

## **Memorandum**

**AC-C 1-2025**

**Subject:** Internal Audit Function – Transition, Role, and Independence

**Date:** March 24, 2025

**To:** Audit Committee

**From:** Hari Vemuri, Manager, Internal Audit

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### **Background: Transition from ICOPS to Hybrid Model**

In 2019, Niagara Region undertook a rationalization of the Internal Controls and Organizational Performance Division (ICOPS) as part of a broader service sustainability review. Council considered the results of the review and passed a motion at its meeting on November 7, 2019, recommending a restructuring of this division. This restructuring aimed to achieve efficiencies while maintaining robust oversight functions. The transition resulted in a net reduction of eight (8) full-time positions and annual recurring operating cost savings of approximately \$750,000, which were utilized to mitigate tax levy increases. It is crucial to note that the internal audit function was not eliminated but was instead restructured into a hybrid model.

This restructuring aligned with recommendations from KPMG's 2019 Service Sustainability Review, approved by Regional Council, which identified opportunities to supplement internal capabilities through third-party professional firms. The objective was to enhance audit efficiency while leveraging specialized external expertise, such as cybersecurity audits, financial controls, and operational compliance. The model was implemented in early 2020, with a Manager of Audit overseeing the function and external firms conducting the majority of audit engagements.

### **Current Internal Audit Function and Role**

The internal audit function follows a hybrid model, combining internal oversight with external expertise to ensure effective risk management and accountability across regional operations. The model includes:

- **Manager of Audit (Internal Oversight):** This internal role is responsible for developing an annual audit work plan, prioritizing areas of risk and ensuring effective coordination with external audit firms. The Manager also conducts select internal reviews and monitors compliance with recommendations.

- **External Professional Audit Firms:** Niagara Region engages third-party professional firms through a competitive procurement process to execute the majority of audit projects. This approach enables access to specialized skills (e.g., cybersecurity, forensic accounting) while maintaining cost-effectiveness.
- **Audit Activity and Performance:** Since the adoption of this model in 2020, a total of 13 audits have been conducted. However, the audit manager position was vacant during 2021 and part of 2022, leading to a slowdown in audit activity. With the current manager in place, the audit function is now running at full capacity, completing four audits per year in 2023 and 2024.

The effectiveness of this hybrid model is evident in recent audit projects, demonstrating how internal and external resources are used to improve efficiency:

- The Corporate Purchasing Card (P-Card) Follow-up audit in 2024 was conducted internally, ensuring optimal use of in-house resources while strengthening internal controls.
- The Vendor Performance Management Audit in 2024, which focused on tier 1 contracts and consulting services, was handled externally. This allowed the region to leverage industry expertise, adopt best practices, and ensure a robust vendor evaluation framework.

These examples highlight how the model works in practice. Internal audits focus on areas where existing expertise can be efficiently applied, while external audits bring in specialized knowledge to improve processes and enhance outcomes. For the model to work effectively, there must be a lead ensuring proper coordination, timely execution, and strategic alignment of audit activities.

Audit findings from both internal and external engagements are reported directly to the Audit Committee, reinforcing transparency, accountability, and governance effectiveness.

### **Independence and Oversight of Internal Audit**

Niagara Region has adopted a hybrid internal audit model that strategically combines the in-house audit capacity of one (1) full-time internal audit manager with the use of external audit firms. This model is well-suited to Niagara's needs and aligns with many of the effective practices observed in other municipalities. Niagara's hybrid model achieves independence in fact and appearance through multiple layers:

- **Audit Committee Oversight:** The Internal Audit Manager works with and reports to the Region's Audit Committee – a committee of Council – which approves the audit plan and receives audit reports. This governance structure means that internal audit work is directed by Council (not by departmental management), thereby preserving objectivity. Niagara's Audit Committee has the authority to initiate audits and even retain third-party experts to assist, underscoring Council's control over the audit agenda. This ensures that if any sensitive findings arise, they can be communicated to Council without dilution.
- **Use of Independent External Auditors:** By outsourcing the majority of audit projects to external firms, Niagara Region injects an additional level of independence. These firms are professionally obligated to be objective and have no operational role within the Region. They are engaged through transparent procurement and report their findings without influence from those being audited. In practice, an external audit firm's only interest is to deliver a thorough audit to maintain its professional reputation. Councillors can take comfort that these external auditors approach each assignment with fresh, impartial eyes. The Internal Audit Manager coordinates their work but does not interfere with their conclusions, ensuring the integrity of the audits. In essence, the Region gains arm's-length assessments of its programs.
- **Adherence to Professional Standards:** External professional services firms conducting the audits follow Institute of Internal Auditors (IIA) Standards, maintaining best practices in risk-based auditing and governance.

### **Financial and Service Delivery Considerations**

The hybrid model enables Niagara to deliver top-tier audit quality by drawing on the strengths of both in-house knowledge and external expertise.

- **Strategic use of external professional firms:**
  - The Region can select external firms with the precise expertise needed for each audit topic. This tailored approach means every audit is led by professionals highly knowledgeable in that subject matter.
  - External auditors also bring benchmarking data and insights from other municipalities and industries, allowing Niagara Region to gauge its performance against peers.

- While external teams perform audits, Niagara Region's Internal Audit Manager (who is also a Chartered Professional Accountant) provides critical oversight, coordination, and quality assurance. The Manager ensures that the external auditors understand the Region's context, risks, and objectives, so their work is relevant and adds value. The Manager also conducts follow-up audits internally on past recommendations to ensure that they are implemented.
- By handling follow-ups in-house, Niagara Region saves money (since these are shorter engagements suited to the Manager's capacity) while maintaining momentum on implementation.
- Niagara Region's model also adheres to professional frameworks (e.g. developing risk-based annual plans and aiming for compliance with Institute of Internal Auditors standards), which Councillors can regard as an assurance that our audit processes meet recognized quality criteria.
- As the hybrid model is adaptable, Niagara Region can quickly respond to emerging risks or Councillor concerns by reallocating audit resources. If a new issue arises mid-year, we can engage an external team on short notice. This agility ensures high-priority concerns get audited promptly. It also allows us to pilot new types of audits by bringing in experts temporarily. Any changes to Council's strategic priorities can also be embedded into the audit plans, as necessary.
- Niagara Region's approach is fiscally responsible, achieving strong oversight without the overhead of a large permanent department:
  - The hybrid model operates on a mostly variable cost basis. Rather than funding multiple full-time internal auditor positions (with salaries, benefits, and downtime between projects), Niagara hires external auditors per project. The single in-house Audit Manager position is the only fixed cost, and that role is multi-purpose (planning, overseeing externals, doing follow-ups and some audits), providing excellent value.
  - By judiciously choosing which projects to self-perform versus outsource, the hybrid model optimizes spending on a case-by-case basis.
  - When Niagara Region engages external audit firms, it typically does so through competitive requests for proposals or quotations. This harnesses market competition to keep fees reasonable. Firms know that they must offer skilled resources at competitive rates to win the Region's business.

- Audits under the hybrid model are reported with full transparency. Audit reports are presented to the Audit Committee (and thereby to Council) and made public, demonstrating Niagara's commitment to open governance. All Audit Committee meeting minutes go to Council and the Committee's Terms of Reference include that audit results be made available for examination by any Councillor upon request.

## **Conclusion**

The transition to a hybrid internal audit model has preserved the Region's commitment to effective oversight, risk management, and accountability, while also achieving financial sustainability. The function remains independent, well-governed, and aligned with best practices, ensuring ongoing transparency and operational efficiency. The Audit Committee continues to play a central role in maintaining this independence, ensuring that audit activities effectively serve the Region's governance framework.

Respectfully submitted and signed by

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Hari Vemuri  
Manager, Internal Audit