
Auditing Risk Management in UK Local Authorities: Issues of Independence and Perspective Inherent in a Dual Role for Internal Auditors

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Abstract

This article describes an exploratory study of compliance of UK Local Government with risk management procedures in the CIPFA/SOLACE Framework for Corporate Governance. Interviews of risk managers and internal auditors in five UK local authorities revealed differences in approach to risk management but similarities in the roles of internal auditors in that they were either formally in control of risk management or in an informal partnership with the risk manager. Our findings reinforce the view of many internal auditors that they possess the skills necessary to facilitate risk management. However, the paper does raise questions about a) internal auditors' ability to then offer the Framework's required objective review of risk management and b) the breadth of their view of risk.

Introduction

In the United Kingdom, risk management (RM) has come to the fore in the wake of the Combined Code of best practice in corporate governance (Combined Code, 1998), as expanded by the Turnbull Guidance (ICAEW, 1999). Corporate governance is thus extended to consideration of all business risks – operational, financial and compliance – which may prevent an organisation from achieving its objectives. In other words, internal control must now include aspects of RM. To meet this responsibility, organisations require to adapt and combine the expertise of their existing internal audit function with that of RM and to relate the resulting effort to the business and operational needs of the organisation. UK stock exchange listed companies are required to conduct a review of their procedures to ensure that any threats to the organisation have been systematically identified, carefully evaluated and effectively controlled. They must make a statement to that effect in their annual financial statements.

The Combined Code has also influenced statements of good practice in the public sector. With the publication of the *Framework for Corporate Governance in Local Government* and related guidance notes (CIPFA/SOLACE, 2001), local authorities have to put in place robust RM systems, including internal control. Internal control in local government is thus extended to consideration of all risks – operational, financial and compliance – which may prevent an authority from achieving its objectives.

Under the Framework, it must be demonstrated not only that procedures are in place to identify and evaluate such risks but that they are actually achieving results. The exploratory study described in this paper questions how far local authorities have moved to meet this new responsibility by combining the expertise of the existing internal audit function with that of RM specialists. We do so by examining the systems and structures adopted by UK local authorities for identifying, controlling and reporting on risks, and for reviewing the effectiveness of these systems. Five authorities were studied in the first half of 2002. Internal auditors and risk managers were questioned on their organisations' RM systems and the scope of their respective responsibilities. The structures in place and the backgrounds and responsibilities of the various players were examined.

Background

Historically, there is an established view that internal control systems are the province of accountants, and to be reviewed by internal and external auditors. Risk management is a newer field. The term was first coined in the 1950s by large American corporations seeking alternatives to costly or inadequate insurance cover. Although RM soon began to develop as a distinct field of business management, it was initially mainly populated by people from an insurance background. Protection of physical assets and transfer of risk exposures by insurance or other means remains a core skill for most risk managers (Ward, 2001). Expertise in both financial controls and traditional risk management skills is rare, yet the corporate governance guidance that has emerged for private and public organisations stresses the need for an overall view of risk.

Arguably, modern RM in local authorities began with the ‘big bang’ of the demise of the Municipal Mutual Insurance Company (MMI). Hood and Kelly (1999) observe that the 1992 collapse of MMI brought an end to the low-cost, full insurance regime which had previously existed. MMI were unprepared for the rapid growth, in both frequency and severity, of liability and property claims from local authorities. Post-MMI, local authorities faced steeply rising premiums and reducing availability of cover. Local authorities were, therefore, forced to rapidly develop alternative RM strategies, particularly in high-risk services such as education where school fires and security had become a major issue and of little appeal to the insurance industry.

Defining the role of Internal Audit

Corporate governance has always included the legal requirement to appoint *external* auditors who report to shareholders on whether the annual financial statements filed by the directors show a ‘true and fair’ view of the company’s affairs. Large organizations may also employ *internal* auditors whose remit is defined by management. Internal auditors have, traditionally, a financial focus although their responsibilities may have been extended by Value for Money or Best Value audits, particularly in the public sector. The auditing profession sees the Combined Code requirements as a natural extension of their remit.

