

# **MERTON PARISH COUNCIL**

## **Internal Audit Policy.**

This document sets out Merton Parish Councils approved and agreed practices. Any deviation must be made by resolution of the full Council and recorded below.

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Signed     *S. Papworth*     ~~Chairman/Vice-Chair~~

Date     11<sup>th</sup> November 2019    

**Original signed document retained by Clerk.**

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## **PART A**

- 1. Clerks summary**
- 2. Background**

*This summary is a brief precis of the full internal auditor policy report.*

*It is for the Parish Councillors to make an informed decision based on the entirety of the report after careful consideration of the full details and not just this precis.*

*Merton Parish Council and its Councillors have a legal responsibility to approve, adopt and implement an internal auditor Policy based on their own determinations.*

### **1. SUMMARY**

The External Auditor is responsible for checking the accounts.

The Internal Auditor is responsible for ensuring our practices, policies and procedures are legal, accurate and compliant and, including our accounting process.

From the start of 2017/18 financial year, a 'smaller authority' (less than £25,000pa turnover), will be exempt from having to submit an annual financial return to its external auditor, but will still need to have an auditor appointed in case there are questions from electors to be resolved, the S.A.A.A. (Smaller Authority Audit Appointments Limited), will be the first point of contact in such a case as the appointed sector led body (SLB) external auditor, this incurs a one off fee for a five year period of £100 (to be confirmed). Any investigation by the S.A.A.A will be at additional unsubsidised cost.

MPC must annually review the effectiveness of the internal audit

### **2. BACKGROUND**

The work of internal audit should be subject to a signed contract on first appointment by the Council, setting out the terms of the appointment.

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**It is also important for Councils to recognise that internal audit's function is to test and report to them on whether the Council's system of financial control put in place by management is adequate and working satisfactorily.**

It is not for the external auditor, nor is it a matter for internal audit, to actively seek evidence of fraud, corruption, error or mistake. Internal audit's role is to assist the Council in fulfilling its responsibility to have and maintain proper internal control arrangements and those for the prevention and detection of fraud, error or mistakes

Local Councils should carry out an internal auditor review periodically. It is recommended that reviews be carried out no longer than three years apart and also in the year of any change of internal auditor

Any review should balance the Council's internal audit needs and usage. It should be designed to provide sufficient assurance for the Council that standards are being met and that the work of internal audit is effective

**A key point to note is that any review should be undertaken by the Council. This is not a review that can be carried out by the external auditor or as part of the annual audit. Nor is it something that can be delegated to the clerk or RFO, and certainly not to internal audit.**

Although the internal audit provider cannot be allowed to influence the direction or extent of the review, it is good practice to seek their input into the process.

There are no hard and fast rules about who actually performs the review or how it is carried out, but Councils may wish to set up a small working party for this purpose. Regardless of how the review is carried out, the results should always be reported to and considered by a full meeting of the Council.

**Internal audit is a key component of a local Council's internal controls. Local Councils report each year on internal controls so it is recommended that internal audit reviews should be carried out at least once every three years.**

Those carrying out the review of internal audit will need to understand the purpose of the review, what it includes, and how to carry it out. Training on this may be delivered by DALC/NALC and SLCC.

### **PART B**

- 1. Internal audit plan**
- 2. Schedule of internal control testing**
- 3. Terms of reference**
- 4. Standards to be met by the internal auditor**

#### **1. INTERNAL AUDIT PLAN**

Governance and Accountability for Local Councils

**A Practitioners' Guide (England) March 2016**

**Appendix 9 – An approach to internal audit testing**

1. The Council will determine the scope and coverage of the work to be carried out by internal audit in accordance with proper practices guidance. Internal audit testing of internal controls will be sufficient for the proper completion of the annual internal audit report. The

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annual internal audit report should provide an adequate level of assurance for the Council to complete assertions 2 and 6 in its annual governance statement.

2. In completing the annual report at section 4 of the annual return, internal audit will have planned and carried out the work necessary to give the assurances called for. The ten key control tests in the annual report represent the minimum level of internal audit coverage required. Additional testing and reporting should be tailored to local circumstances.

3. Internal audit work always requires the application of judgement and should only be carried out following risk assessment. The scope and frequency of testing should reflect that assessment, and therefore should always be in proportion to the likelihood of fraud, error or misstatement that could occur. It should be directly related to the size and level of business activity of the council.

