

# The Possible Risks and Countermeasures of Internal Audit Outsourcing

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## Abstract

At the beginning of the twenty-first century, there was a wave of discussion about whether internal audit was outsourced, and the more mainstream conclusion was that it was left to the market to choose, and today, the phenomenon of internal audit outsourcing is becoming more and more common. However, whether the internal audit function can be fully utilized after outsourcing, whether it can effectively promote the improvement of the internal control of the enterprise, what kind of risks will exist when outsourcing, and how to avoid it, this is the problem to be discussed in this paper.

## Keywords

Internal audit; Outsourcing of internal audit; Externalization of internal audit.

## 1. Introduction

From the perspective of legality, internal audit outsourcing is legal both domestically and internationally. Internationally, Article 201 of the Sarbanes-Oxley Act (SOX Act) passed in 2002 prohibits accounting firms from providing both statement auditing services and internal auditing outsourcing services to the same enterprise, but does not prohibit accounting firms. Only provide internal audit outsourcing services to enterprises. Domestically, the new "China Internal Audit Standards" issued in August 2016 added that "other organizations or personnel who accept the internal audit business entrusted, hired, undertaken or participated in by the organization shall also abide by these standards". This means that my country's internal audit outsourcing is also legal.

In the early 21st century, my country set off a wave of discussion on whether to outsource internal auditing. A paper published in "Auditing Research", through analysis, came to the conclusion: "Whether outsourcing should be decided by the market." What is the outcome of market selection after this? According to a 2015 survey by the Global Community of Internal Audit Knowledge, nearly 40 percent of organizations outsource internal audit. In 2017, Li Wanfu, Du Jing and others published "Internal Audit Outsourcing Practice Survey and Development Strategy of Enterprises" in "Accounting Research". After a questionnaire survey, they concluded that "Internal audit outsourcing has developed rapidly in my country in 2014, and there are currently nearly 20 % of companies choose internal audit outsourcing services; the high professional ability of outsourcers is the main reason why companies choose internal audit outsourcing, and the main reason why companies build internal audit is because they are worried that the outsourcer does not know enough about the company." Internal audit Outsourcing services are usually provided by accounting firms, management consulting firms, financial institutions and other related organizations. However, in my country, the average ratio of choosing accounting firms as internal audit outsourcing service providers is 81.27%, which shows that accounting firms are still the first choice for domestic enterprises to entrust internal audit services. [1]

No matter from the perspective of legal supervision environment or market choice, internal audit outsourcing has become a trend, and the risks of outsourcing also follow. This paper will

discuss what risks will exist in outsourcing internal audit in order to give full play to the function of internal audit after outsourcing, and how to avoid it?

## 2. The Development Characteristics of My Country's Internal Audit

### (1) Unbalanced development of the main body

Internal audit subject, that is, the issuer of internal audit behavior, that is, internal audit department or internal auditor. The unbalanced development of internal audit subject includes two levels, macro level and micro level. From a macro perspective, whether an internal audit department is established within an organization has caused uneven development of the department. On a micro perspective, the number of internal auditors is generally small, and the number of internal audit services that can be implemented each year is relatively small; The business capabilities are uneven, and most of the internal auditors of enterprises are not from the audit profession, but are transferred from other departments in the organization, or from financial personnel. In general, the development of internal audit subjects in various organizations is uneven.

### (2) Unbalanced development of objects

The internal audit object has a wide range of connotations. All the objects that are confirmed and consulted within the company are the objects of internal audit, ranging from the company, a department of the company, to the procurement process of raw materials. Among these objects, the development of each company is uneven, the development of various departments within a company is uneven, and the procurement process of raw materials of each company is unevenly developed, which together lead to the uneven development of internal audit objects.

### (3) Unbalanced model development

The internal audit model, that is, the internal audit department has different positions and functions in the internal structure of the organization. In some organizations, the internal audit is linked to the financial department, and the leader of the financial department also serves as the leader of the internal audit department. A major part of the internal audit business is to confirm the authenticity and legality of the financial business. The leadership of the two departments is not separated, which leads to the embarrassment of the internal audit in the actual implementation of the audit process, which will affect the performance of the internal audit function.

### (4) The concept is backward

Organizational leaders and some functional departments lag behind in auditing concepts, emphasizing confirmation rather than consulting services. From the perspective of demand, most of the organization's internal audit institutions are established by external forces, and there is no internal audit demand from within the organization. my country's internal audit departments are under the mandatory requirements of the state on large enterprises, and these enterprises have established internal audit departments. ; From the perspective of supply, the professional quality of the internal auditors of the organization is relatively low and cannot provide high-quality audit services.