‘An effective and properly resourced internal audit function should have a key role in helping organisations respond to the challenges of the Turnbull report. It...can contribute to the achievement of business objectives.’ (ICAEW, 2000)

‘Internal auditors also add value by the identification of opportunities to improve the cost-effective management of risk, thereby ...benefiting shareholder return.’ (ICAEW, 2000)

‘Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.’ (Institute of Internal Auditors, 2000)

‘For many organizations looking at implementing a more formal risk management structure, internal audit can play a valuable part. In a public sector organization, for example, internal audit have recently instituted a project on risk management and have developed the risk management strategy and begun its implementation. They are leading the process as they are perceived within the organization as being the experts in risk management processes and internal control’.

(Gill Bolton, Technical Development Adviser, Institute of Internal Auditors, UK and Ireland, in AIRMIC PLUS, November 2000)

Guidance on risk management models for local authorities

A number of sources of guidance, providing models of RM, have emerged specifically for local authorities (Accounts Commission for Scotland, 1999; SOLACE and Zurich Municipal, 2000; Audit Commission, 2001) but these have to a considerable extent reflected what has taken place in some authorities rather than serving to initiate the process. One of these documents, *Worth the Risk*, observes that “risk management developments in local government have been dependent on initiatives taken by individual authorities rather than as a sector-wide response” (Audit Commission, 2001, p5). Thus, much of the guidance has been an effort to draw together developments springing up right across the local authority service. These developments have, in a sense, matured with the publication of the *Framework for Corporate Governance in Local Government* and related guidance notes (CIPFA/SOLACE, 2001) which places RM in the wider context of Corporate Governance. It calls upon councils to “put in place effective arrangements for an objective review of the

effectiveness of risk management” and to publish within an annual report “an objective, balanced and understandable statement and assessment of the authority’s risk management and internal control mechanisms and their effectiveness in practice”. In order to comply with the requirements of the Framework relating to RM, local authority organisations are in the process of establishing structures and allocating responsibilities. It is not made explicit in the Framework who is to undertake the objective review of effectiveness which will underpin the annual statement.

Guidance on the role of local authority internal auditors in risk management

In 2001, the Audit Commission published a document *Worth the Risk: Improving Risk Management in Local Government*. As its title suggests, its aim was to provide guidance to authorities seeking to manage risks in a more effective way. It stresses the link between RM and the statutory requirement to demonstrate Best Value. The role of Internal Audit is stated clearly:

‘Internal audit has a vital role to play in challenging established risk management processes, challenging risk identification and evaluation, and more fundamentally, in providing assurance to officers and members on the effectiveness of controls. This important role should, however, be separated from the activity of establishing and operating risk management processes and control structures. This should remain the responsibility of line management.’

(*Worth the Risk*, Audit Commission, 2001)

In the same year, the Accounts Commission for Scotland published *A job worth doing: Raising the standard of internal audit in Scottish councils* which assesses the level of compliance with the CIPFA Code of Practice for Internal Audit and highlights opportunities and challenges:

‘The changing role of internal audit - Internal audit is emerging from its traditional ‘policing’ role to developing a more proactive corporate role. This changing role demands broader competencies than those of traditional audit services.’

(Accounts Commission for Scotland, 2001, p7)

Having acknowledged the emerging role of proactive internal auditors, the *A job worth doing* guidance document does not overlook the issue of independence. It regards maintaining internal audit independence as one of a number of critical factors. The report acknowledges that a lack of independence will compromise the work of internal audit and may lead to audit findings not being fully reported or implemented. Their suggested route to independence is to ensure that the chief internal auditor should not report at a lower organizational level than the responsible finance officer.

If internal audit becomes more proactive in risk management matters there may be an expectation that the external audit function can provide comfort about the effectiveness of the RM system. However, the *Code of audit practice* states:

“The auditor is not responsible for reviewing the effectiveness of the audited body’s procedures for ensuring compliance with the code or framework.”

(Audit Scotland, 2001a, p18).

Implementing the new concepts

While the concepts are reasonably clear, there are a number of reasons to take a closer look at how complex implementation may be in practice. As stated above, local authorities will have to adapt and combine the expertise of existing internal audit and RM functions, and relate the resulting effort to the operational needs of the organisation. Since internal control in the financial sphere has historically been the province of internal auditors, the whole area of RM and Internal Control is naturally of

importance to the accounting profession. Risk managers also see the increased emphasis on risk in governance as an opportunity to raise the profile of their young profession. The *Risk Management Standard* published jointly by AIRMIC (Association of Insurance and Risk Managers) IRM (Institute of Risk Management) and ALARM (Association of Local Authority Risk Managers) (2002) provides no guidance on the independence issue. However, the Institute of Internal Auditors – UK and Northern Ireland has published a Professional Issues Bulletin entitled, *Independence and objectivity – the new challenge for internal auditors?* (Institute of Internal Auditors, 2003) which tackles head on the issue of how to be active in RM yet retain independence. It sees the solution as maintaining a distinction between ‘facilitation’ and ‘management’ of the RM process:

“Increasingly, internal auditors are becoming involved in facilitating risk and control workshops as part of the overall process of embedding risk management and internal control into the culture of the organisation. Provided internal audit only facilitate the process and management retains ownership of the process along with the risks, controls and action plans, this should not compromise independence or objectivity.”

