

Date: 2024-09-27

Subject: **2025 Internal Audit Budget**

Contact: Claire Fang Mu, Director, Internal Audit

Report number: CAO's Office-2024-792

RECOMMENDATIONS:

1. That the report titled: **2025 Internal Audit Budget** to the Audit Committee Meeting of October 7, 2024, be received;
2. That the proposed 2025 Internal Audit Budget as outlined in this report and the appendices be approved and forwarded to the Mayor's Budget for consideration.

OVERVIEW:

- **Purpose:** This report presents the Internal Audit's 2025 Budget Request, emphasizing unmet mandates and the need for additional resources to support the Audit Committee's oversight responsibilities and meet audit standards.
- **Request Aligns with the City's Strategic Priorities:** The request aligns with the City's strategic priorities, particularly in cybersecurity, risk management, and international audit standards compliance. Approval is crucial to maintain audit effectiveness and close resource gaps.
- **Audit Committee Authority:** As outlined in its Terms of Reference (By-law 108-203) and in accordance with IIA Global Internal Audit Standards, the Audit Committee is required to approve the Internal Audit budget to maintain audit independence and ensure adequate resources.
- **Internal Audit Transformation:** Since 2022, Internal Audit has significantly addressed staffing shortages by offering competitive salaries, filling all open positions, and reducing employee turnover. Internal Audit made significant progress aligning with Global Internal Audit Standards. Structural changes were implemented to reinforce audit independence.
- **2025 Budget Request:** The total budget request is \$2,310,806, divided into two categories:

- **Baseline Budget Request:** \$2,220,806, reflecting a \$255,000 increase over the 2024 Budget. This baseline is the minimum required to address funding gaps, meet Internal Audit mandates, achieve and maintain conformance with IIA Standards.
- **Permanent Cybersecurity Audit Funding:** \$90,000 for ongoing, recurring cybersecurity audits to address a critical corporate risk.
- **Budget Priority:** The Lead Internal Auditor position of \$165,000 is a key component of the \$255,000 incremental request. This role is essential for closing IIA Standards conformance gaps and mitigating reputational risk.
- **Appendix 1** includes a detailed budget table with line-item breakdowns while **Appendix 2** contains the budget presentation.

BACKGROUND:

This report presents Internal Audit’s 2025 Budget Request to the Audit Committee, highlighting unmet mandates and additional resource requirements for review and approval.

This section outlines:

- The Audit Committee’s authority and relevant requirements from the IIA Standards.
- Improvements in Internal Audit since 2022, addressing challenges like understaffing and below-market salaries.

Audit Committee Authority:

The Audit Committee must approve Internal Audit’s budget to ensure audit independence and resource adequacy, as required by the Audit Charter¹ and IIA Standards². The Director of Internal Audit is responsible for developing strategies to secure sufficient resources and addressing any shortfalls.

¹ City’s *Audit Committee Terms of Reference* (By-law 108-2023), states: “To establish, maintain, and assure that the City’s Internal Audit has sufficient authority to fulfill its duties, the Audit Committee will:

- Approve Internal Audit’s budget and resource plan.”

²Standard 6.3 Board and Senior Management Support

The Board will: “*Demonstrate support by: Approving the internal audit charter, internal audit plan, **budget, and resource plan.***”

Standard 8.2 Resources “Requirements:

The chief audit executive must evaluate whether internal audit resources are sufficient to fulfill the internal audit mandate and achieve the internal audit plan. If not, the chief audit executive must develop a strategy to obtain sufficient resources and inform the board about the impact of insufficient resources and how any resource shortfalls will be addressed.”

Internal Audit's Transformation:

Over the past two years, Internal Audit has made significant progress in aligning with Global Internal Audit Standards and supporting the Audit Committee's oversight mandate. Through collaboration with the Audit Committee, HR, and the CAO's Office, competitive salaries were introduced, vacancies filled, and turnover reduced. This has resulted in a stronger, more effective audit team that better meets the City's needs.

