

Protocol for liaison between internal and external audit

City of York Council

November 2010



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Status of our Reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
 - any third party.
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Introduction

- 1 The Audit Commission has made a commitment to strategic regulation. The principles of strategic regulation were incorporated into the 2005 Code of Audit Practice. The Code requires external auditors to carry out their audit economically, efficiently and effectively, and in as timely a way as possible. It specifies that as part of their audit approach, auditors should establish effective co-ordination arrangements with internal audit and seek to place maximum reliance on internal audit work wherever possible.
- 2 Although internal and external auditors carry out their work with different objectives in mind, many of the processes are similar and it is sensible and good professional practice that they should work together closely.
- 3 This protocol sets out the proposed working relationship that should exist between internal and external audit.

Objectives

- 4 This protocol sets out how internal and external audit (the Audit Commission) will work together and establishes a framework for co-ordination, co-operation and exchange of information. It outlines:
 - the respective roles of external and internal audit;
 - the Audit Commission Code of Audit Practice (the Code);
 - the requirements of the International Auditing Standards (UK and Ireland) and their impact on the work of external auditors;
 - working with internal audit, and liaison arrangements.
- 5 Overall, the protocol should promote an effective working relationship within the bounds of the respective roles of internal and external audit, and maximise the benefit to the Council from available audit resources.
- 6 This protocol covers all aspects of audit, including IT audit and value for money, and takes account of external audit responsibilities under the International Standards of Auditing (UK and Ireland) (ISAs (UK&I)).

Respective roles of auditors

- 7 Table 1 outlines the respective roles of external and internal audit. The roles and objectives are different but complementary. There are therefore benefits to be gained from working together, and from external audit relying on internal audit's work. Any such reliance is governed by International Auditing Standard (ISAs) (UK and Ireland) 610.
- 8 This standard requires external audit to review internal audit's work, which usually involves re-performing specific tests as well as a more general review against accepted standards – in this case, CIPFA's Code of Audit Practice for Internal Audit in Local Government in the United Kingdom 2006 (the Code)

Table 1 Respective roles of auditors

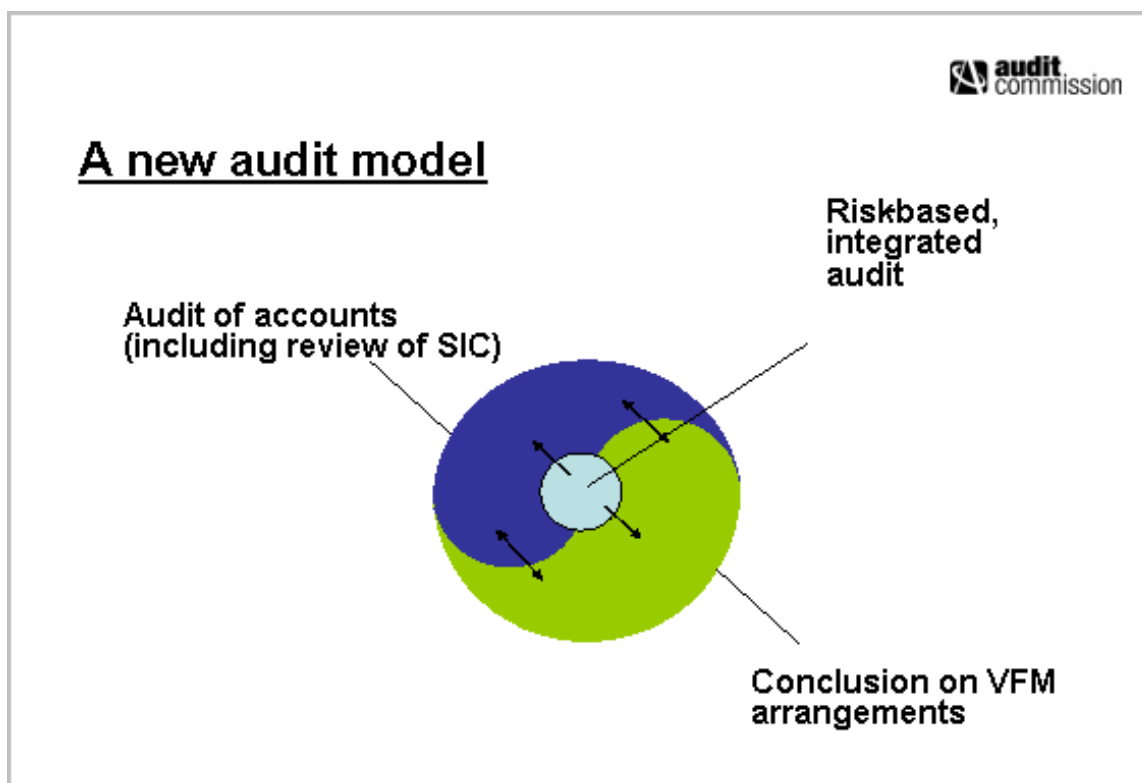
Internal Audit	External Audit
<p>CIPFA's Code of Practice for Internal Audit defines internal audit as an 'assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.'</p> <p>Internal Audit must have documented terms of reference that accord with the requirements of the Code.</p> <p>The key output from Internal Audit is the annual opinion on the Council's control environment which is reported to the Audit and Governance Committee.</p> <p>Internal audit's strategy and plan is agreed between internal audit and management and is approved by the Audit and Governance Committee, and cannot be directed by external audit.</p>	<p>External audit conduct their work in accordance with International Standards on Auditing (ISAs) (UK and Ireland) and with the Audit Commission's Code of Audit Practice.</p> <p>External audit in the local government is characterised by three distinctive features:</p> <ul style="list-style-type: none"> • Auditors are appointed independently by the Audit Commission. • The scope of auditors' work covers the audit of financial statements, probity in the use of public money and value for money in the use of resources. • Auditors may report aspects of their work widely to the public and other key stakeholders.