(Institute of Internal Auditors, 2003).

One small study (Crawford & Stein, 2002) of five organizations from across the UK public and private sectors found that internal auditors and risk managers were both involved in risk management but their respective roles were insufficiently well defined to avoid overlaps and gaps. Although only one of the organisations in that study was a local authority, it suggests that councils are as worthy of further study in this regard as private sector companies.

Research Question

From the above background, there are three key points that lead to an interesting research question. Firstly, it has been established that management of risk is part of good governance. Secondly, models of risk management are now generally well understood and developed. Thirdly, at the heart of published principles of good governance is a requirement that the highest level of management in an organization should establish mechanisms by which they may be assured that the risk management procedures they believe to be in place, actually *are* in place and *working*. All three points are now relevant for UK local authorities.

The object of our study is, therefore, to answer the following question: How do UK local authorities achieve the required objective assessment of risk management and internal control mechanisms and their effectiveness in practice?

Research Method

Risk management implementation in a particular organisation is likely to involve unique elements related to its circumstances; nevertheless selecting a small number of local authorities as case studies may be a useful source of practical guidance. It may assist in formulating a Risk Review framework and provide insights into the future development of professional responsibilities in this important area. During the first six months of 2002, semi-structured interviews were arranged with a senior risk manager and senior internal auditor from each of five Councils, with the aim of identifying the range of activities carried out by each and the processes embedded in the organization for reporting risks and their management. The Councils were selected at random from different areas of the UK to avoid any undue influence on the results if neighbouring authorities collaborated. Two of them were in Scotland and three were in England. Two were in rural areas and three were urban. In terms of size, one was large, two were medium, and two were small (see Table 1 – Note that the interviews were arranged on a confidential basis. By using approximate rather than exact figures, we have sought to preserve the anonymity of the Councils yet give the reader sufficient feel for the mix of councils).

Table 1. Comparative sizes of sample of Councils

	Population	Hectares	Persons per hectare
1st rural council	110,000	220,000	0.5
2nd rural council	500,000	200,000	2.5
1st urban council	450,000	25,000	18
2nd urban council	150,000	9,000	17
3rd urban council	350,000	9,000	39

Structuring the interviews to support the research question

Our research question (as stated above) was expanded and restated as a set of seven key interview questions to form the core of semi-structured interviews. The questions (undernoted) were provided in advance to the interviewees.

1. How is your Council's risk management effort structured?
2. Who is responsible for implementing risk management at operational unit level?
3. Has a risk identification exercise been carried out?
4. Has the risk identification process been independently reviewed?
5. How are risks reported upwards?
6. Is there an independent review of the risk reporting process?
7. Do you have an independent review of your process of internal control of risks?

To ease subsequent analysis, permission was sought to tape record the hour-long interviews. The tapes were transcribed in full for detailed analysis. As a first step the responses were searched for themes. Two aspects of phenomenological or qualitative analysis proved helpful in the analysis of the interview responses (Colaizzi, 1978; Hussey & Hussey, 1997). Firstly, an awareness that as interviewers we set the tone of the interview and will impose some influence, albeit subtle, upon the responses given by participants. Secondly, to enhance the objectivity of our analysis of the recorded answers, we adopted the multi-stage methods for data analysis advocated by many proponents of the phenomenological approach, for example, Colaizzi's process of analysis: i) reading to acquire a feeling for the ideas; ii) extracting significant statements; iii) formulating meanings; iv) clustering meanings into themes; and v) reducing the description to an essential structure. The time consuming task of transcribing and analysing interviews produced a wealth of observations which we have necessarily had to edit severely for the purposes of this paper.

Summary of responses to interview questions

Selected quotations from interview responses have been included in order to convey some sense of the frankness of our interviewees.