Structural changes were also implemented to reinforce Internal Audit's independence, ensuring it remains an impartial contributor to the City's governance.

CURRENT SITUATION:

2025 Budget Request

Internal Audit's 2025 Budget Request is submitted for review and approval by the Audit Committee. The requested resources are critical to achieving and maintaining conformance with IIA Standards and supporting the Audit Committee's oversight role.

- **Total Request:** \$2,310,806, divided into two categories
 - **Baseline Budget Request:** \$2,220,806, reflecting a \$255,000 increase over the 2024 budget to address funding gaps, fulfil audit mandates, achieve and maintain conformance with IIA Standards.
 - **Permanent Cybersecurity Audit Funding:** \$90,000 allocated for ongoing, recurring cybersecurity audits to address a critical corporate risk.
- **Incremental Requests:** \$345,000, consisting of \$255,000 for baseline budget increases and \$90,000 for permanent cybersecurity audit funding. For detailed line-item breakdowns, Refer to **Part 1: Baseline Incremental Requests** and **Part 2: Permanent Cybersecurity Audit Funding** below.

Part 1: Baseline Incremental Requests:

This baseline budget represents the minimum required to close the funding gap and enable Internal Audit to effectively execute the Internal Audit Work Plan, fulfill its mandate, and achieve and maintain alignment with industry standards. The 2025 budget increase of \$255,000 includes:

- Salary Incremental Request: \$190,000 for additional full-time and part-time staff to support IIA standards compliance efforts and audit functions.
- Discretionary Spending: \$65,000, including \$39,000 to restore funding for Professional & Consulting Services, supporting critical audit projects and ensuring compliance with IIA Standards.

A breakdown of our baseline incremental request is provided in **Table 1**.

Table 1: Internal Audit 2025 Baseline Budget – Incremental Funding Request

Budget Item	Amount (\$ 000)	Description
ACHIEVE AND MAINTAIN CONFORMANCE WITH THE AUDIT STANDARDS		
<i>Salary Incremental Requests</i>		
Compensation adjustments	(15)	Compensation adjustments to reflect actual costs and forecasted actuals.
Lead Internal Auditor	165	One full-time staff member to: 1. Validate the implementation of management action plans (0.4 FTE) 2. Conduct ongoing monitoring and self-assessments to ensure compliance with IIA Standards (0.4 FTE) 3. Enhance the assessment of fraud risk across the City (0.2 FTE)
Audit Coordinator	24	One part-time student to assist in drafting the audit manual in preparation for the upcoming IIA External Quality Assessment by IIA.
Research Support Officer	16	Two summer students will help with the extra workload in preparation for the upcoming IIA External Quality Assessment.
TOTAL SALARY	190	Incremental funding
<i>Discretionary Spending Incremental Requests</i>		
Operating expenditure adjustments	12	Operating expenditure adjustments to align with actual and projected costs, covering areas such as staff development, association membership, mileage, and other related expenses.
Internal Audit Licensing	14	Additional licenses for audit software tools (ACL and Pentana) are needed to address the current shortage caused by a full team complement. These tools are essential for conducting effective audit engagements.
Professional & Consulting Services	39	Last year's budget cut created a discrepancy between actual expenses and the allocated budget. This request restores funding for Professional & Consulting Services, ensuring compliance with IIA Standards and providing adequate resources for critical upcoming core audit projects. Further details are provided after the table.
TOTAL DISCRETIONARY	65	Incremental funding
GRAND TOTAL	255	Total budget increase to meet standards

Key Focus of this Baseline Budget:

1) Request for an Additional Lead Internal Auditor

The proposed budget includes one additional Lead Internal Auditor to build capacity for three unmet mandates. With a new staff position, Internal Audit will carry out the following mandates, ensuring compliance with the 2024 Standards. These mandates include:

1. validating the implementation status of management action plans (*IIA Standard 15.2*)³
2. implementing a robust Quality Assurance and Improvement Program incorporating on-going monitoring and self-assessment of Internal Audit activities against the IIA Standards and regularly reporting the results to Audit Committee (*IIA Standard 8.3*)⁴
3. improving the assessment of fraud risk facing the City and incorporating fraud risk assessment into individual audit engagements. (*IIA Standard 4.2*)⁵

³ Standard 15.2 Confirming the Implementation of Recommendations or Action Plans:

This standard requires Internal Auditors to follow up on the implementation of recommendations using a risk-based approach and to update the status of management actions. Internal Auditors must verify that management has implemented their recommendations.