4. The following schedule suggests an approach to the testing of key internal controls to provide assurance that the minimum level of coverage has been met.

### **2. SCHEDULE OF INTERNAL CONTROL TESTING**

<b>Internal Control</b>	<b>Suggested testing</b>
<b>Proper bookkeeping</b>	<ul style="list-style-type: none"><li>• Is the cashbook maintained and up to date?</li><li>• Is the cashbook arithmetic correct?</li><li>• Is the cashbook regularly balanced?</li></ul>
<b>a) standing orders and financial regulations adopted and applied; and</b>	<ul style="list-style-type: none"><li>• Has the council formally adopted standing orders and financial regulations?</li><li>• Has a Responsible finance officer been appointed with specific duties?</li></ul>
<b>b) payments controls</b>	<ul style="list-style-type: none"><li>• Have items or services above the de minimus amount been competitively purchased?</li><li>• Are payments in the cashbook supported by invoices, authorised and minuted?</li><li>• Has VAT on payments been identified, recorded and reclaimed?</li><li>• Is s137 expenditure separately recorded and within statutory limits?</li></ul>
<b>Risk management arrangements</b>	<ul style="list-style-type: none"><li>• Does a review of the minutes identify any unusual financial activity?</li><li>• Do minutes record the Council carrying out an annual risk assessment?</li><li>• Is insurance cover appropriate and adequate?</li><li>• Are internal financial controls documented and regularly reviewed?</li></ul>
<b>Budgetary Controls</b>	<ul style="list-style-type: none"><li>• Has the Council prepared an annual budget in support of its precept?</li><li>• Is actual expenditure against the budget regularly reported to the council?</li><li>• Are there any significant unexplained variances from budget?</li></ul>
<b>Income Controls</b>	<ul style="list-style-type: none"><li>• Is income properly recorded and promptly banked?</li><li>• Does the precept recorded agree to the Council Tax authority's notification?</li></ul>

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- Are security controls over cash and near-cash adequate and effective?
- Payroll Controls**
- Do all employees have contracts of employment with clear terms and conditions?
  - Do salaries paid agree with those approved by the Council?
  - Are other payments to employees reasonable and approved by the council?
  - Have PAYE/NIC been properly operated by the council as an employer?
- Assets controls**
- Does the council maintain a register of all material assets owned or in its care?
  - Are the assets and Investments registers up to date?
  - Do asset insurance valuations agree with those in the asset register?
- Bank Reconciliation**
- Is there a bank reconciliation for each account?
  - Is a bank reconciliation carried out regularly and in a timely fashion?
  - Are there any unexplained balancing entries in any reconciliation?
  - Is the value of investments held summarised on the reconciliation?
- Year-end procedures**
- Are year-end accounts prepared on the correct accounting basis (Receipts and Payments or Income and Expenditure)?
  - Do accounts agree with the cashbook?
  - Is there an audit trail from underlying financial records to the accounts?
  - Where appropriate, have debtors and creditors been properly recorded?

### **3. TERMS OF REFERENCE**

It is the Council as a whole that is responsible in law for ensuring that its financial management is adequate and effective and that the Council has a sound system of internal control which facilitates the effective exercise of their functions and which includes arrangements for the management of risk. - Governance and Accountability for Local Councils: A Practitioners' Guide 2014

To safeguard Merton Parish Council finances there are 3 systems of control:

#### **1. Internal control**

Internal control incorporates up-to-date standing orders, financial regulations, code of conduct, insurance and audit review.

See Part C for proposed Internal Control/audit review process

#### **2. Internal Audit**

Internal audit is a key component of the system of internal control. Its purpose is to review whether the systems of financial control and other controls over the activities of the Council

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are adequate, effective, and in line with current regulations. Internal audit does not actively seek evidence of fraud, corruption, error or mistakes, but can assist the Council in its responsibility for the prevention and detection of such occurrences.

### **3. External Audit**

The External Auditor is independent of the operations (financial control/management) of the Council and competent in the understanding of the law as applicable to Local Councils, of simple accounting and basic PAYE and VAT requirements. Any change in personal circumstances that may cause a question over the independence requirement must be reported to the Council.

