

Establishment of an Internal Audit Function

The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice is *Establishment of an Internal Audit Function*, approved by the GFOA in 1997 and 2006. Other sources used are footnoted in the text.

Recommendation

The GFOA offers five recommendations regarding the internal audit function. Municipalities should consider an internal audit function because it can help management maintain a comprehensive framework of internal controls. Furthermore, a charter or a mandate should establish an internal audit function. Internal auditors should also adhere to professional auditing standards (generally accepted government auditing standards) found in the CICA Handbook. In addition, an internal auditor should have the proper accreditations to perform the audit (e.g. certified internal auditor, certified accountant). Lastly, all reports of internal auditors and the annual internal audit work plan should be made available to the municipality's audit committee or its equivalent.

Purpose

The establishment of an internal audit function can work in conjunction with internal controls established by managers and the audit committee. An internal audit can provide management with a greater ability to monitor how a municipality accomplishes its objectives. It can help municipalities accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

It should be noted that internal audit functions are not mandatory or subject to legislation. Internal audits functions are not particularly applicable to small municipalities, but are conventionally found in large and complex municipalities.

Background

The internal auditing function should be designed to add value and improve an organization's operations. It provides assurance to the audit committee and councilors, and adds to the credibility of the financial statements and assessments. The role of the internal auditor is largely up to the municipality, as the responsibilities may vary depending on size, complexity, and need. Internal auditing can also provide an audit committee with objectivity, auditing skills, and in-depth knowledge of the organization.

Internal audits often address broader aspects of control. For instance, internal controls can review controls over major projects and new computer systems to help anticipate problems, and this can allow for timely corrective action. Internal auditors can also conduct audits of the efficiency and effectiveness of operations. Furthermore, internal audits can assess the risks related to reputation, citizen satisfaction, the environment, and privacy. Internal audits can also provide consulting and advisory services on control and related matters. Lastly, internal audits also aid in the investigation of fraud.

Considerations in Policy Development

There are a number of considerations that should be made by a municipality when developing an internal audit function. Primarily, a municipality must determine if an internal audit function is feasible. An internal audit function is typically applied to medium and large municipalities with complex financial issues to manage.

Specific Policy Recommendations for an Internal Audit Function:

1. The audit committee and the councilors of the municipality should agree upon the scope of the activities of the internal audit function.
2. A terms of reference is needed to provide legitimacy, independence, establish its objectives, help establish its functions and goals, and the needs of the audit committee.
3. Internal audits should be compared to external audits to confirm the quality of an organization's system of internal control. Internal and external auditors should work cooperatively to achieve best possible values in audit coverage.
4. An annual internal audit plan based on a review and analysis of the municipality's activities and their associated risks. This should include projected internal audits and other activities; the budget and staff resources, and it should be flexible to respond to unforeseen issues and events during the year.
5. A formal follow-up process should exist to determine if the suggestions from an internal audit function were implemented and if they are effective.

6. Performance measures should be developed where internal auditors can evaluate its performance based on the performance measures.
7. An external quality assurance review should be conducted once every five years.¹

¹ Fraser, John and Hugh Lindsay. 20 Questions Directors Should Ask about Internal Audit. Toronto, ON: Canadian Institute of Chartered Accountants, 2004.

References

“Controls are Everybody’s Business.” Tone at the Top. Altamonte Springs, FL: Institute of Internal Auditors. 20, November 2003.

Government Finance Officers Association. Establishment of an Internal Audit Function, Approved 1997. <http://www.gfoa.org/downloads/caafrinternalauditfunction.pdf>.

Fraser, John and Hugh Lindsay. 20 Questions Directors Should Ask about Internal Audit. Toronto, ON: Canadian Institute of Chartered Accountants, 2004. http://www.cica.ca/multimedia/Download_Library/Research_Guidance/Risk_Management_Governance/Recent_Publications/20Qs_MDAeng.pdf.

“Internal Auditing and the Audit Committee: Working Together Toward Common Goals.” The Institute of Internal Auditors.