Grant Thornton

Rest assured?

Bridging the internal audit gaps for New Zealand's public sector

April 2024

Contents

Introduction

This snapshot about the current state of play in internal audit (IA) in New Zealand's public sector reveals how leaders are navigating changes that are chipping away at the very foundations of their purpose.

With intense scrutiny and the prospect of doing much more with a lot less, the sector is perhaps operating under levels of pressure never seen before. For internal audit practitioners, organisational disruption driven by changes to budgets and resourcing represents huge changes in the risks faced by agencies, increasing the levels of assurance their agencies now require. Yet, expectations remain the same: Be transparent. Be responsible. Be efficient. But – cut your resources.

However, while budget and headcount reductions are inevitable, there is also a real opportunity for agencies to recalibrate their internal audit functions. This could be anything from increasing the use of technology, and changing how assurance is delivered, to dropping certain non-value adding tasks and functions altogether. Afterall, "We've always done this", or "We've always done it this way" doesn't mean, "We have to do it forever".

This is particularly critical for internal audit leaders who fulfil roles beyond their internal audit programmes, and who will likely see their workloads grow as budgets are pressured and team numbers decline.

And of course, all of this means the assurance that controls continue to work is now more important than ever. It's a balancing act: make the mandated cuts – but make sure you are cutting fat, not muscle.

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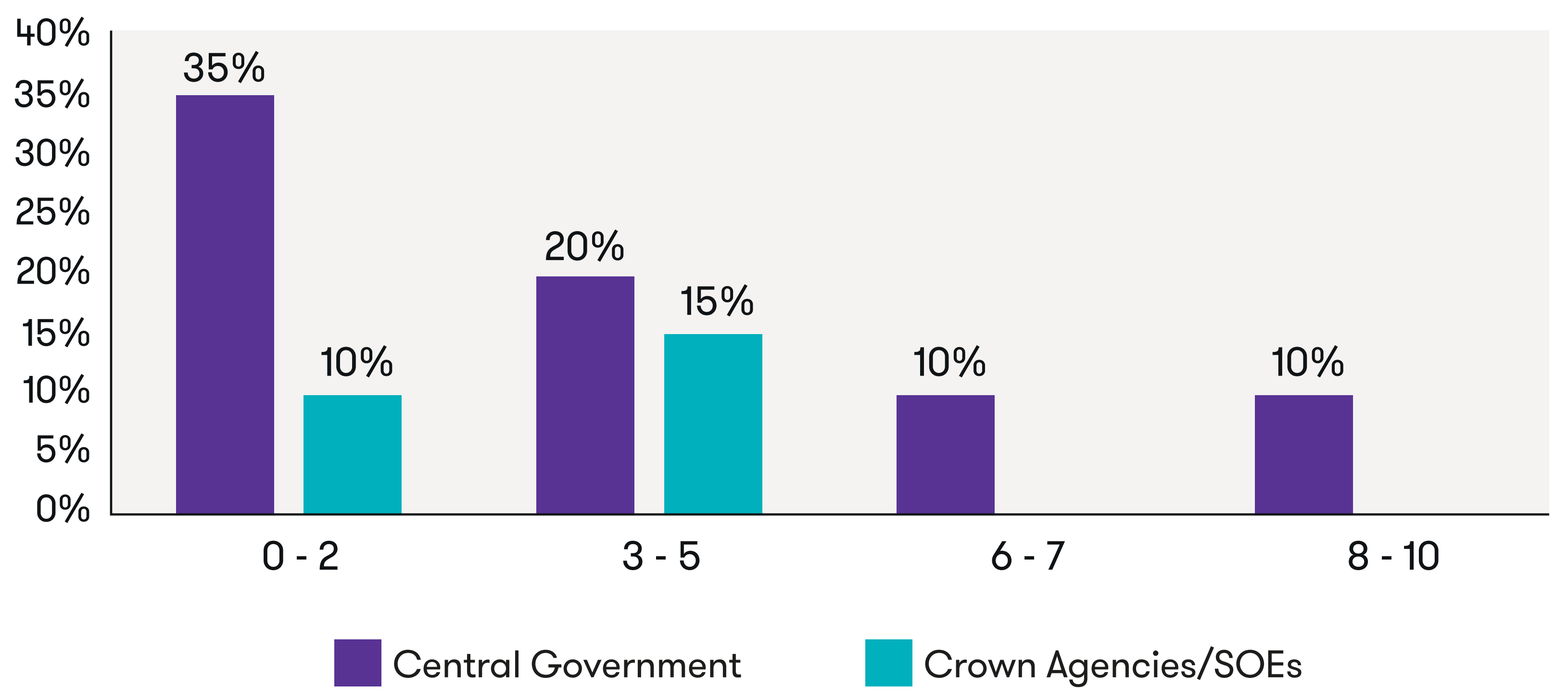
The skills squeeze

