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White paper

Resourcing Internal Audit

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Background

Purpose

Provide a basis for audit committees to determine the adequacy of internal audit resourcing.

Background

Audit committee charters typically include a requirement for the audit committee to periodically advise the board and / or chief executive officer on the adequacy of internal audit resources to carry out its responsibilities.

Discussion

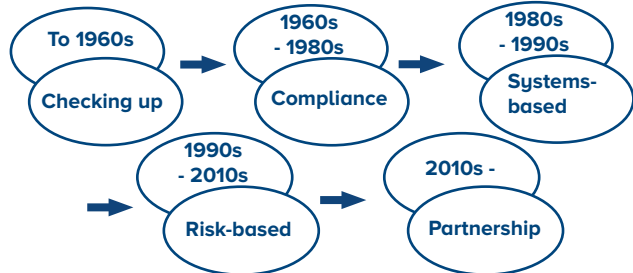
Issue

While there is no simple formula for determining an internal audit budget and the appropriate level of resourcing, a combination of techniques can be considered to arrive at a reasonable, objective and scientific basis.

History

Internal auditing has evolved appreciably since the mid-twentieth century when auditors simply 'checked-up' on things, predominantly of a financial nature. The evolution is discussed in an IIA-Australia Fact Sheet *Evolution of Internal Audit* which recognises five key changes over the last century. These are illustrated in **exhibit 1** below. An emerging approach at the start of the 2020's is values-based internal auditing, and we will likely hear more on that as we move through the decade.

Exhibit 1 – Evolution of Internal Auditing Approaches



Contemporary internal audit functions will offer a comprehensive range of assurance and consulting services consolidated into a service catalogue. An IIA-Australia white paper on *Internal Audit Service Catalogue* reflects that, “It is reasoned a range of services can better serve an organisation, whilst spreading the internal audit budget and resources further.”

There are a number of models that can be used to resource internal audit services to an organisation:

- › In-house.
- › Co-sourced.
- › Outsourced.
- › Outsourced with in-house management.

These are more fully described in an IIA-Australia Factsheet on *Internal Audit Resourcing Models* that states in part, “Carefully choose the resourcing model that best suits your organisation and will provide fit-for-purpose internal audit services. Be an informed buyer – clearly define the internal audit services you are seeking and then procure it – whether in-house, service provider, or a combination.”

Irrespective of which resourcing model an organisation utilises for its internal audit function, most boards, audit committees and chief executives are looking for internal audit to ‘add value’ and the optimal level of resourcing. An IIA-Australia White Paper on *Balanced Scorecard Reporting* makes the point, “The most visible part of an internal audit activity is characteristically the final audit reports on the respective audit engagements. But internal auditors are typically measured on more than the outcomes of individual audit assignments, with key stakeholders interested in having a well-considered set of KPIs that help them evaluate the overall success of the internal audit activity. By helping to translate the internal audit strategy into action, balanced scorecards measure and report on internal audit performance (through the KPIs used). They also help to connect the internal audit activity’s strategy with that of the organisation.”

Discussion

Audit committee charters typically include a requirement for the audit committee to periodically advise the board and / or chief executive officer on the adequacy of internal audit resources to carry out its responsibilities.

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As a starting point, there are several elements that influence the basis for determining the budget for internal audit as illustrated in **exhibit 2**. But there is no simple formula.

Exhibit 2 - Elements that Influence Internal Audit Budget-setting



Vision for Internal Audit

An important role for the audit committee is to establish a vision for internal audit in consultation with the board, chief executive officer and chief audit executive. The vision should encapsulate the future state of the internal audit function in three to five years' time. It provides the chief audit executive the basis for determining their strategic priorities for maintaining the momentum, building capability, embracing leading edge practices, and enhancing the organisation's governance arrangements.

Meaning of Vision

The preferred future state of an internal audit function in an organisation.

Exhibit 3 illustrates different levels of internal audit maturity and some abridged examples of common features. The cost for achieving a 'world class' internal audit function is likely to be greater than settling on a vision for an 'implemented' level of internal audit maturity.