The Internal Auditor will carry out under the direction and management of the Council the following tasks:

- To review twice during the year the accounting and internal control systems noting that their establishment and alteration is the responsibility of the Council. One interim review midway through the year and one after the year end accounts have been completed.
- To report in writing to Council twice each year on the results of such tests of the system that are carried out;
- To report to Council in the format required in the Annual Return as published by the Audit Commission each year;
- To carry out test checking of the books accounts and vouchers as required.

### **4. STANDARDS TO BE MET BY INTERNAL AUDITOR**

**Accounts and Audit Regulations (SI 2006 No. 564), requires all local Councils to now review the effectiveness of the system of internal audit at least on an annual basis**

The following five standards will need to be addressed:

#### **Scope of Internal Audit**

What should be included in the audit plan, or, in other words, what is it that the Council wants the internal audit to do. In this respect, I would suggest that the minimum requirements should be those contained in the suggested approach at Appendix 9 of the “Governance and Accountability in Local Councils in England and Wales – A Practitioners Guide” (*see below*). There may, of course, be other areas or other, more in depth work, which the Council requires to be undertaken by the internal auditor, perhaps, for example, as a one off or as a result of previously discovered system failures or discrepancies. Whatever the works required, or terms of reference, they should be approved by the Council and communicated to the auditor. The work should take account of the risk management processes (e.g. the Annual Financial Risk Assessment) and also the wider internal controls (the whole system of checks and controls, financial or otherwise, established by management in order to provide assurance regarding the achievement of the organisations objectives). A good example of an (or a set of) internal control in local councils is financial regulations.

The terms of reference should define the responsibility of the auditor in relation to fraud, that is, who the auditor should report to – Council, chairman or clerk? This, of course, will depend on the type of fraud discovered.

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### **Independence**

The internal auditor should be allowed to have direct access to those charged with governance (i.e. the Council) where this is thought necessary by the auditor (for example, in the case of fraud - see above).

The internal auditor should have no other role within the Council and the Council should confirm this. This is not to say that he/she cannot be an employee of the Council. This may happen within larger local Councils and certainly does happen in principle authorities, but the internal auditor should have no role in the financial or decision-making processes.

The internal auditors report should be made in his/her own name and addressed to the Council. It is perfectly feasible to prepare the audit report on a “negative” basis, i.e. only those items which require amendment or improvement to be mentioned, but where the auditor finds that no matters have arisen from the audit which necessitates bringing to the attention of members, then the report should reflect this.

### **Competence**

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 to be sought should be:

- 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 and the legal framework and powers of local councils.

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

### **Relationships**

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.

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 consideration 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.

### **Audit Planning and Reporting**

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

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what it sets out to do. The Council should approve the plan. Internal audit should report in writing in accordance with the plan.

A good internal audit will comprise 2 parts done at different times of the year. The interim audit is usually done part way through the year, and is an audit of the Councils processes and procedures.

The final audit is undertaken after completion of the year-end, so that balances within the accounts may be verified, the auditor will submit written reports to the Council after the interim and final audit.

The internal auditor is appointed by and reports to the Council not the clerk/RFO.

### PART C

#### **1. Review of Effectiveness of the Internal Audit – Overview**

#### **2. Internal Audit Review**

##### 1. REVIEW OF EFFECTIVENESS OF INTERNAL AUDIT

##### **Overview**

Regulation 6 of the Accounts and Audit Regulations 2003 as amended Imposes a duty on local councils to “maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control.”

Internal audit is a key component of the system of internal control. The purpose of internal audit is to review whether the systems of financial and other controls over a council’s activities and operating procedures are effective.

Local councils are required, at least once a year, to conduct, in accordance with proper practices, a review of the effectiveness of internal audit. The council is required to sign the annual governance statement (on the annual return submitted to the external auditor) to evidence that this review has been undertaken.

##### **Review of effectiveness of internal audit**

...*Mrs Melanie Bickell*...has acted as the Merton Parish Council internal auditor for ...*2018-19 year*.. His/her work as internal auditor is done on a paid basis. He/she has indicated that they are prepared to continue to act as the Council’s internal auditor for ...*2019-20*.