“Requirements

Internal auditors must confirm that management has implemented internal auditors’ recommendations or management’s action plans following an established methodology, which includes:

- *Inquiring about progress on the implementation.*
- *Performing follow-up assessments using a risk-based approach.*
- *Updating the status of management’s actions in a tracking system.”*

⁴ Standard 8.3 Quality

“Requirements

The chief audit executive must develop, implement, and maintain a quality assurance and improvement program that covers all aspects of the internal audit function. The program includes two types of assessments:

- *External assessments. (See also Standard 8.4 External Quality Assessment.)*
- *Internal assessments. (See also Standard 12.1 Internal Quality Assessment.)*

At least annually, the chief audit executive must communicate the results of the internal quality assessment to the board and senior management. The results of the external quality assessments must be reported when completed. In both cases, such communications include:

- *The internal audit function’s conformance with the Standards and achievement of performance objectives.*
- *If applicable, compliance with laws and/or regulations relevant to internal auditing.*
- *If applicable, plans to address the internal audit function’s deficiencies and opportunities for improvement.”*

⁵ Standard 4.2 Due Professional Care

“Requirements Internal auditors must exercise due professional care by assessing the nature, circumstances, and requirements of the services to be provided, including:

Impact:

The IIA's Gap Assessment Report identified the above three areas as the main risks to non-conformance for our upcoming External Quality Review scheduled for mid-2025. This additional staffing request is crucial to close these gaps.

2) Reinstate Professional Consulting Services**Why is Professional Consulting Service important for the Internal Audit function?**

A Professional and Consulting budget enables the Director of Internal Audit to hire external specialists for complex audits, maintain proficiency, and meet IIA Standards, particularly for specialized or high-demand audits. It also allows the Director to independently secure external expertise, reinforcing audit independence and objectivity, while ensuring flexibility, compliance with standards, and responsiveness to emerging risks. For these reasons, Internal Audit has established a vendor roster with the support of the City's Purchasing Division.

Specifically, IIA Standard 3.1 Competency⁶ and Standard 9.5 Coordination and Reliance⁷ spell out the requirements.

On average, the Internal Audit has been taking on two or three such projects per year. Consulting fees are influenced by market conditions, which are beyond our control. In the four years prior to 2023, there was no budget growth despite significant market price adjustments for professional consulting services. In 2023, Internal Audit raised its Professional Consulting Services from \$160,000 to \$210,000 to catch up with market inflation.

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- *“Probability of significant errors, fraud, noncompliance, and other risks that might affect objectives, operations, or resources.”*

Examples of Evidence of Conformance

- *“(Audit Planning) Notes showing assessment of risks including errors, noncompliance, and fraud.”*

⁶ Standard 3.1 Competency states:

“Requirements:

Internal auditors must possess or obtain the competencies to perform their responsibilities successfully.”

“To ensure the internal audit function collectively possesses the competencies to perform the internal audit services, the chief audit executive should:

Consider contracting with an independent, external service provider when the internal audit function collectively does not possess the competencies to perform requested services.”

⁷ Standard 9.5 Coordination and Reliance

“The chief audit executive may choose to rely on the work of other providers for various reasons, such as to assess specialty areas outside the internal audit function's expertise, ... and to enhance risk coverage beyond the resources of the internal audit function.”

However, in the 2024 budget cycle, the Internal Audit's consulting budget was cut by \$39,000 to \$171,715. Our 2023 actual was \$212,000. Reinstate this budget ensures that we have sufficient funds to carry out core audit projects.