Code of Audit Practice

- 9 The most recent Audit Commission Code of Audit Practice came into effect from April 2005 and is designed to secure:
- a more streamlined audit, which is proportionate to risk and targeted on areas where auditors have most to contribute to improvement;
 - a stronger emphasis on value for money, focusing on bodies' corporate performance and financial management arrangements (rather than individual services and functions); and
 - better and clearer reporting of the results of audits.
- 10 The audit model is shown in Figure 1. Following subsequent changes to accounting regulations, the reference to the review of the SIC (statement of internal control) should now refer to the Annual Governance Statement.

Figure 1 The Code of Audit Practice

The Code of Audit Practice came into effect from April 2005



Source: Code of Audit Practice, Audit Commission

International Standards on Auditing (UK and Ireland)

- 11 The external audit is undertaken in accordance with International Standards on Auditing (ISAs). The standards that principally affect our working relationship with Internal Audit are:
- ISA 315 – understanding the entity, its environment and assessing the risks of material misstatement;
 - ISA 330 – procedures in response to assessed risks;
 - ISA 240 – consideration of fraud; and
 - ISA 610 – considering the work of Internal Audit.
- 12 In summary, the approach requires us, as external auditors, to:
- gain an understanding of the information systems that are relevant to producing material figures in the accounts;
 - gain an understanding of the way transactions in these systems are initiated, recorded, processed and reported;
 - carry out interim opinion audit planning - identifying risks of material mis-statement (inherent risks in the systems, or specific risks that are identified), and planning tests of controls that are designed to prevent the material mis-statements;
 - carry out tests of controls where those controls are key to ensuring there are no material mis-statements in the assertions in the financial statements;
 - reassess the risks at the time the draft financial statements are produced; and
 - plan and carry out tests of control or substantive tests of detail against the remaining risks for each of the assertions for material entries in the accounts.
- 13 Where the work internal audit undertake for its own purposes overlaps with work that the external auditor would undertake to comply with the Code of Audit Practice, external audit may seek to place reliance upon the work of internal audit.
- 14 Internal audit undertake the following activities and external audit will seek to place reliance on this work wherever possible:
- systems documentation;
 - identification of controls; and
 - testing of controls.

ISA 610: considering the work of Internal Audit

- 15 We will seek to maximise our reliance on the work of Internal Audit particularly in relation to the Council's core financial systems. In this respect, ISA 610 requires external auditors to:
- review whether Internal Audit is effective as a management control, as part of the control environment assessment; and
 - review (and seek to place reliance on) specific pieces of Internal Audit work, where that work covers areas relevant to our Code of Audit Practice objectives.
- 16 Where external auditors intend to use Internal Audit work to inform conclusions, the specific work must be evaluated and this may involve re-performance of this work, testing of similar items or observing Internal Audit work.

