

Evaluating Whether Outsourced Functions Represent Key Internal Controls

1. Is the outsourced function a key internal control?

Division of Administration (DOA) agencies or sections must evaluate and determine whether a function being outsourced is a key internal control. This will not be a clear cut decision and judgment must be exercised.

Some outsourced functions are critical to financial operations, some are critical to the mission of the user entity, and some are of a sensitive nature and involve security over confidential information. When outsourcing the administration of an entire program, system, or function to a contractor, this may represent the outsourcing of a key internal control.

Accounting literature refers to a key internal control as “a control that, if it fails means there is at least a reasonable likelihood that a material error in the financial statements would not be prevented or detected on a timely basis.” A key internal control is also described as a “control that provides reasonable assurance that material errors will be prevented or detected in a timely manner.” Key internal controls are those controls that have a pervasive effect upon the accomplishments of management’s control objectives.

If unsure whether or not a key internal control is being outsourced, DOA sections or agencies may consult other resources within the DOA to assist in making the determination. DOA’s Office of Information Technology (OIT) may be consulted if the function involves an IT service. DOA’s Internal Audit section may also be consulted in making the evaluation.

If the outsourced function meets any of the criteria listed below, it is likely to be a key internal control. DOA sections or agencies should consider the impact on their section individually and on the DOA as a whole if the function or process being administered by a contractor fails or is performed improperly. Indicate below if the process or function being outsourced represents any of the following. (Select all that apply.)

	The function is critical to the operations of the section.
	If the function or process fails, will a material error in the financial statements occur?
	Does the function or process have a pervasive effect upon management’s core mission?
	The function involves sensitive or confidential information.
	Failure to properly administer the function would result in detrimental effects on the section.

Based on my judgment, the core mission and responsibilities of my section, and other information obtained, the program, process, or function being outsourced through this planned contract is a “Key Internal Control.” Select the appropriate answer below.

Yes _____ No _____

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2. If outsourcing a “Key Internal Control,” what assurances must be obtained from the contractor?

When an outsourced function is a key internal control, individual DOA sections or agencies *must* monitor the contractor’s performance throughout the life of the contract and obtain independent assurances regarding how the contractor administers the process or function for DOA. Contract language should also identify what assurances the contractor is required to provide and who is responsible for the cost of providing the assurances.

When key controls are outsourced, DOA is exposed to risks which must be mitigated through assurances. Assurances come in various forms and may vary depending on the function being performed by the contractor. Some forms of assurances DOA sections or agencies might obtain include:

- An annual independent examination that results in a service organization control (SOC) report could be required. SOC reports replace SAS 70 reports and provide certain independent assurances on the internal controls of a contracted entity. There are 3 types of SOC reports available depending on the type of examination needed to obtain assurances on the function being outsourced. If the DOA section or agency determines that a SOC report is needed from a contracted entity, the party responsible for the cost of obtaining the report should be specifically addressed in the solicitation (where applicable) and contract.
- The contractor could be required to provide certain independent assurances during the term of the contract. These assurances may be provided in the form of a quality control plan. The individual DOA section or agency should review the contractor’s quality control plans. If this type of assurance is required the contractor should be monitored during the life of the contract to ensure that the requirements of the contract are met.
- The DOA sections or agencies could also conduct periodic monitoring reviews of the function being performed by the contractor. The results of any monitoring reviews should be documented and maintained by the individual DOA section or agency.