Exhibit 3 – Different Levels of Internal Audit Department Maturity

Internal Audit Maturity Assessment	
Internal audit learns from inside and outside the organisation, with a constant focus on continuous improvement: <ul style="list-style-type: none"> > Innovates good practices. > Strategic business partner. > Leader in the internal audit profession. 	World Class
Internal audit integrates information from across the organisation to improve risk management, control and governance: <ul style="list-style-type: none"> > Emphasises good practice. > Anticipates change. > Expands roles in response to business needs 	Managed
Internal audit management and professional practices uniformly applied: <ul style="list-style-type: none"> > Generally conforming with the internal audit practice standards. 	Implemented

Sustainable and repeatable practices: <ul style="list-style-type: none"> > Partially conforming with the internal audit practice standards. 	Defined
Few sustainable and repeatable practices: <ul style="list-style-type: none"> > Not conforming with the internal audit practice standards. 	Initial

Once the vision has been agreed and included in the internal audit charter, the chief audit executive should develop a strategic roadmap aligned to the vision, to articulate internal audit strategic priorities and guide its evolution to further align with the organisation's strategies, objectives, risks and assurance needs. The strategic roadmap should be reviewed and approved by the audit committee, and implementation should be monitored through quarterly or half-yearly progress reporting.

Internal audit's strategic roadmap should capture strategic and tactical improvement ideas to present a visible illustration of the internal audit 'end state'. The strategic roadmap should reflect the chief audit executive's leadership assessment, risk profile, priority actions, prioritisation, allocation, timeframes, monitoring arrangements, and funding where necessary. It may include:

- > What its future audit work profile should be to best support the organisation, and this is likely to include greater use of technology for auditing.
- > What technology capability may be necessary to support the future work profile.
- > What professional development may be necessary to assist transition to new ways of working, which may require advanced technology audit skills.
- > How service provider specialist knowledge and skill can best be transferred to in-house auditors.
- > Succession planning.

Audit Committee Construct

The way the audit committee is constructed is likely to influence the budget-setting process for the internal audit function. The audit committee's objectivity in setting the internal audit budget can be diminished where it consists wholly or partly of non-independent members (e.g. management representatives).

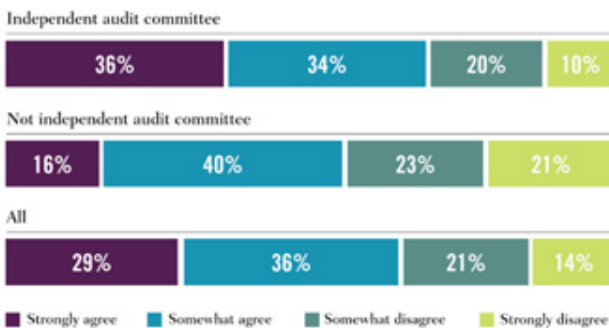
An IIA North American Pulse survey conducted in late-2018 asked respondents to indicate their level of agreement with the following statement: "The internal audit activity at my organisation is sufficiently resourced with competent and objective professionals able to carry out the internal audit plan"; the result (illustrated in **exhibit 4**) was that chief audit

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executives were significantly more likely to state they had sufficient resources at organisations with independent audit committees than at organisations where the audit committee was not independent of management¹.

Exhibit 4 – Audit Committee’s Influence in Setting the Internal Audit Budget

Internal Audit Has Resource Sufficiency



Source: *Tone at the Top*, December 2018

While it is useful to get insights from chief audit executives on whether the internal audit function is adequately resourced, it is important for there to be a reasonable, objective and scientific basis to these insights.

Business Setting

The *New Auditor’s Guide to Internal Auditing* (Internal Audit Foundation, 2019) reflects, “The twenty-first century is offering up many fresh challenges as a consequence of rapid business changes, global connectivity, emerging technologies, and increasingly complex economic, regulatory, and operating environments. The internal audit profession is responding by evolving significantly to meet the growing demands.” No two organisations are the same. And each organisation will respond to these changes differently. The consequent impact on the internal audit function will also be different.

In some organisations, the chief audit executive will now be sitting within the C-suite as a trusted partner of the Board and chief executive officer. In some industries and across different jurisdictions the importance of having a capable and well-equipped internal audit function has become increasingly recognised (accelerated in some parts of the world by governments and regulators moving to make internal auditing mandatory). And many boards, audit committees, and senior management are expecting more from their symbiotic partnership with independent internal auditors.

A comprehensive environmental assessment will consider a range of elements, illustrated in **exhibit 5**.