Working with Internal Audit

17 Where internal and external audit work closely together, the following benefits should accrue.

Table 2 The benefits of joint working

Effective joint working should secure the following benefits

Internal Audit	The Council	External audit
Increased credibility and presence with management and Members (those charged with governance)	Clearer, more consistent reporting of audit issues	Better understanding of the corporate framework
Greater emphasis on Internal Audit's own objectives	Reduced opportunity for duplication or omission of audit work	The audit is more tailored and relevant to the Council
Greater awareness of risk from an external observer's perspective	Better focused audit work that provides relevant information	Increased awareness of risk factors at the Council
Opportunity for cross training, eg IT audit	Maximises the positive impact of audit	More efficient audit approach

18 Effective co-operation between external and internal auditors means more than avoiding duplication. An effective framework of co-operation and co-ordination ensures liaison, co-operation on work programmes and the sharing of information. Reflecting this, our joint working protocol covers:

- liaison meetings;
- external audit reliance on internal audit work;
- arrangements for sharing documents and information;
- arrangements for pre-Audit and Scrutiny Committee liaison; and
- external audit's review of internal audit's work.

19 The principles of co-operation and co-ordination, and agreed actions are set out in table 3.

Table 3 Co-operation - principles and details

<p>Liaison meetings</p> <p>Regular meetings take place every quarter between:</p> <ul style="list-style-type: none"> • the Chief Internal Auditor and Internal Audit Manager • the external audit Manager and Principal Auditor <p>to discuss audit planning (in particular, to avoid unnecessary duplication of planned audit work), audit progress and any other issues of mutual interest. These meetings are typically held on a quarterly basis.</p>
<p>External audit reliance on internal audit work</p> <p>Internal Audit prepares its audit plans independently, on the basis of its assessment of the risks existing at the Council. It is likely that some of this work will be in areas in which external audit will wish to obtain assurance to meet their Code of Audit Practice responsibilities. It is appropriate for external audit to seek to place reliance on internal audit's work, wherever it is practical to do so.</p> <p>There is an ongoing dialogue between internal and external audit and this includes discussion of work where reliance on internal audit work is sought.</p>
<p>Arrangements for sharing documents and information</p> <p>It will enhance understanding and effectiveness if audit reports and other audit information is shared promptly.</p> <p>Internal audit will provide external audit with:</p> <ul style="list-style-type: none"> • audit reports and access to electronic working paper files; • details of any significant changes to the audit plan; • key documents, in particular the terms of reference, audit strategy and audit plan; and • formal details of all significant frauds (all frauds of £10,000 or more) and all instances of corruption. These are required for submission to the Audit Commission, using form AF70. <p>External audit will provide internal audit with copies of:</p> <ul style="list-style-type: none"> • annual work programmes, including proposed tests of control in financial and IT systems • final reports, • relevant working papers (subject to specific agreement); and • details of any significant changes to the audit plan. <p>External and internal audit will communicate promptly to the other auditor any significant concerns arising that the auditor feels should be dealt with other than through the usual reporting arrangements set out in this protocol.</p>

Liaison meetings

External audit's approach to its review of Internal Audit

External auditors review the work of Internal Audit for two main purposes:

- to establish if Internal Audit is undertaking its role effectively in accordance with internal audit standards; and
- to determine what reliance can be drawn from internal audit work in relation to the external auditor's Code of Audit Practice responsibilities.

External audit will undertake an annual review of the internal audit work that it intends to place reliance upon and will feedback annually on its view of Internal Audit as an effective part of the control environment.

The Accounts and Audit (Amendment) (England) Regulations 2006 require that a Council review the effectiveness of the system of internal audit. This review is the responsibility of the Council and is not intended to be a review carried out by the external auditor.

Liaison arrangements

- 20 We will continue to meet regularly with IA to update issues identified in relation to the audit, review progress and exchange information. The agreed contacts for the Audit Commission and Council are identified in Table 4.

Table 4 Key contacts

Key contacts for ongoing liaison have been agreed as follows

Key contact	E-mail	Telephone
Audit Commission		
Lynn Hunt Audit Manager	l-hunt@audit-commission.gov.uk	0844 798 1675
Keith Illingworth Principal Auditor	k-illingworth@audit-commission.gov.uk	0844 798 7141

Key contact	E-mail	Telephone
Internal Audit		
Max Thomas Director of Veritau Ltd	max.thomas@veritau.co.uk	01904 552940
Richard Smith Audit Manager	richard.smith@veritau.co.uk	01904 552942

The Audit Commission

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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