

Department of Natural Resources Evaluating Whether Outsourced Functions Represent Key Internal Controls

1. Is the outsourced function a key internal control?

Department of Natural Resources Offices (DNR Offices) must evaluate and determine whether a function being outsourced is a key internal control. This may 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, DNR Offices may consult other resources within DNR Fiscal Services to assist in making the determination. DNR’s Internal Auditor 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. DNR Offices should consider the impact on their Office individually and on DNR 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, can 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, DNR Offices *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 DNR. 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, DNR 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 DNR Offices might obtain include:

- An annual independent examination that results in a service organization control (SOC) report could be required. SOC reports replace Statement on Auditing Standards (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 DNR Offices 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 DNR Office 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 DNR Offices 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 DNR Office.