Internal resource

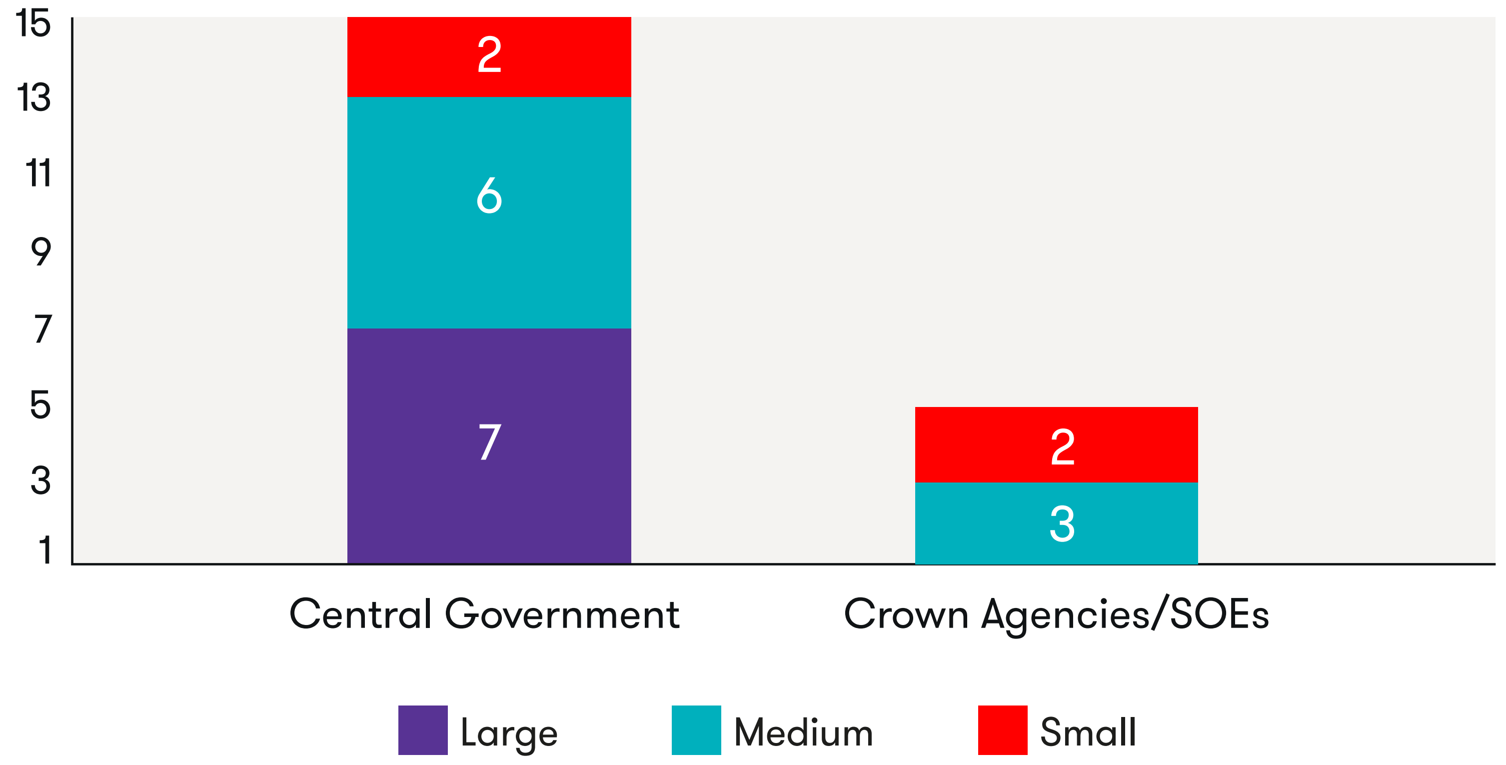
Twenty public sector internal audit leaders participated in this research and represent a mixture of central government agencies, crown entities and one state-owned enterprise.

Their inhouse teams focussed solely on internal audit ranged in size from one person to 10 people with a total of 67 personnel currently working in the organisations surveyed.

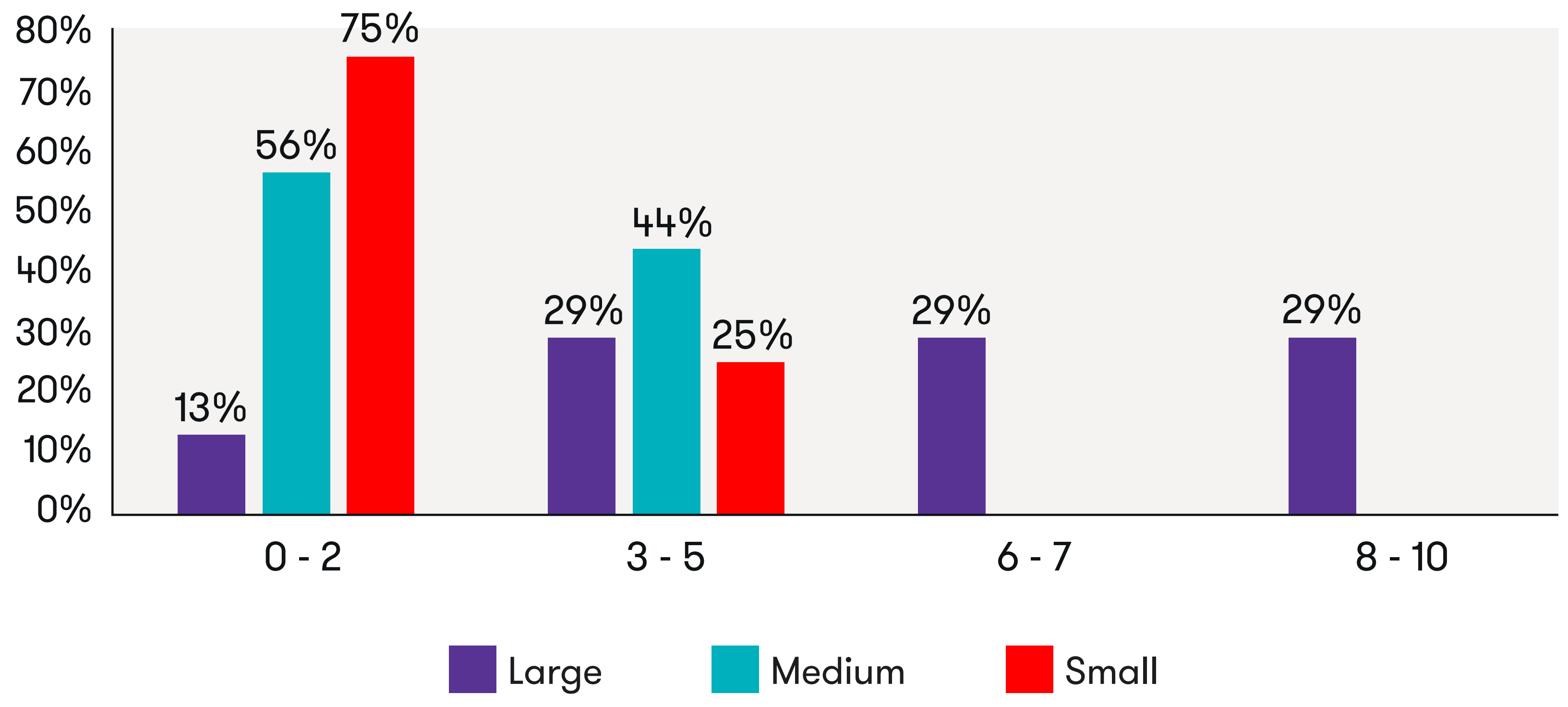
Internal audit team headcounts by agency type