1. How is your Council's risk management effort structured?

COUNCIL A - Internal Audit, RM, Health & Safety, and Insurance all operate as separate departments. The RM department consists of a single Risk Manager. The Risk Manager advised us that he would like to join Internal Audit (with 20 members of staff) 'to have more clout'.

COUNCIL B - RM and Insurance were combined in a single department but the Council planned to split into separate departments in response to a view that increased insurance workload is reducing the effort available for risk management activities. An RM Group had operated since 1994.

"It was around 1993/1994 that we were moving into risk management. It was born out of the insurance function and the fact that much was becoming uninsurable because of our then losses – particularly on education and highways."

Health & Safety operated as a separate department and would continue to do so. Internal Audit operated as a separate Department.

COUNCIL C - A group of five distinct functions came under the control of one director (an internal auditor) - Internal Audit, Value for Money, RM, Insurance and Benefits Fraud. Health & Safety was run as a separate department under a different director. The RM and Insurance activities were looked after by a team of two persons plus input from a director.

COUNCIL D - RM and Insurance operated as a single department. There was a separate Health & Safety department but it linked with RM and Insurance by having all three functions represented on a RM Group. Internal audit operated as a separate department.

COUNCIL E - RM and Insurance operated as a single department. There was an RM Group. This was the only one of our five councils where Internal Audit was outsourced (to one of the major accountancy firms). The outsourced Internal Auditor sat on the RM Group and was also required to audit the RM process.

2. Who is responsible for implementing risk management at operational unit level?

COUNCIL A - The process of designating Officers in each operational unit was underway but not yet complete.

COUNCIL B - Representatives of varying seniority from Operational Departments or Units carried responsibility for implementing RM.

COUNCIL C - The responsibility for implementing RM lay with an RM Group, populated by representatives from Operational Departments or Units. Not all Operational Departments or Units had yet contributed a representative to the RM Group.

COUNCIL D - Operational Departments or Units were each free to decide their own approach. A member of each Operational Department or Unit acted as representative on an RM Group.

COUNCIL E - There was a nominated 'champion' for each Operational Department or Unit but some individuals were pulling out because of the workload. There was agreement that the minimum level of seniority for 'champions' was to be not lower than 2nd tier.

3. Has a risk identification exercise been carried out?

COUNCIL A - Risk identification had been left to individual Operational Department or Unit managers' own discretion. Nothing was dictated centrally thus far, however, there was agreement that whenever a central plan was agreed it would be a joint RM and Internal Audit approach – 'Internal Audit has the expertise' being the view. Compilation of a Risk Register had just commenced - Operational Departments or Units had been requested to nominate an officer to take a lead in this.

COUNCIL B - A risk identification initiative for the Education department had been outsourced to RM Consultants. This initiative, and other risk management initiatives, had been funded from insurance savings - mainly directly related to the Education department. This had originated with risks to premises but had progressed to school security issues after the Dunblane shooting and others e.g. bullying, failure to educate. No complete risk register had yet been compiled but a checklist derived from these first initiatives was now available to all departments via the council intranet. A working risk register had been compiled by the Insurance Manager (who had since left

to work with another council) and this had been done with help from some Operational Department or Unit representatives but it did not cover all areas.

"A risk register was constructed as part of a Best Value review of risk management, health and safety. But it was something the insurance manager compiled, albeit with assistance from service department representatives."

COUNCIL C - Two or three corporate RM initiatives were started each year, chosen, typically, for problem areas highlighted by insurance claims information. This encouraged the RM effort within departments by allocating insurance costs i.e. they felt the consequences of *not* controlling risks in a very tangible, obvious way. There was no compulsion to use a risk register, but as the risk manager noted:

...the excesses, and charging them out, is quite a strong risk motivating tool, isn't it? You know you are getting people to think about, if I look after my own patch here, this will be reflected in what I am charged.

There was no systematic approach to risk identification. The council were in the process of considering using RM Consultants to start the RM process including Risk Identification - but just for strategic rather than operational risks. The use of RM Consultants would be part of a gradual skills transfer process. At the time of the interview the council had not yet commenced compilation of their planned Corporate and Operational Departments or Unit risk registers.

COUNCIL D - Risk identification efforts only existed at Operational Department or Unit level thus far and risks identified tended not to be significant at a strategic level. Departments were meant to follow a 'blueprint' but most did as they wished. The result was a fragmented system. The risk register blueprint was issued a few years ago but the risk manager had become aware that the processes needed to be revised if it is to contribute to corporate governance:

"The seminar made me realize strategic risk management is very, very important...it made me think yes, we are approaching [RM] the wrong way... some of the major risks facing us have nothing to do with what we're looking at the moment with RM... I have got to think, how are we going to do this at the operational level and tie it in with the strategic so we have not wasted three years."