Exhibit 5 – Environmental Assessment

The Environment in Which Internal Audit is Operating			Determine Internal Audit’s Spend
Define Audit Universe	Assess Risk Profile	Develop Audit Plan	
Geographical coverage	Risk appetite of board	Vision for internal audit	Employee costs (total)
International operations	Risk management maturity	Extent of internal audit plan	Co-sourcing expenses
Number of locations	Business specific risks	Resourcing model	Consulting costs
Extent of centralisation	Disruptive innovation effects	Size of internal audit	Investment in training
Business maturity	Control effectiveness	Capability of internal audit team	Technology license costs
Assurance arrangements	Maturity of lines of defence	Efficiency and productivity	Travel expenses
Regulatory requirements	Collaborative reporting	Technological tools	Administrative costs

The internal audit function is expected to deliver a broader range of services while in the field to optimise value to stakeholders, and in so doing, help their organisation accomplish its objectives and improve its operations through an independent and objective approach designed to add value.

Meaning of Audit Universe

The range of business activities, programs, functions, and entities that collectively contribute to the achievement of strategic objectives and could potentially be the subject of an audit.

Analysis of Audit Spend

A benchmarking study conducted in 2018 to establish how much is the right amount to spend on internal audit proved to be inconclusive because the data collected showed inconsistencies in the responses to the key measures concerning the *internal audit budget by organisational turnover and cost per productive audit day delivered*.²

While the need for internal audit is dependent upon a number of factors – most specifically on the complexity of the organisation – the total turnover would be expected to

¹ “Budgeting the Internal Audit Function: How Much Is Enough?”, *Tone at the Top*, (Lake Mary, FL: The Institute of Internal Auditors, Issue 90, December 2018), 1-4.

² *Internal Audit Benchmarking Survey* (Sydney, Australia: Institute of Internal Auditors Australia, 2018), 2,6,7

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be a significant factor; nevertheless, the survey did not reflect this assumption. The study did conclude that benchmarking 'spend' or size of the internal audit function should only be considered as a guide, and one factor to be considered when assessing an organisation's overall assurance coverage.

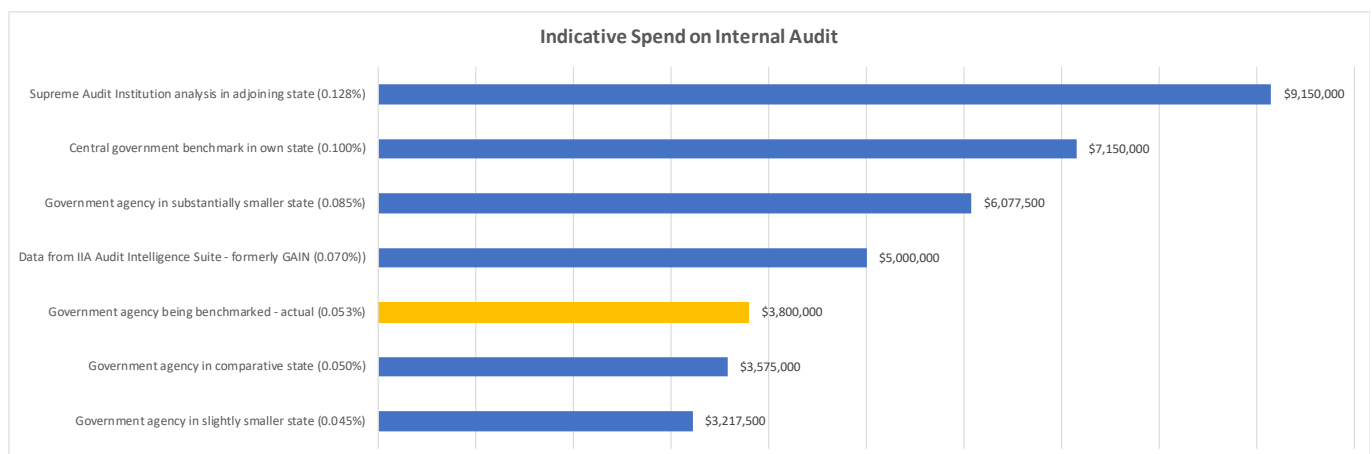
Benchmarking internal audit resourcing can be difficult irrespective of whether the organisation sits within the public, private or not-for-profit sector. Given that it can be difficult to determine the internal audit budget of competitors in the private sector, an example has been developed (**exhibit 6**) that demonstrates how benchmarking for the same type of government activity in different jurisdictions in the public sector will not always produce meaningful comparatives ... even though, prima facie, it is comparing 'apples with apples'.

A government agency (shown in yellow in the chart - **exhibit 6**) wanted to compare the reasonableness of its spend on internal audit to government agencies performing the same role in other states, and to other reported benchmarks. While the government agency's current spending on internal audit was \$3.8 million per year (representing 0.053% of the agency's total revenues), the analysis pointed to wildly different results of between \$3.2 million (0.045% of revenues) and \$9.1 million (0.128% of revenues). The indicative spend on internal audit was calculated as a percentage of the revenue of the government department which was \$7,150 million (the percentages are shown in the chart).