Internal Audit has four projects planned, with two already committed: the Ethics Hotline Intake Service and the External Quality Review. Additionally, Internal Audit is scheduled to refresh its audit universe through a city-wide risk assessment, and a cybersecurity project is planned for the Library Board. The restored professional & consulting budget, following the \$39,000 reinstatement, will cover the first three projects. We are seeking additional funding of \$90,000 to support the ongoing cybersecurity audit project, as detailed in **Table 2**.

Impact:

Without reinstating the Professional & Consulting budget line, Internal Audit will lack the necessary funding to support critical audit projects essential to its effectiveness. For example, there will be insufficient resources to update the City's audit universe and develop a comprehensive 5-year audit work plan based on a citywide risk assessment. The audit universe, last updated in 2021, is now outdated, which hampers the Audit Committee's ability to perform its oversight responsibilities effectively.

Budget Request Priority: While establishing cybersecurity funding is important, the request for an additional Lead Auditor to address gaps in compliance with IIA Standards is a higher priority. Failing to meet these standards would have a greater impact on the overall effectiveness of the Internal Audit function and pose a significant reputational risk to the organization.

Part 2. Permanent Cybersecurity Audit Funding:

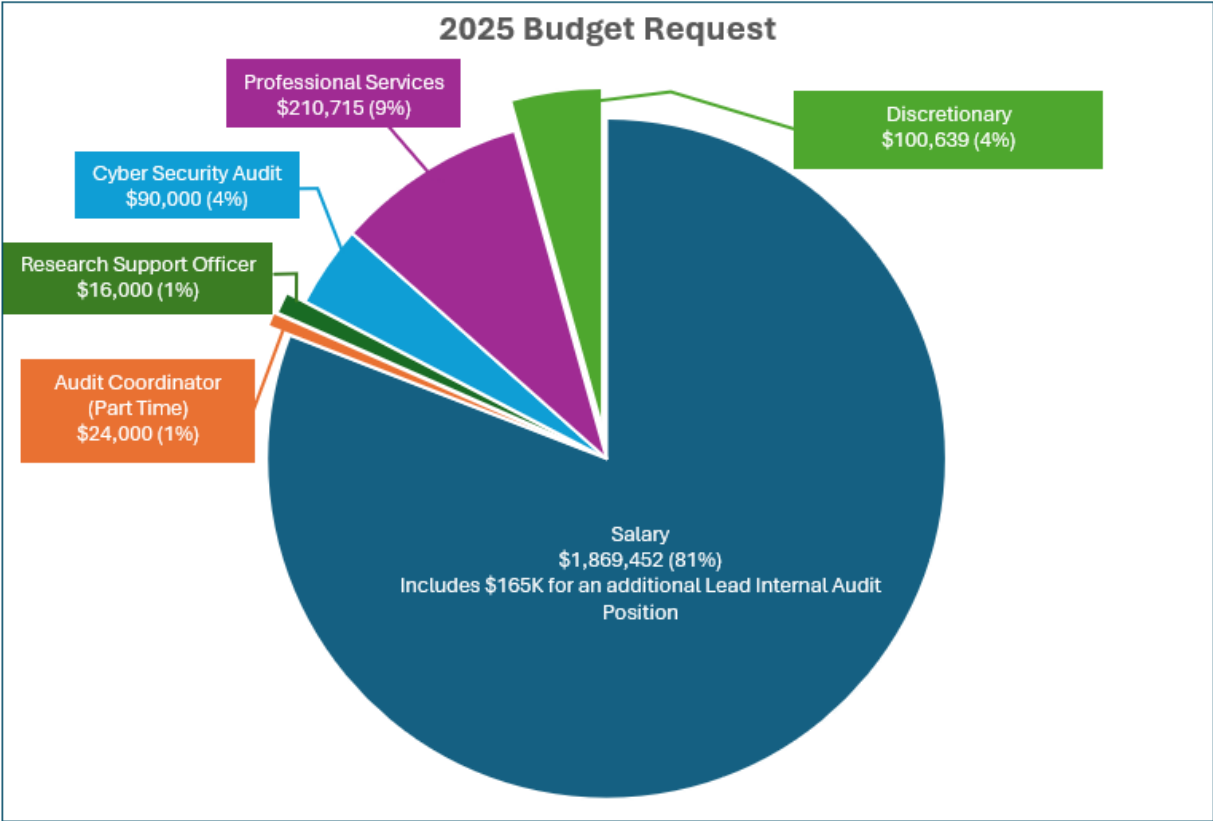
In addition, we are requesting \$90,000 to establish permanent funding for cybersecurity audits. Cybersecurity is flagged as a top corporate risk, and we have previously diverted funds from core audit projects to cover these activities. Given the recent cybersecurity events in neighbouring cities, this funding will ensure that sufficient resources are available to conduct independent Security assessments on an annual basis.