For internal audit to be considered effective, the following criteria must be satisfied:

- that the internal auditor is independent of the other financial controls and procedures of the council which are subject of review;
- that they are competent to carry out the role in a way that will meet the business needs of the council;
- that consideration is made to how many times in a year the systems and records should be subject to internal audit;
- that the scope of internal audit is sufficient;
- that any internal audit report is considered in full by a meeting of the parish council; and
- that appropriate action is taken on any recommendations contained in the internal audit report.
- The council must also satisfy itself that the quality of delivery of the internal audit service provides reliable assurance about the council’s internal controls and its management of risk.

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Considering these requirements for internal audit for Merton Parish Council:

### **Independence**

... *Mrs Melanie Bickell* .....has no involvement in the Council’s financial controls, procedures or decision making. He/she is not related to, any member of the Council or the Clerk. The internal auditor has direct access to the Council should he/she think this necessary.

### **Competence**

... *Mrs Melanie Bickell* ..... Is ~~Qualified~~/unqualified (FMAAT) and operates as an individual. He/she has experience of carrying out audit work for parish councils. He/she has built up knowledge of local council finance over the years. She has a copy of “Governance and Accountability for Local Councils – a Practitioner’s Guide 2016” which he/she uses as a reference tool for his/her audit work.

There is no evidence/reason to believe that the internal audit will not be carried out competently, ethically and with integrity and objectivity.

### **Scope of Work**

The scope of the internal audit work carried out by Mr/Mrs *Melanie Bickell* .. Follows the suggested approach to internal audit provided by Appendix 9 of the “Governance and Accountability for Local Councils – a Practitioner’s Guide 2016.”

### **Audit Report**

Mr/Mrs ... *Melanie Bickell* .... will prepare a report in her own name and addressed to the council following her completion of the internal audit. It will be presented in full to the Council at the next meeting after it has been issued. Any actions to be taken on the recommendations made will be minuted.

**Recommendation:** That Merton Parish Council considers that the system of internal audit is sufficiently effective.

Signed by: \_\_\_\_\_ Date: \_\_\_\_\_

Print Name and Position: \_\_\_\_\_

## **2. Review of Effectiveness of Merton Parish Council Internal Audit**

Reviewed and adopted on: \_\_\_\_\_

<b>Characteristics of ‘effectiveness’</b>	<b>Evidence of Achievement</b>	<b>Areas for development</b>
1. Scope of internal audit	Terms of Reference were approved on Scope of audit work takes into account risk management processes and wider internal control. Risk Assessment defines audit responsibilities in relation to fraud	
2. Independence	Internal Auditor has direct access to all records. Reports are made in own name to management. Auditor does not have any other role within the Council	

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3. Competence	No evidence that internal audit work has not been carried out ethically, with integrity and objectivity.	
4. Relationships	Responsible Officer consulted on the internal audit and on the scope of each audit. Responsibilities for officers and internal audit are defined in relation to internal control, risk management and fraud and corruption matters. The responsibilities of council members are understood; training of members is carried out as necessary.	
5 Audit Planning and reporting	The Audit takes account of corporate risk. The details of the internal audit will be approved by the council as report received. Internal Audit has reported in accordance with the objectives and responsibilities of the Council	
Internal audit work is planned	Planned Internal audit work is based on risk assessment and designed to meet the Councils needs	
Understanding the whole organisation its needs and objectives	The annual audit demonstrates how audit work will provide assurance in relation to the Councils responsibilities	
Be seen as a catalyst for change	Supportive role of audit for developments such as risk management and ethics.	
Add value and assist the organisation in achieving its objectives	Demonstrated through positive management responses to recommendations and follow up action where called for.	
Be forward looking	When identifying risks and in formulating the annual audit, changes on national agenda are considered. Internal audit maintains awareness of new developments in the services and risk management	
Be challenging	Internal audit focuses on risks and encourages	

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	The council to develop their own responses to risks, rather than relying solely on audit recommendations. The aim of this is to encourage greater ownership of the control environment.	
Ensure the right resources are available	Adequate resource is made available for internal audit to complete its work. Internal auditor understands the body and the legal and corporate framework in which it operates.	

**Note: Review of effectiveness of internal audit must be reviewed and adopted by council annually during the financial year and before 31 March**

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**Revision History**

<b>Date</b>	<b>Version</b>	<b>Notes</b>
29-10-19	1.0	Policy created