Number and type of organisation surveyed



Internal audit headcounts by agency size



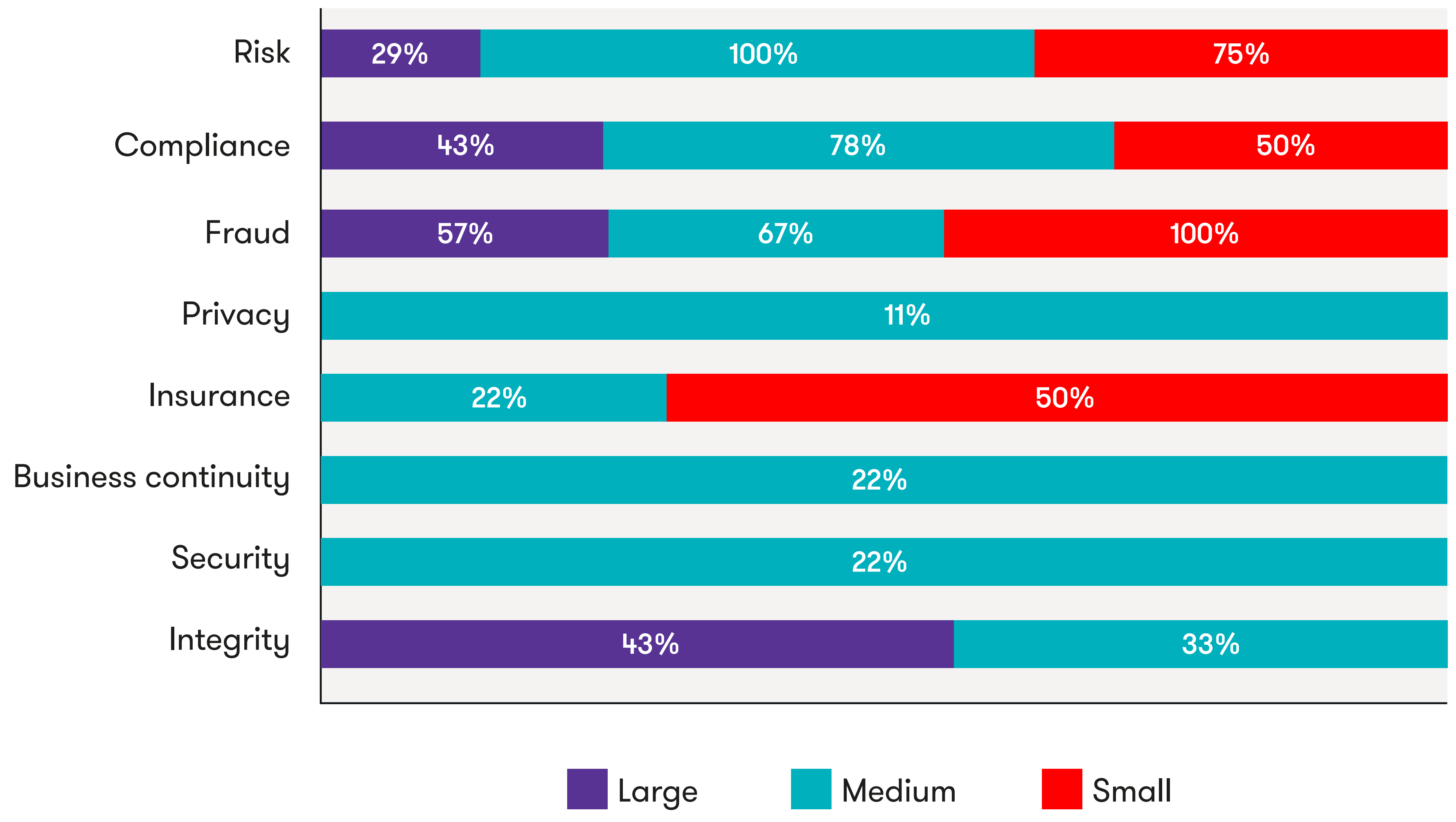
As resources start to reduce, so too will the comfort levels of IA leaders who will still be expected maintain a stable control environment.

All organisations surveyed use external providers to some extent (see p6); despite this, the size of internal audit teams still appears to be on the low side. Sixty-seven percent of large organisations have IA teams of six or less and medium size agencies average two team members; naturally there is widespread concern that internal audit numbers will fall further this year. As these resources start to reduce, so too will the comfort levels of IA leaders who will still be expected maintain a stable control environment.

Our research explored the number of responsibilities leaders have outside of their internal audit roles. Unsurprisingly, risk and fraud sit within most leaders' remit. However leaders in many medium and small agencies have increasing levels of responsibility leaving them with less time to focus on internal audit. These organisations are exposed to more risks when it comes to demonstrating accountability, efficiency and transparency, particularly at a time when the sector is experiencing intense scrutiny from senior ministers, taxpayers and the media.