Ten Action Steps

1. Assess whether the internal audit function has the right amount of competent and professional resources to provide the right blend of internal audit services to the organisation in line with the vision, approved internal audit service catalogue, and internal audit plan.
2. Identify and document the features of the audit universe
3. Identify any unique features of the audit universe that influence operational risks and internal audit coverage, such as the geographical coverage, international operations, number of locations, extent of centralisation, business maturity, assurance arrangements, and regulatory requirements.
4. Assess the reasonableness of internal audit's coordination with other internal and external assurance providers and whether there is a reasonable spread of assurance costs.
5. Determine the chief audit executive's insights on whether they consider their resources to be sufficient.
6. Assess past internal audit budgets within the organisation, including performance against budget (e.g. reasonableness of variances) and the organisation's adjustment factors (e.g. efficiency dividends in the public sector).
7. Obtain comparisons of the organisation's internal audit spend for similar organisations, and analyse this data using global and local benchmarks.
8. Undertake an environmental assessment of the typical factors that influence the internal audit resourcing and budget-setting (see **exhibit 5**).
9. Establish how internal audit has considered the velocity of risks, or the speed at which risks are likely to develop, in its environmental assessment.
10. Consider how well the internal audit function is performing in the context of its Key Performance Indicators (e.g. as reported in the Balanced Scorecard Report or equivalent if this structured style of KPI reporting is used).

Exhibit 6 - Example of Inconsistencies in Benchmarking Analysis for a Government Agency



Source: Developed by author based on published and sourced data of agency revenues, then that data was modified consistently to de-identify the organisation; multiplier reflects percentage of agency revenues.

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Conclusion

Audit committees are keen to have a firm basis for determining whether resources for the internal audit function are adequate to fulfil its mission, deliver upon its vision, and complete the approved program of work. The internal audit budget will be influenced by the vision for internal audit, the audit committee construct, the business-setting, and analysis of the internal audit spend.

While there is no simple formula for determining internal audit resourcing (and henceforth its budget), a combination of techniques can be considered to arrive at a reasonable, objective and scientific basis using the ten action steps. At the centre of any analysis is evidence (such as a Balanced Scorecard) that the internal audit function is high-performing and credible, and is adding value and improving the organisation's operations in line with the mission of internal auditing.

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Purpose of White Papers

A White Paper is an authoritative report or guide that informs readers concisely about a complex issue and presents the issuing body's philosophy on the matter. It is meant to help readers understand an issue, solve a problem, or make a decision.

Author's Biography

This White Paper was written by:

Bruce Turner AM

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Bruce remains active as an audit and risk committee chair, company director, executive coach, mentor, and white ribbon ambassador. He has held board and independent audit committee roles over the last decade in thirty diverse organisations, including six years on the IIA-Australia Board to mid-2018.

His forty years of practitioner and leadership experience

in internal auditing across the globe traverses the energy, financial services (commercial, merchant and central banking), government, manufacturing, and transport sectors. Prior to his retirement in 2012, he held chief audit executive roles at the State Rail Authority of NSW, Integral Energy Australia, and ultimately the Australian Taxation Office.

In his role on various audit committees, Bruce has maintained a keen interest in ensuring the adequacy of internal audit resources to carry out its responsibilities in terms of professional capability, optimal performance, and financial resources.

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About the Institute of Internal Auditors–Australia

The Institute of Internal Auditors (IIA) is the global professional association for Internal Auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world including Australia.

As the chief advocate of the Internal Audit profession, the IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for Internal Audit integrity and professionalism around the world with its 'International Professional Practices Framework' (IPPF), a collection of guidance that includes the 'International Standards for the Professional Practice of Internal Auditing' and the 'Code of Ethics'.

The IIA–Australia ensures its members and the profession as a whole are well-represented with decision-makers and influencers, and is extensively represented on a number of global committees and prominent working groups in Australia and internationally.

The IIA was established in 1941 and now has more than 200,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

Historians have traced the roots of internal auditing to centuries BC, as merchants verified receipts for grain brought to market. The real growth of the profession occurred in the 19th and 20th centuries with the expansion of corporate business. Demand grew for systems of control in companies conducting operations in many locations and employing thousands of people. Many people associate the genesis of modern internal auditing with the establishment of the Institute of Internal Auditors.

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