Table 2: Establish Permanent Cyber Security Audit Funding

Budget Item	Amount (\$ 000)	Description
ESTABLISH PERMANENT CYBER SECURITY AUDIT FUNDING		
Yearly Cyber Security Audit Funding	90	Cyber Security is flagged as a Corporate risk. Funding is to ensure independent tests can be conducted yearly.
GRAND TOTAL	90	Total budget increase

The following chart summarizes the total budget request by category. See **Appendix 1** for a detailed list by account.

Chart 1: Total Budget Request



Budget Summary

The 2025 Internal Audit Budget Request, presented to the Audit Committee, seeks approval for the additional resources necessary to fulfill the mandates of the Audit Charter and IIA Standards. These resources are vital to ensuring Internal Audit's continued effectiveness in supporting the Audit Committee's oversight role.

The baseline budget request of \$2,220,806 includes \$255,000 incremental requests over the 2024 budget, including:

- \$165,000 for a new Lead Internal Auditor,
- \$39,000 to reinstate the Professional & Consulting Services budget,
- \$40,000 for part-time and summer students to assist with the increased workload from the upcoming IIA External Quality Assessment.
- \$26,000 to cover rising operating expenses due to a full complement, partially offset by \$15,000 reduction in labour costs.

This request emphasizes the need for an additional Lead Internal Auditor to address three critical areas: validating management action plans, developing a robust Quality Assurance and Improvement Program, and managing the Ethics Hotline. These resources are essential for meeting IIA Standards and improving fraud risk assessments in every audit engagement, as identified in a recent IIA Quality Assessment.

In addition, Internal Audit is requesting \$90,000 to establish recurring funding for cybersecurity audits, in alignment with the City's strategic priorities. This funding will enhance Internal Audit's ability to support the City's internal control, risk management, and governance processes. Approval from the Audit Committee is crucial for strengthening the City's cybersecurity posture.

The total budget request amounts to \$2,310,806. The budget request has been reviewed and is supported by the CAO's Office and are subject to further approval by the City's Budget Committee. The Audit Committee's support and approval are crucial for Internal Audit to obtain additional resources to achieve and maintain IIA Standards.

Strategic Focus Area:

Government and Leadership: Focusing on service excellence with equity, innovation, efficiency, effectiveness, accountability and transparency.

Conclusion:

Per the new Global Internal Audit Standards, Audit Committee is required to work with the Director, Internal Audit to review and approve the Internal Audit Budget before forwarding to the Budget Committee. The proposed 2025 Internal Audit Budget outlined in this report addresses key gaps and unmet needs thereby allowing Internal Audit to fulfill its mandate and workplan. The Director, Internal Audit will continue to engage with the Audit Committee and provide updates on resourcing and budget needs to mitigate any risks and shortfalls.

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Reviewed by:

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Attachments:

- **Appendix 1** – Internal Audit 2025 Budget Request
- **Appendix 2** – Internal Audit 2025 Budget Request Presentation