This means now more than ever, leaders need to reassess where their time is invested and ask themselves, "What tasks can be delegated to other areas of the organisation?", and "What tasks don't add value to the agency? What can I drop altogether?"

Responsibilities outside internal audit

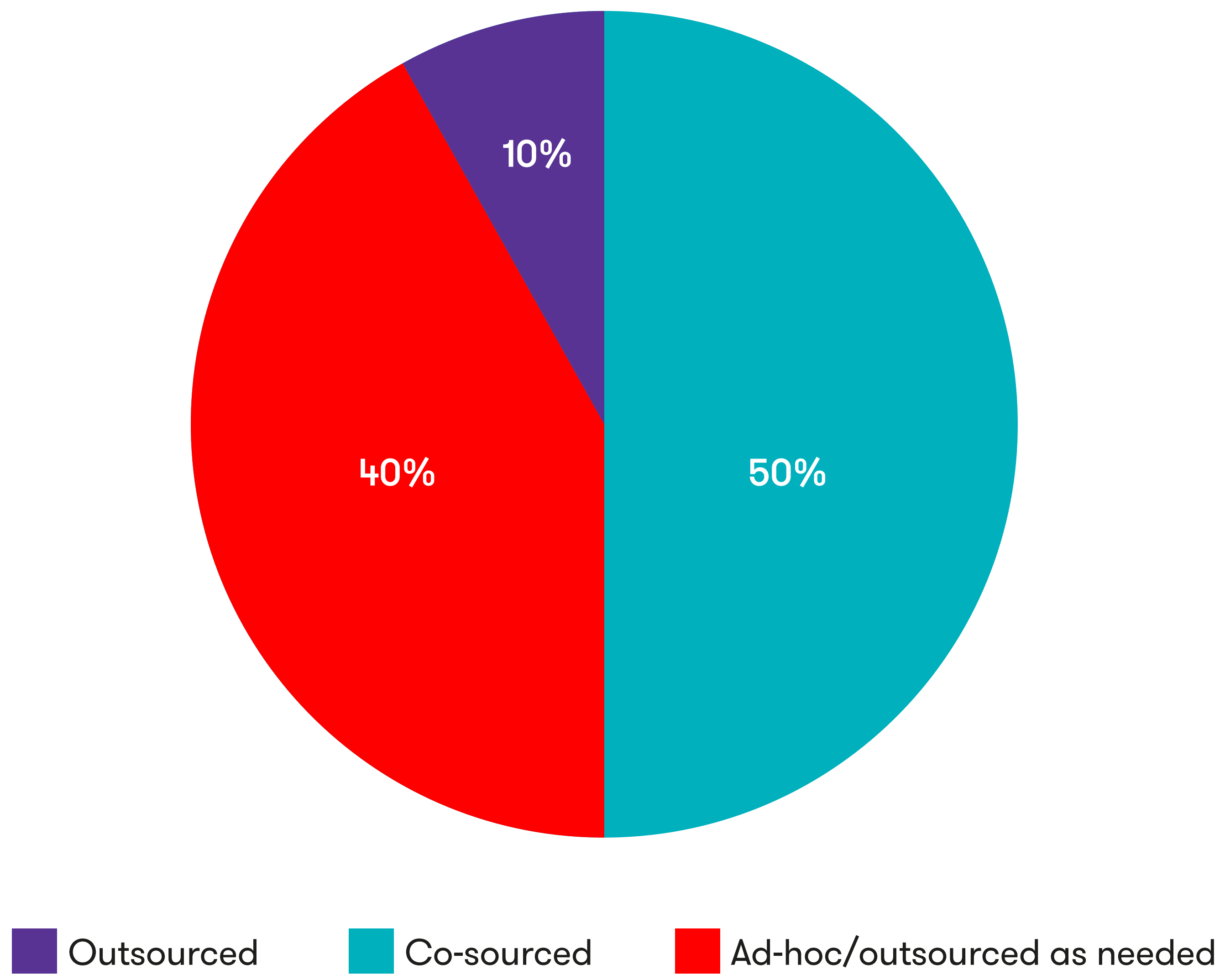


Larger and decentralised agencies must also continue a laser focus on maintaining consistent processes and behaviours to avoid the emergence of a 'wild west' environment where ease and convenience are favoured over policy and procedure. Spending decisions can also start to stray from an organisation's purpose and fail to deliver the right outcomes – or worse – fraud can start to occur.

External resource

Access to specialist skills was the most common reason for using external providers. Currently, a majority of respondents use them either in a co-sourced arrangement or on an ad-hoc basis, while only two outsource their internal audit provision completely. However, conversations with many internal audit leaders revealed a shift away from such heavy reliance on single source external support due to concerns about quality, efficiency and cost-effectiveness. An increasing proportion of these practitioners are looking to establish a panel of providers or outsourcing ad-hoc assignments competitively to improve IA outcomes.