It was reported to us that the most successful risk identification exercises had been facilitated by RM consultants. In terms of completed risk registers, some Operational Departments or Units had completed these in accordance with the blueprint, but far from all of them.

COUNCIL E - A 'strategic risk review' had been prepared using RM consultants. In an organisation-wide review they were following a standard RM procedure of open discussions and brainstorming sessions at the top level within each department to identify risks. They found that the risk headings in the guidance (e.g. terms such as 'professional', 'environmental' etc.) were not helpful and they tried to adopt an approach that staff would understand more readily:

"people still think in terms of people, processes, plant, property – they don't think of a general concept; we ask them what keeps them awake at night."

This had resulted in a collection of 60 to 70 risks which were subsequently pruned down to 20 by the Head of the Policy Unit. A deliberate 'top down' approach was being followed, looking for the biggest risks and beginning this process with the managers of Operational Departments or Units.

They were soon to be required to attend 'brainstorms' and to identify their own risks. The next level down was to appoint 'champions' from each Operational Department or Unit. It was felt that it would be several years before the process reached the 'grass roots'.

4. Has the risk identification process been independently reviewed?

COUNCIL A - No

COUNCIL B - No

COUNCIL C - It was understood that the independent review would be done by Internal Audit but the means of doing this had not yet been formalised.

COUNCIL D - No. The Internal Auditor had clear views on where the line had to be drawn between 'facilitator of RM' and 'practitioner' delivering a service that involved risks to be managed.

"As an auditor how could I go in and say that somebody's identification of risk was right or wrong? I mean, I am not operationally involved in the service. I would not presume to go in to social work or to child protection."

"As an audit section you can look at the process that is put in to identify risks and the process that is put in to manage the risks. You can audit that there is a clear trail that makes sure a risk is identified and then makes sure a risk is managed. And that if an action plan is put against a list, that something actually happens with that action plan. But you cannot actually say, oh I do not think that you have classified that risk right, I think that should be a seven not a four."

"I like the concept of bringing in risk management consultants because it gives a level of independence."

COUNCIL E - Internal Audit were already engaged in reviewing progress with the risk identification exercise.

5. How are risks reported upwards?

COUNCIL A - There was no definite plan. This was, and would continue to be done on an ad hoc basis.

COUNCIL B - A schedule for reports had been established. Every three months, an RM report would be submitted by Operational Departments or Units to the Corporate level RM Group. On a six-monthly basis, a report would be made to the Resource Management Group (consisting of Chief Officers and relevant council members) – that report would be filtered by the Chair of the RM Group.

"With all due respect you are sometimes left with people who have not got the clout to take action with their department or who have not got a channel of communication to those who can. We arranged as part of our action plan that we would report quarterly to the Resource Management Group and at least twice a year through to the Chief Officers Group portfolio member. The chair of the Corporate Risk Management group is responsible for filtering risks to the Chief Officers Group."

COUNCIL C - Every three months, the minutes of the RM Group were submitted to the council Management Team. Also, ad hoc reports were made on individual risk management initiatives. The RM Group reported annually to the Finance & Information Technology Committee.

COUNCIL D - There were no arrangements for risks to be reported upwards. Operational Departments or Units did not report to the Risk Manager. It was felt that within Operational Departments or Units, the RM representatives “probably” reported annually to the Operational Departments or Unit chief officer. As the undernoted quotation shows, there was confidence that good RM was actually being done – the problem was that the system to formally capture a picture of that and to report it upwards was muddled.

“There have been a number of false starts and there have been a number of changes of rules and goalposts have been moved. Because of things like Comprehensive Performance Assessment. But it has not been structured in a way that there has been anything to report. What should have happened in theory was that each department ranked its risks on the basis of the most important risks for that particular department and then we as a group should have tried to assess which were priorities for the council as a whole. That in theory should have happened within the last six to eight months. In practice, because we became aware of the way that we were approaching it at operational level, the risks that we would identify as being the major risks to the council were, quite honestly, farcical when you consider the strategic risks that we should have been looking at. So what we have identified are the more common risks that are not necessarily that important, but risks that are important to several departments - things like the quality of drivers and the way drivers are controlled. Now that is a common problem with all departments but it has not actually been identified that one of our strategic risks might be a fatality involving half a dozen school children in a bus. There are guidelines in place, there are tests that we undertake for our drivers before they are allowed to drive school minibuses. It is all down there but it is not actually in any risk management plan.”

