

Warwickshire and West Midlands Association of Local Councils

(Affiliated to the National Association of Local Councils)



Warwick Enterprise Park, Wellesbourne, Warwickshire CV35 9EF

Telephone: 01789 472616 Fax: 01789 472619

Email: walc@walc.org.uk Website: www.walc.org.uk

Clarification of the role of Internal Auditor, Tests to be Carried out by the Internal Auditor and Suitable Candidates

The following guidance is published jointly by SLCC and NALC in consultation with the Audit Commission. Essentially local councils and their clerks/RFO's are free to decide whether they consider it necessary for internal auditors they choose to appoint to have professional indemnity insurance cover. Possession of such cover is likely to be reflected in the fees charged.

In discussions with representatives of both Zurich Municipal AON (Cornhill Insurance) SLCC and NALC have been advised that neither company feel it necessary or appropriate for local councils to seek PI cover in respect of internal auditors they appoint and who do not have such insurance for the reasons stated below.

The NALC/SLCC joint publication in support of the new 'lighter touch' audit approach for local councils – *Governance and Accountability for Local Councils in England and Wales – A Practitioners' Guide* – covers in some detail the subject of internal audit within the context of the council's risk management. We are aware that there have been a number of questions posed by local councils regarding the need for internal auditors to carry professional indemnity insurance. Representatives of NALC and SLCC, together with the Audit Commission, recently met with the principal insurers in the local council sector and as a result of that meeting have prepared this further guidance.

All councils should first consider and determine the level of internal audit they need based on risk (not the risk that the appointed internal auditor could be no good, but the real business risk of service interruption). Where it is decided that a professional firm should be used to provide the service, because, for example, of the complexity of the systems of control and/or the high value of assets at risk, then it would be a matter of proper due diligence to ensure that the proposed provider, like any other professional, was properly equipped to carry out the work, including relevant insurance, if appropriate.

In smaller councils, the internal auditor requirement could well be met by a non-professional individual who meets the competence and independence tests who would, in the vast majority of cases, not have, and probably find it impossible to get, PI cover.

In all cases the potential losses arising should be risk assessed, as with any other expenditure, and appropriate risk management processes adopted. As the

insurers informed us, it is difficult to envisage the basis on which a local council could credibly ask for PI cover, as this would be admitting to making an internal auditor appointment about which they were unsure or which is not independent of the council's financial controls. This would be contrary to the guidance in the Practitioners' Guide.

The fault may lie in the misunderstanding of what an internal auditor does (and doesn't do), and what the duties are. The council should not be basing any of their management decisions on the advice of the internal auditor but correcting internal control systems weaknesses identified by the internal auditor and reported to them. The internal auditor should not be part of the management process, but an adjunct to it, maintaining their independence at all times. In this way it is difficult to make a 'cause and effect' link between management decisions (or a lack of decisions) and any catastrophe occurring as a result of them, and the work of the internal auditor.

However, if the "information providing" role of the internal auditor is abused and she or he is asked by the council or its officers to give advice (particularly if that is in an area where there is a lack of expertise) or is allowed by the council to become part of the management process, then the risk profile changes significantly. This still does not, however, create an insurable risk.

Alan Fairchild, Chairman SLCC Training & Advisory Services Committee

Tests to be carried out by the internal auditor:

- Checking that books of accounts have been properly kept throughout the year.
- Checking a sample of payments to ensure that the council's financial regulations have been met.
- Checking income records to ensure that the correct price has been charged, income has been received, recorded and promptly banked and VAT is correctly accounted for.
- Reviewing petty cash records to ensure payments are supported by receipts, expenditure is approved and VAT correctly accounted for.
- Reviewing the council's risk assessment (insurance cover) and ensuring that adequate arrangements are in place to manage all identified risks.
- Checking that salaries to employees have been paid in accordance with council approvals and that PAYE and NIC requirements have been properly applied.
- Verifying that the annual precept request is the result of a proper budgetary process; that budget progress has been regularly monitored and that the council's reserves are appropriate.
- Checking the accuracy of the asset register
- Testing the accuracy and timeliness of periodic and year end bank account reconciliation
- Year end testing on the accuracy and completeness of the financial statements

Who should be the internal auditor?

For appointment as an internal auditor, the person concerned should be both competent and independent and have acted without influence of the council.

The council must be satisfied that the internal auditor is competent to carry out the work. The internal auditor does not have to possess any qualifications, but the following essential competencies should be sought:

- Understanding of basic accounting processes;
- Understanding of the role of internal audit in reviewing systems rather than undertaking detailed checks that are more appropriately the responsibility of management;
- Awareness of risk management issues; and
- Understanding of accounting requirements of the legal framework and powers of local councils.

An internal auditor does not need to do the work for reward. Many local councils have engaged an internal auditor from within the parish, who is happy to do the work for free. There should be no evidence that the internal audit work has not been carried out ethically and with integrity and objectivity.

Although serving councillors are unlikely to be accepted as being independent enough to internally audit their own council, they could audit other councils. If a partner of a councillor meets the above criteria then he or she would be a suitable person to carry out the internal audit. But the councillor concerned should be advised not to become involved in the finance committee, or be a cheque signatory.

Officers of the council should be consulted on the content of the audit plan and all concerned should agree this beforehand.

Responsibilities for officers and internal audit should be defined in relation to risk management, internal control and fraud and corruption matters. These will be clearly set out in such documents as job descriptions and the auditor's engagement letter.

Council members should be clear on their own responsibilities for "the protection of the public purse" and within the internal audit framework. The council has a duty to consider the annual internal audit report and to demonstrate that by inclusion in the minutes. Each item mentioned in the report should be fully addressed. There may be a need for councillor training to ensure that all members fully understand this role and budget provision should be made where necessary.

Every council should issue terms of reference and a letter of appointment. Below are two models: one for use where the internal auditor will be appointed on a self-employed basis and the second where the internal auditor becomes an employee of the council. The former is the more usual arrangement.

The audit plan should properly take account of the corporate risk, i.e. controls and procedures within the council which minimise the risk of the body not being able to function or carry out what it sets out to do. The council should approve the plan. Internal audit should report in writing in accordance with the plan.

JANUARY 2008