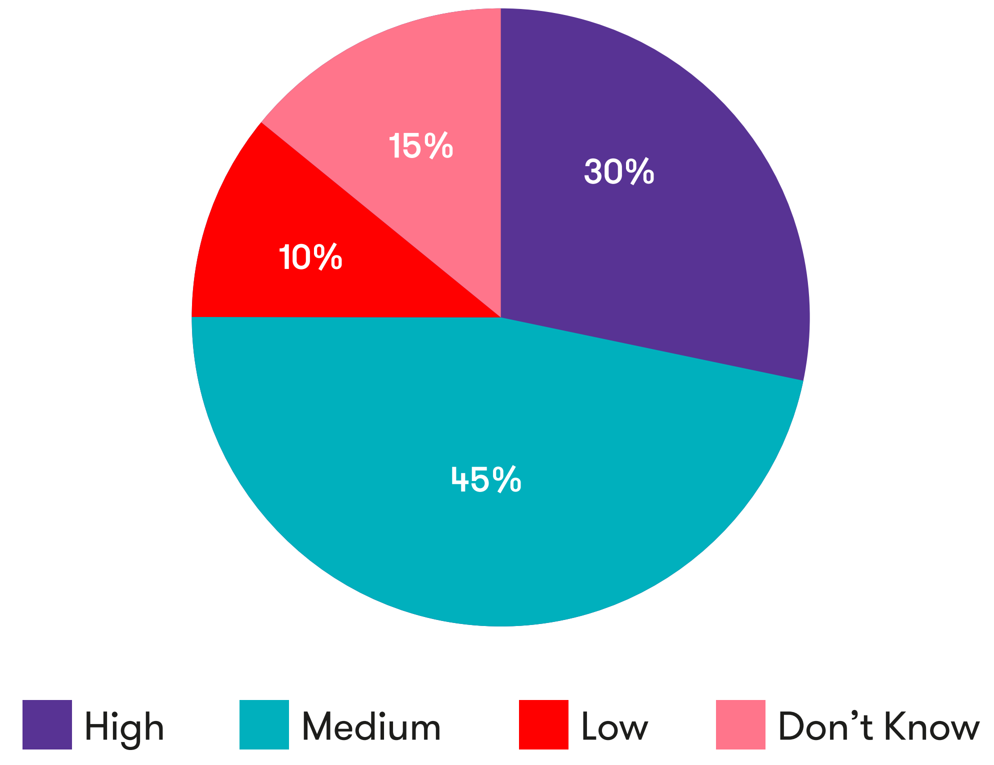
Investment in external support



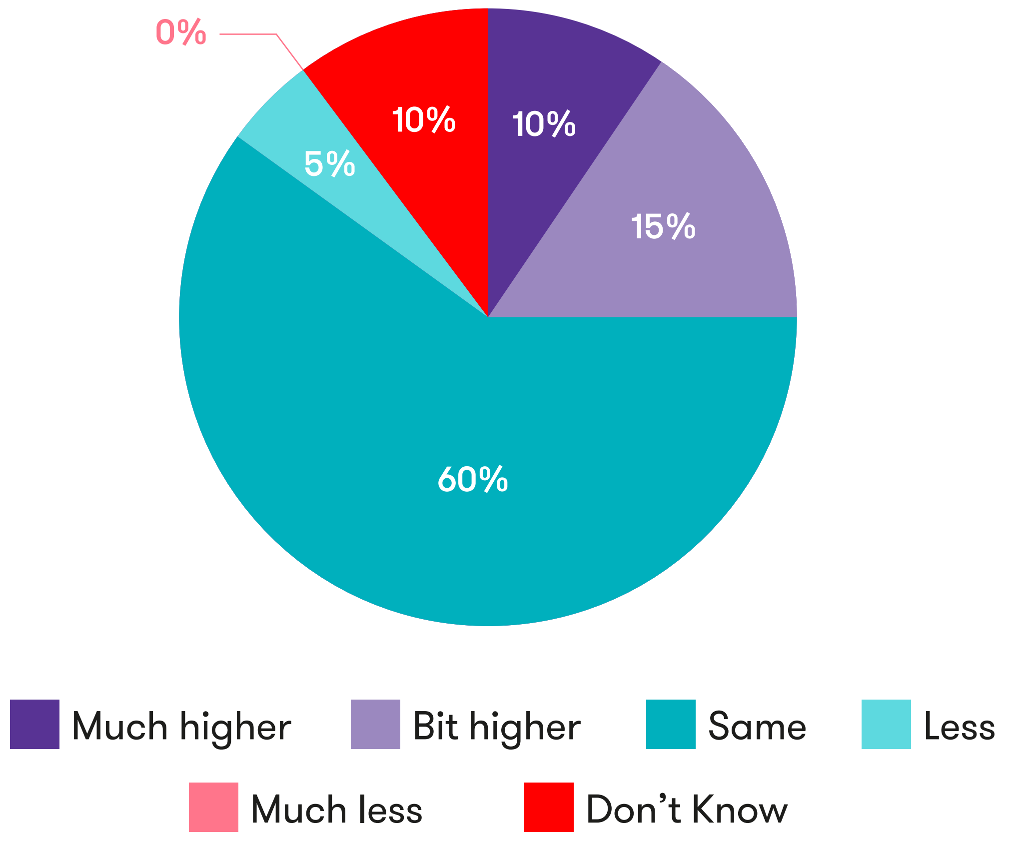
Navigating budgetary bottlenecks

Our research took place after most organisations had been informed of the Government's announcement about the cost savings required throughout the public sector, but before many agencies had finalised their cost reduction plans. We explored IA leaders' budget expectations for the next 12 months and the likely impact of Government expectations.