COUNCIL E - Risks were reported upwards only as and when mentioned in normal Operational Departments or Unit reporting channels. There was no audit committee.

6. Is there an independent review of the risk reporting process?

COUNCIL A - No

COUNCIL B - No

COUNCIL C – No, but there was a plan in place to agree on the approach to this with the council’s External Auditor.

COUNCIL D - No – but a plan was in place for Internal Audit to do so.

COUNCIL E - No – but there was a plan in place for independent review of the risk reporting process to be done by Internal Audit.

7. Do you have an independent review of your process of internal control of risks?

For all five councils, the answer to this question was ‘no’.

Themes emerging from the interviews

Although risk management has been taking place for some time in various areas of the five local authorities in this study, changes to policies and structures are underway or anticipated soon in all five cases. Three dominant drivers are observed to lie behind the changes: (1) the existence of the CIPFA/SOLACE Framework; (2) the requirement for Chief Executives to ‘sign off’ year end statements on risk and governance; and (3) the growing expectations of the Audit Commission and Audit Scotland. These drivers centre on achieving an RM system which encompasses the whole

organisation. Observed progress towards this aim appears to be very reliant on the availability of risk management 'champions' at each of three levels of activity: 1) at *operational level* e.g. where a social work manager determines to drive forward risk management in a specific field such as child abuse, 2) at *risk manager level* e.g. where lack of a high seniority post is compensated for by personal enthusiasm and charisma, and 3) at *strategic level* e.g. where the Chief Executive and/or other 'cabinet' member is personally driving it.

We also observe that 'strategic' and 'operational' risk management is operating as two distinct activities, *top-down* and *bottom-up*. Only two of the authorities in our study indicated that they have a structure which will be able to draw together the results of these processes under the scrutiny of a senior committee in order to achieve a corporate overview of risk exposure.

The role of risk managers

The role of risk manager is central to maintaining an effective RM system throughout an organisation and achieving a corporate view of significant risks. Our study indicates that local authority risk managers appear to have neither the seniority nor the breadth of remit that [a study by Ward (2001) suggests] many of their counterparts in industry and commerce enjoy. Some compensate for this by personal enthusiasm and by welcoming an alliance with internal auditors who tend to have a more established role. Risk management expertise also appears very variable as does the relevance of professional qualifications. There is a sense that councils settle for the quality of staff that they have – for better or worse - rather than choosing to exercise the fullest possible influence over appointments.

The nature of operational risk management

Operational risk management expertise appears to be very variable, and typically located around each authority in a fragmented way e.g. health and safety, insurance, treasury risks, fire control, and contingency planning operate, separately, across departments. Some departments have well developed RM systems for operational risks and some do not. Thus some risk management is done at an operational level but not coherently brought together at a strategic level.

We observed that 'across the board' risk management information systems are not generally in existence at present and from our interviews it appears that some departments are less willing than others to discuss their RM systems with those responsible for corporate RM. There is a sense that 'interference' is resisted and it may be that this feeling is stronger where RM is associated with audit.

The role of internal auditors

In one authority studied, the internal auditor is also responsible for RM. In three others they are in an informal partnership with the risk manager. We observe that internal auditors have an appetite for wider risk management as an extension of their interest in the management of financial risks; they see the current emphasis on RM as a welcome development towards the objective of good financial control over operations. By training, they have the procedural skills to oversee it as a process and they occupy influential positions, being typically located at a senior organisational level, with regular access to chief officers. Internal auditors may therefore become too involved in the process to be able to offer an independent review of its effectiveness. In addition, the shape of RM influenced by accountancy trained officers may differ from RM influenced by risk-trained officers. The language of audit includes references to 'risk' which revolve around financial concerns and auditing concerns. In the language of risk management the term has a much wider meaning.

Discussion

In this section we consider possible explanations for, and implications of, our findings. Our analysis indicates that there may be a need for greater professionalism in the development of risk

management skillsets in Local Authority managers. In many Local Authorities, there appears to be no developed culture of risk management roles in middle management. Managers manage a particular area, be it environmental health, finance or human resources, in which they have professional qualifications. Risk management is not traditionally a distinct function therefore no senior risk managers are 'home grown'. Further, there is no cadre of professional managers who can move between departments in the same way as in the National Health Service. This all poses questions around how local authority managers are recruited, trained and developed.

