal audit for Protiviti. “Rather than taking a reactive approach, CAEs can use service providers to help them meet the needs of the board of directors and the audit committee by both anticipating and creating a risk-based audit plan that addresses emerging risks.”

Conclusion

The CBOK 2015 Global Internal Audit Practitioner Survey provides a valuable snapshot about the use of internal or external third-party services to augment the skills or capacity of an internal audit department. On average, 1 out of 3 internal audit departments worldwide say they use third-party services to some extent. The results regarding future expectations for use of third parties are similar. About 1 out of 3 survey respondents worldwide expect their budgets for third-party services to increase, with higher levels in South Asia, Middle East & North Africa, and Sub-Saharan Africa.

Third-party usage is higher in the financial sector and among publicly traded organizations, and lower in the public sector and privately held organizations. Among those who use third-party services, the average level of outsourced activity worldwide is 23%, with higher levels in South Asia and Middle East & North Africa.

Very small internal audit departments report the lowest use of third parties (about 1 in 4), while medium to large departments (50 to 300 people) have double that rate. The largest departments (with more than 300 people) trend in the opposite direction. Their current use of third parties is low, but they have higher percentages who expect to increase their third-party usage in the next year.

To ensure successful relationships with third parties, CAEs should clarify objectives, choose the appropriate provider, supervise the activity, and proactively maintain the relationship.

About the Project Team

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About CBOK

SURVEY FACTS

Respondents	14,518*
Countries	166
Languages	23

EMPLOYEE LEVELS

Chief audit executive (CAE)	26%
Director	13%
Manager	17%
Staff	44%

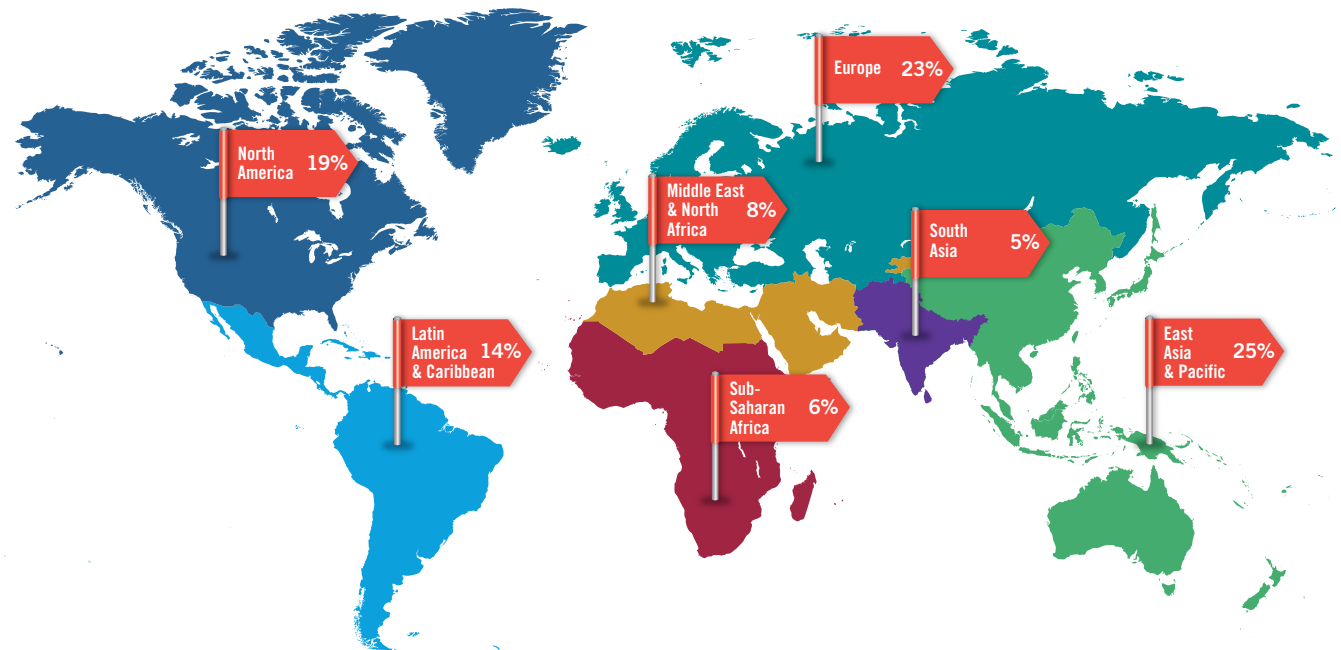
*Response rates vary per question.

The Global Internal Audit Common Body of Knowledge (CBOK) is the world's largest ongoing study of the internal audit profession, including studies of internal audit practitioners and their stakeholders. One of the key components of CBOK 2015 is the global practitioner survey, which provides a comprehensive look at the activities and characteristics of internal auditors worldwide. This project builds on two previous global surveys of internal audit practitioners conducted by The IIA Research Foundation in 2006 (9,366 responses) and 2010 (13,582 responses).

Reports will be released on a monthly basis through 2016 and can be downloaded free of charge thanks to the generous contributions and support from individuals, professional organizations, IIA chapters, and IIA institutes. More than 25 reports are planned in three formats: 1) core reports, which discuss broad topics, 2) closer looks, which dive deeper into key issues, and 3) fast facts, which focus on a specific region or idea. These reports will explore different aspects of eight knowledge tracks, including technology, risk, talent, and others.

Visit the CBOK Resource Exchange at www.theiia.org/goto/CBOK to download the latest reports as they become available.

CBOK 2015 Practitioner Survey: Participation from Global Regions



Note: Global regions are based on World Bank categories. For Europe, fewer than 1% of respondents were from Central Asia. Survey responses were collected from February 2, 2015, to April 1, 2015. The online survey link was distributed via institute email lists, IIA websites, newsletters, and social media. Partially completed surveys were included in analysis as long as the demographic questions were fully completed. In CBOK 2015 reports, specific questions are referenced as Q1, Q2, and so on. A complete list of survey questions can be downloaded from the CBOK Resource Exchange.

About The IIA Research Foundation

CBOK is administered through The IIA Research Foundation (IIARF), which has provided groundbreaking research for the internal audit profession for the past four decades. Through initiatives that explore current issues, emerging trends, and future needs, The IIARF has been a driving force behind the evolution and advancement of the profession.

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