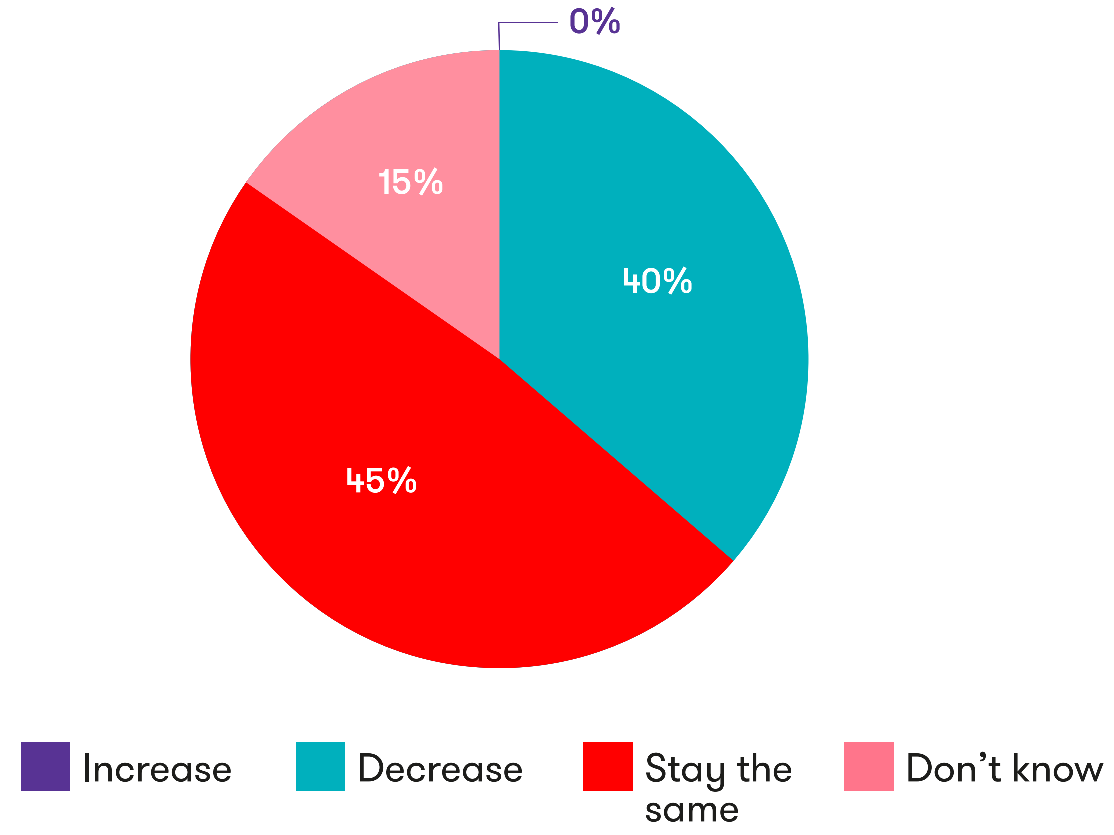
Impact of Government's policy changes or baseline reductions



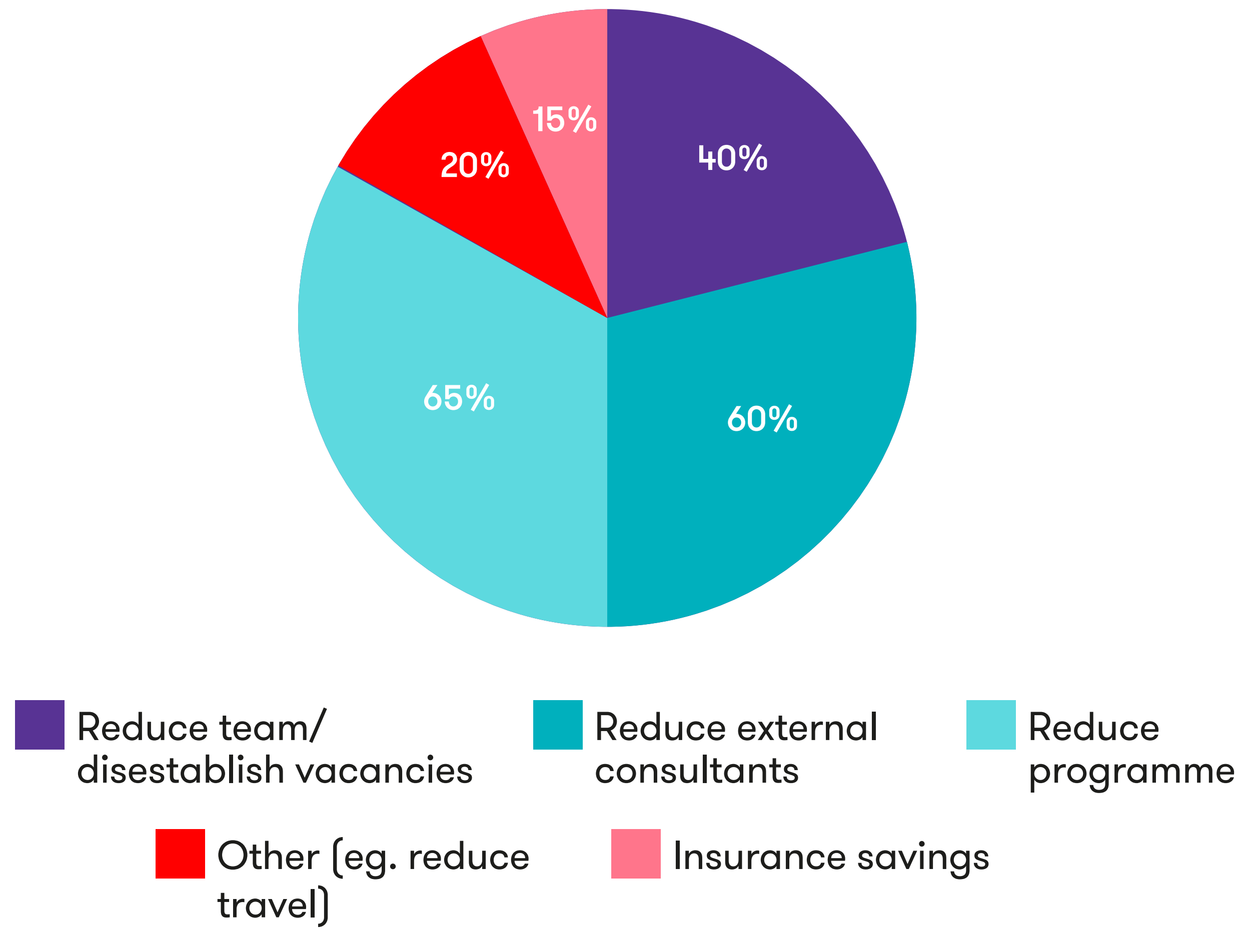
Impact of assurance levels required by your organisation



Budget expectations in 2024



If you experience budget reductions, how will you economise? Select all that apply.