To sum up, internal audit has the characteristics of unbalanced development. Unbalanced development of audit objects is an objective fact. This unbalance cannot be eliminated. Unbalanced model development needs to be eliminated from the system level, and it needs to be promoted by the state or by social and economic growth. eliminate. For example, if a domestic enterprise wants to enter the international market, it must follow the requirements of the business development country for the internal control of the enterprise. The concept of backwardness belongs to the problem of the stage of social development. The unbalanced development of the main body is a problem that can be solved at present, and the problem of

the unbalanced development of the internal audit main body can be solved with the help of external audit force, which leads to the outsourcing of internal audit.

### 3. Possible Risks of Internal Audit Outsourcing

(1) The selected accounting firm does not understand the audited unit, which leads to the inability of the internal audit function to fully exert

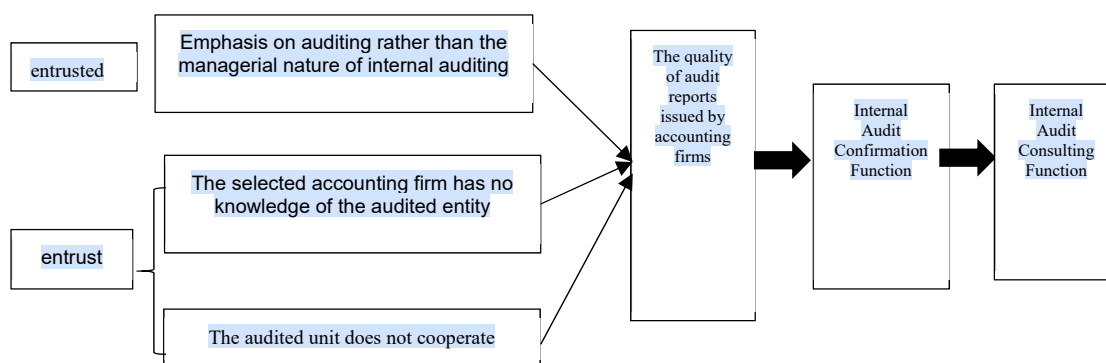
When an accounting firm accepts an entrustment, it needs to have a comprehensive and clear understanding of the overall situation of the audited entity in a short period of time. Traditional financial auditing requires accounting firms to focus on material misstatements that affect financial statements, and only affect financial statements. The internal control of the report is understood and tested, and the goal of internal audit is to increase the value of the organization and serve the goals of the organization. Compared with financial audit, it is more macroscopic. This requires auditors to have a clear understanding of the overall situation of the organization in order to be more effective. Give full play to the consulting function of internal audit and promote the development of the organization. However, the certified public accountant may not have a comprehensive understanding of the organization due to the length of the audit project and the principle of cost-effectiveness, which will affect the quality of the audit report provided by the certified public accountant, thereby affecting the confirmation function of the internal audit, and at the same time, it will also affect the internal The quality of the advisory recommendations made by the audit department based on the audit report.

(2) Accounting firms attach importance to auditing rather than the management essence of internal auditing Most of the certified public accountants are engaged in the audit business, with the goal of issuing audit reports, and their functions are authentication, evaluation and supervision, and there is a certain deviation from the confirmation and consulting functions of internal audit. When social auditing is entrusted to carry out internal auditing, it tends to focus on confirmation rather than consulting. The focus is on finding problems and finding evidence, and the suggestions made are superficial and not practical. From this perspective, CPAs underestimate the fact that internal auditing is essentially management rather than auditing.

(3) The CPA cannot understand the situation of the auditee due to the failure of the auditee to cooperate

The audited units, especially in the internal audit outsourcing business of colleges and universities, often encounter the situation that the audit project team cannot obtain information in a timely manner, resulting in a slow audit process, or even unable to obtain due audit evidence. On the one hand, this is related to the importance attached by organizational managers to internal audit, that is, related to the status of the internal audit department in the organization. The process of the department, and the audited unit and department do not know the project team members, and may be deliberately or unintentionally obstructed in the process of requesting information and communication.

To sum up, the risks in the process of internal audit outsourcing are shown in the figure below:



**Figure 1.** Risks in the process of outsourcing internal audit

#### 4. Avoidance of Internal Audit Outsourcing Risks

##### (1) Select an appropriate accounting firm for internal audit outsourcing

Select long-term cooperative accounting firms or long-term cooperative certified public accountants to carry out internal audit work. Compared with other accounting firms or certified public accountants, they have a better understanding of organizational strategies, organizational goals, and internal control systems, and can effectively save various resources, especially time resources, during the implementation of internal audit work. In the process, the most important procedure is communication. Long-term cooperative accounting firms or certified public accountants can accurately locate the internal communication objects of the organization and establish effective communication methods, such as the inquiry procedure in the audit procedure. In practice, you can choose to pass a questionnaire survey. , Communication in the form of discussions. For some enterprises with low frequency of business trips, the form of discussion can be selected to obtain more real audit evidence, while for enterprises with high frequency of personnel travel, the form of questionnaire survey can be selected, but at the same time, it is necessary to reduce the use of the questionnaire as audit evidence. Reliability, implement auxiliary procedures to corroborate the information obtained from the questionnaire. At the same time, accounting firms that have cooperated with each other for a long time have a better understanding of the internal situation of the organization and can be more accurate in determining audit priorities. We all know that the establishment of audit focus belongs to the category of professional judgment of certified public accountants, and the professional judgment of certified public accountants depends on the experience of certified public accountants and the degree of understanding of certified public accountants on the audited unit. The CPA who has a better understanding of the audited unit will choose the audit focus more in line with the actual situation of the audited unit, and it will be more clear about the business activities of the audited unit that are prone to major misstatement risks, and it is more conducive to play the function of internal audit confirmation and consultation. . Of course, choosing a long-term cooperative accounting firm or certified public accountant will have the risk of internal audit fraud, which will damage the performance of the internal audit function. In order to make up for this defect, we can start from two aspects. Different certified public accountants conduct internal audit work, and personnel within the organization conduct regular job rotations.

2. For the first time outsourcing, choose an accounting firm that is good at consulting. The essence of internal auditing is a management activity whose core functions are confirmation and consulting. Among these two core functions, the consulting function requires higher competence and experience of auditors. The ultimate purpose of internal audit is to promote the improvement of the design of the internal control system and the effective operation of the organization. In order to achieve this purpose, internal auditors identify deficiencies in the design and operation of the internal control system of the organization through the

confirmation of various departments and business activities in the organization, and propose improvement suggestions to the management, that is, consultation. The purpose of the confirmation is to make a consultation recommendation. When choosing an accounting firm or a certified public accountant, choosing an accounting firm that is good at consulting is more conducive to the performance of the internal audit function. At present, although financial auditing business accounts for the majority of accounting firms in my country, a group of pioneers have gradually shifted their business centers to management consulting business. Organizations that have internal audit outsourcing needs can choose accounting firms or certified public accountants that are good at consulting.

(2) Increase the participation of the internal audit department in the audit process

1. The audit planning stage is completed by the organization's internal audit department and the entrusted accounting firm, and the organization's internal audit department is the leader to guide the entrusted accounting firm to complete the audit plan. In the overall process of auditing projects, which is the formulation of audit plans, the internal audit department should play its own guiding role and point out the direction for the accounting firm. In the subsequent links, the personnel of the internal audit department may not interfere too much with the audit process. Let the CPA fully implement the procedures from the perspective of social audit and make audit recommendations from different perspectives. The internal audit department can start from analyzing the strategic goals of the organization, and combine the current situation of the organization's internal audit resources to determine the audit focus and audit frequency, so as to form the overall audit plan and specific audit plan of the organization's internal audit. The internal audit department plays a guiding and reviewing role in the process of formulating the audit plan. Ensure that internal audit objectives are aligned with organizational objectives and that the internal audit plan achieves audit objectives.

2. In the implementation stage of internal audit, the internal audit department requires the certified public accountant to formulate the nature, time and scope of its internal audit procedures according to the initially determined audit plan, and proceed from the three levels of governance, operation and finance, respectively, on the organizational risk control design. Evaluate the rationality and effectiveness of implementation. From the perspective of organizational governance, audit work is carried out on the appropriateness of organizational governance structure, the legality of existing regulations, the clarity of job division and the rationality of decision-making. Starting from the operational level, the internal audit work comprehensively evaluates the risk factors and risk levels in the whole process of the organization's operation, reveals the weak links in the organization's operation and management, and seeks effective ways to plug loopholes and solve problems. Starting from the financial level, conduct audit work on the establishment of the organization's sound financial system, budget preparation and implementation, etc., to provide a reasonable guarantee for the organization's effective use of funds. The internal audit department assumes an oversight role in this process.

## 5. Conclusion

After the outsourcing of internal audit, the accounting firm cannot have a comprehensive and clear understanding of the overall situation of the audited entity due to various factors (audit fees, audit time, etc.), thus affecting the accounting firm to replace the internal audit department. The effectiveness of the internal audit confirmation function performed, which in turn affects the performance of the internal audit consulting function. In addition, accounting firms accept a lot of financial statement auditing services. Maybe due to professional inertia, the core functions of internal auditing cannot be effectively played due to professional inertia when conducting internal auditing services. The effectiveness of the improvement of internal control

is reduced. The internal audit department shall act as the guide and supervisor of the entrusted accounting firm, and clearly and clearly express its relevant requirements for internal audit services. Guide internal audit outsourcing to reasonably serve internal audit goals and organizational goals.

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