Outside Service Organizations and Internal Controls

State agencies sometimes rely on outside service providers to operate as effectively and efficiently as possible. These third-party relationships can be very beneficial but can also pose risk to the agency if not managed correctly. The agency receiving the services should have appropriate internal controls in place to oversee the provider.

An agency can delegate certain duties or functions to an outside service organization through a contractual agreement. Although the agency has delegated responsibility of these tasks, the agency is ultimately accountable for these outsourced duties. Agency management should communicate the objective of the entity and related risks, the entity’s standards of conduct, the role of the service organization in the organizational structure, the assigned responsibilities and authorities of the role, and the expectations for competence for its role that will enable the service organization to perform its internal control responsibilities.

Key considerations regarding service agreements include ensuring that contracts are clearly written, costs are accurate and defined, and all parties are compliant with the terms of the contract. If your agency outsources the development of a product or service and the third-party fails to deliver, your agency also fails to deliver. It is crucial to have appropriate internal controls in place to make both parties successful.

The most common breakdown in third-party risk management is easily preventable. More often than not, once a contractual agreement is signed, it is locked away in a filing cabinet or put in a secure folder on someone’s computer never to be seen again. Regularly reviewing the contract allows an agency to make sure the contract is still valid. This review process also allows the agency to make sure the contract is updated to include any changes in technology or the business environment.

Agencies should regularly monitor vendors and confirm they are meeting contract terms. Service providers can make errors. Agencies should validate all work. They can also be tempted to manipulate a situation to their advantage if no one is watching. Internal controls can reduce this risk and help an agency achieve its goals.

**Suggested action steps**

- Review contracts currently in place with third-party service providers.
- Update internal controls to ensure inclusion of outside suppliers and service providers.
- Monitor contracts to verify terms and conditions are met.
- Clarify contract language to ensure all parties understand what is expected of them, how it will be measured, and what the consequences are if they do not meet the expectations.

**Questions?**

Contact [Joshua Botnen, Internal Control Specialist](mailto:Joshua.Botnen@mn.gov)