An assurance vs budget balancing act

As people, processes and programmes are impacted by change, we expected the risks agencies face to grow and the amount of assurance required to increase. However, only a quarter of respondents thought their organisation would require more assurance, with the majority expecting their agencies to conduct the same amount of assurance or even less. This finding indicates either significant faith in public sector employees to adhere to policy and procedure, or a potential lack of awareness about the risks that come with change. This could be attributed to the range of responsibilities held by IA leaders; with so many roles to play in their agencies, internal audit possibly doesn't receive enough attention (see responsibilities outside internal audit on p5).

There is also a major discrepancy between the number of organisations requiring more or the same level of assurance and those having to economise by reducing their internal audit programmes. Half of the respondents expected to have to do more with less, with either increased assurance expectations and a static or declining internal audit budget.

Enter the fraud triangle

Unfortunately, cost-cutting mandates and reduced headcounts go hand in hand, which puts more pressure on remaining team members and the controls agencies have in place. This can be the catalyst for the three elements which increase the risk of fraud, according to the internationally accepted Fraud Triangle: opportunity, motivation and rationalisation.

Employees who become disgruntled about headcount reductions they feel are unfair or unjustified may start to rationalise fraudulent behaviour and become motivated to steal from the workplace. Others might become disengaged or complacent as their tasks and responsibilities grow without an increase in pay. The quality of output from disengaged team members often diminishes, with controls going unchecked; this provides plenty of opportunity for disgruntled employees to commit various levels of theft and fraud.

The increased risk of disengaged or disgruntled employees should prompt agencies to review the continued effectiveness of their controls and the processes used to monitor and assure them. Controls and processes that pose little risk or add limited value to agencies' IA programmes should also be reprioritised or removed altogether to create efficiencies and ease the pressure experienced by team members.

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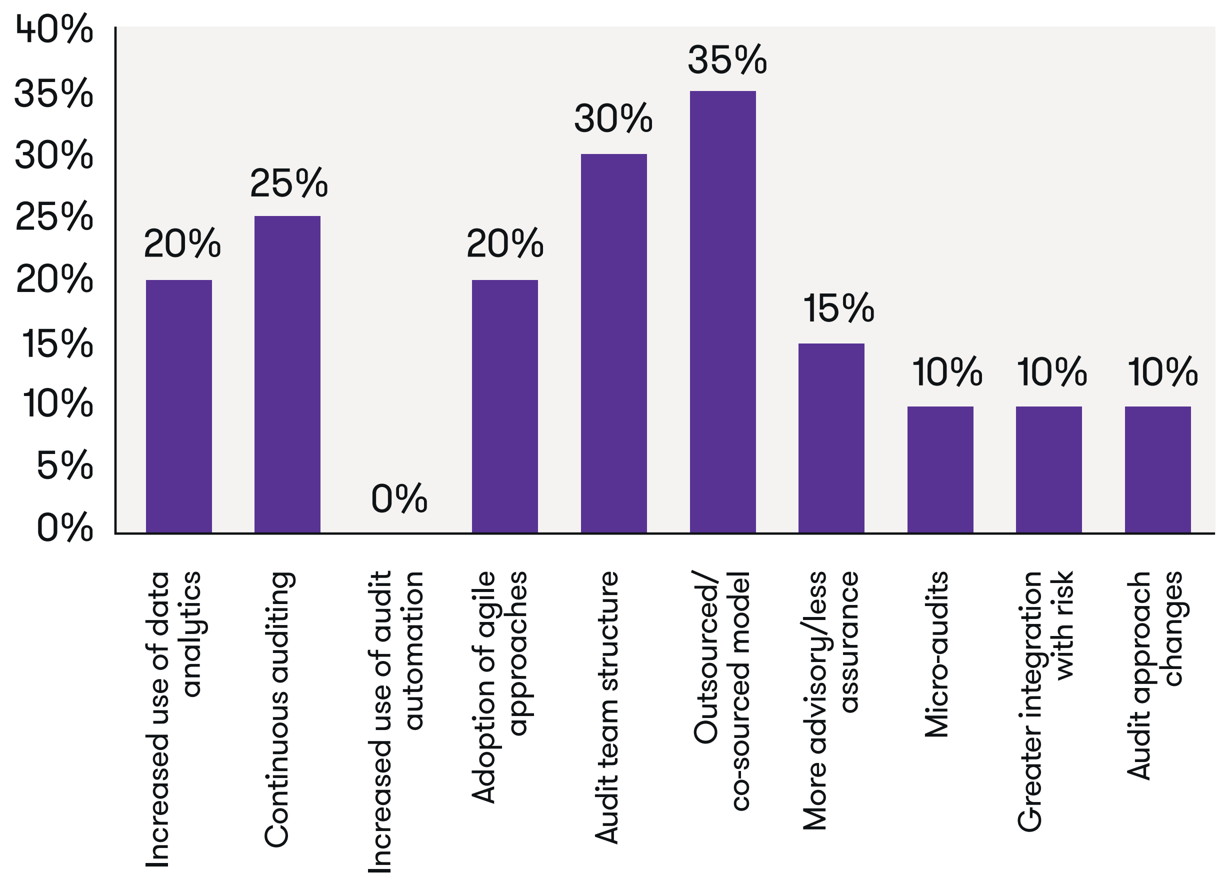
Innovating to survive and thrive