There is one further issue less directly related to staff development but that might explain our observation that risk managers are confined to a middle management status. There may be reluctance to accept another senior manager taking a share of power. This thought may, however, be doing senior officers an injustice. More prosaically, it may be that candidates do not yet exist with sufficient professional standing.

A dual role for internal auditors

There seems little doubt that Internal Auditors possess skills that go at least part way to being competent risk managers – the missing other part being the Operational Department or Unit input and skills. The first point at issue is: can they be both internal auditor and risk manager. Independence from the functions being reviewed is a fundamental requirement of effective audit. It is possible that the contribution of internal auditors in establishing RM systems may be of more value at present than an independent review. Perhaps, as one internal auditor in our study asserted, it may be possible for independence to be 'managed in' by some combination of external audit review of processes and another peer manager as the performance judge.

An accountant's view of risk

A second issue arising from our findings: is the 'accountant's way' becoming the dominant perspective in Local Authority risk management? The finance department generally appears to have a special influence on current developments in risk management structures. Although independent in terms of their remit, internal auditors are (certainly in our study) still accountants. Although their output is destined for the Chief Executive and the Audit Committee (or equivalent) of the Council, and they have unfettered access to that level, their day to day line manager is usually the Director of Finance.

As discussed above, internal auditors have the status and some of the required skills to act in the strategic, corporate RM role. They may however have a tendency to concentrate on areas with which they are most comfortable e.g. financial risks and risks identified by analysis of insurance claims. This may lead to a restricted view of the type of risks which may face the organisation in the future. In his survey of UK industry and commerce, Ward (2001) found few risk managers in the senior, strategic roles that an integrated (i.e. corporate) risk management model requires. Ward comments that the scope of work a risk manager undertakes tends to be defined by the particular functional director to whom he or she reports. Our exploratory study tends to suggest that this may be equally true of local authorities.

Using internal auditors may be the lowest cost option

There may, however, be another reason for the observed involvement of internal auditors. There is clearly a cost implication to the Framework requirements for an organization-wide system of risk identification, evaluation and reporting. If operational units are unwilling to agree and implement a corporate RM system within their current headcount, that cost could be in the form of some new and additional layer of RM personnel. The possibility of avoiding such costs is presented by giving this role to internal auditors. This may be a factor driving forward the enlarged role of internal

auditors to the point where not only are they doing risk management, they are also judging their own effectiveness.

Conclusions

Although our findings say much about the risk management reporting structure and about the nature of professional risk managers in Local Authorities, we will confine our conclusions to those most pertinent to the role of internal auditors. We see two distinct dangers.

Danger 1 - loss of auditor independence

We conclude that local authority internal auditors are actively embracing a role in the implementation of risk management. Indeed, their process skills and seniority leave them poised to be a major facilitator of risk management. However, we must seriously question their ability to then offer the required objective review of risk management.

Danger 2 - dominance of an accountancy perspective

We may be seeing an emphasis on the areas of most comfort to accountants and seeing a risk management approach heavily centred on internal control, the purchase of insurance externally, the operation of an internal insurance style self-fund, and on claims management. This may be at the expense of an open and questioning approach to operational risks, and of less tangible risk approaches such as those relating to employee recruitment, training and development, reputation, culture changing and links with continuous quality improvement. A further point is that risk management needs to be continuous and embedded in operational activities – not introduced as and when internal auditors can fit it in.

Questions prompted by the dangers

This also leads us to pose two interesting questions: (1) is it possible, as some internal auditors interviewed believe, for independence to be ‘managed in’, despite the views of the Audit Commission and (2) is it possible that the ability of internal auditors to implement and control a sound risk management process may outweigh the disadvantages of any loss of independence or narrowness of perspective?

Limitations of the Study

Clearly, a study of five organisations cannot be definitive but we believe it serves as a useful early indication of the problems which surround the issues of independence and perspective in practice. We believe nonetheless that our study contributes to the debate surrounding the role of internal auditors in relation to risk management in UK local authorities. We believe open discussion should take place on these issues as soon as possible so that the annual statements on risk management required by the CIPFA/SOLACE Framework can be seen as meaningful. The authors now plan to survey local authorities UK-wide, focusing on the issues prompted by this exploratory study.

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