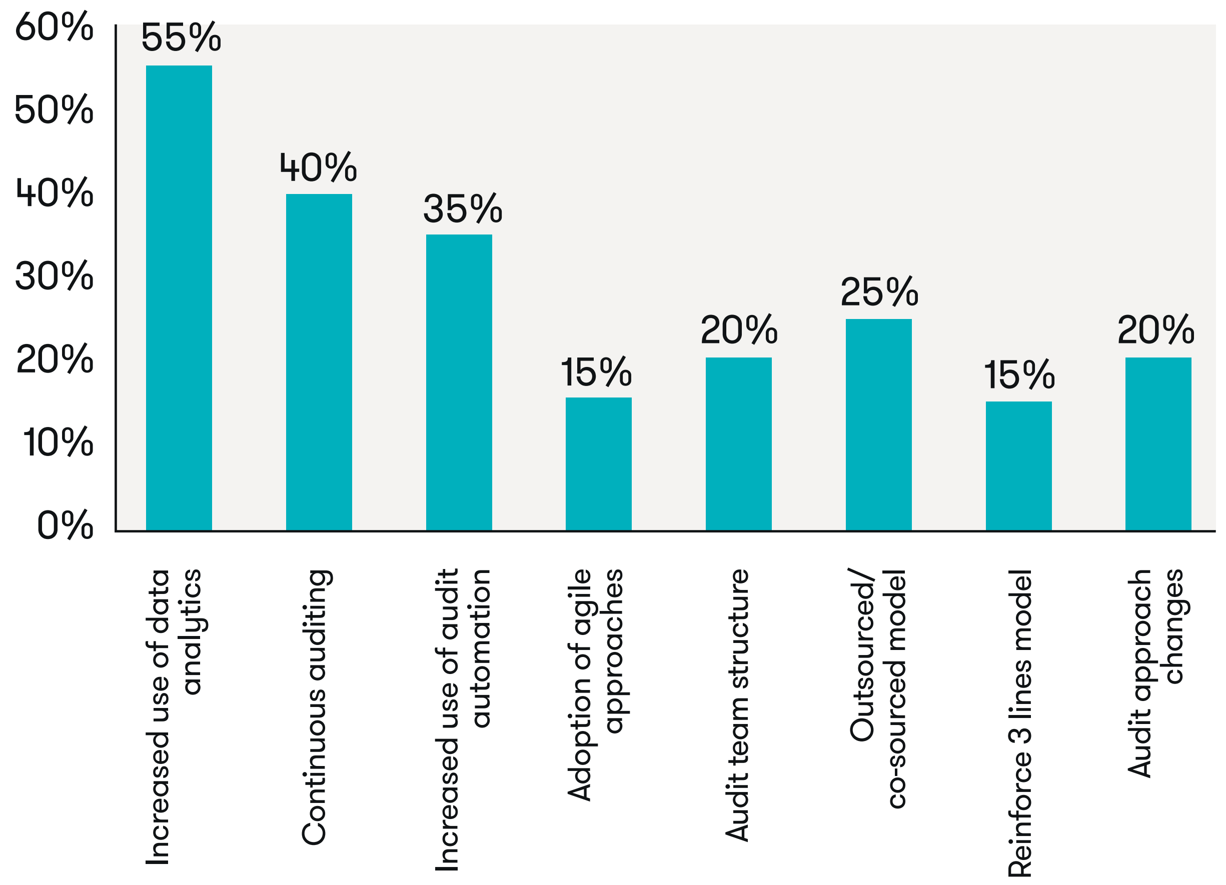
Time saving technology

Many agencies are looking to reduce spend by providing assurance in different and more cost-effective ways. Increased use of the right technology is a solid step towards maintaining or even increasing important areas of an IA programme. We asked IA leaders about new practices they have recently invested in, and what they're looking at implementing in the future.

IA practices adopted in the last 12-18 months



New innovation considered



It's interesting to see a small number of agencies have increased their use of data analytics (DA), and over half have indicated it's something they want to invest in going forward. DA technology has been around for about a decade; slow uptake in the public sector is typically due to three key factors: lack of inhouse skills needed to implement and use the technology, the cost of purchasing tools and applications, and low awareness about the breadth and depth of insights DA can really deliver to an organisation.

The power of DA to scrutinise an entire population - not just a sample - creates obvious benefits for assurance, and the ability to continue to use established DA queries to generate reports can create business insights in real-time dashboards as manual input isn't required by users. Large datasets can be interrogated much faster allowing more focused risk-based internal audit reviews. For example, you could set up a reporting dashboard to continuously monitor instances of supplier accounts with shared bank account numbers in real time, allowing anomalies to be investigated before payments are made; these insights also allow you to investigate and resolve the process weakness which allowed the issue to occur.

Making IA models better, faster, stronger

A number of agencies have spent the past 12-18 months building their teams, and a larger number have revisited how they use external providers - two improvements which are potentially at risk from reduced budgets. A significant number of organisations were considering additional changes to teams and external support, which indicates only approximately half of participants feel they have a well-established model which continues to deliver.

Agencies that have adopted elements of agile approaches, along with the 10% who have adopted "micro-audits" (which can be viewed as an agile approach) represent a group who are attempting to increase the visibility of the value IA delivers by creating assurance insights faster. Even adding in the 10% who have changed their IA processes shows only 40% are changing how they deliver their work, indicating 60% of respondents are either currently delivering excellent work or that progress and innovation are being stymied by other responsibilities and pressures IA leaders face. It is our expectation a majority of public sector internal auditors will need to rethink how and what they do to ensure they deliver the value their organisations need.

60% of respondents haven't implemented new processes indicating innovation is being stymied by other responsibilities and pressures IA leaders face.

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