

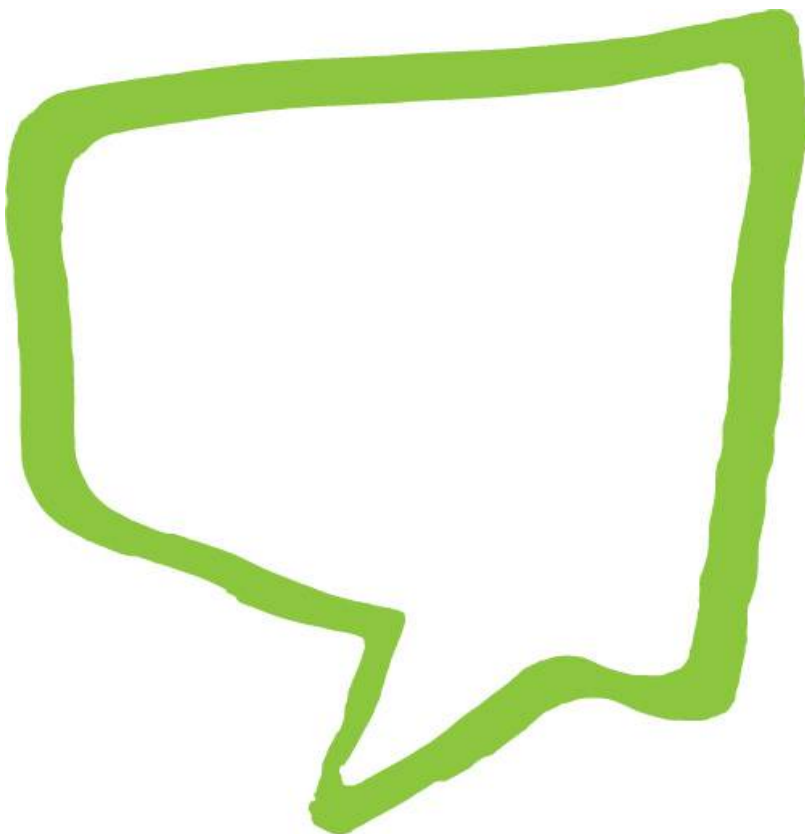
Protocol For Joint Working With Internal Audit

Project Brief

Cheshire East Council

Audit 2009/10

January 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's Code of Audit Practice 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 audit and external audit.
- 4 This protocol will take effect from the audit year 2009/10 and will be subject to annual review.

Objectives of the protocol

- 5 The objective of this protocol is to provide a framework which will optimise the benefits of audit to the Council, whilst enabling internal and external audit to deliver their respective responsibilities. It sets out how internal and external audit will work together to achieve this.
- 6 The protocol aims to:
 - clarify the respective roles of external and internal audit;
 - highlight areas where external audit are likely to place reliance on internal audit; and
 - establish a framework for co-operation in the planning, conduct and reporting of the audit.
- 7 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.
- 8 This protocol covers all aspects of the audit and takes account of external audit responsibilities under the International Auditing Standards (UK and Ireland) (ISAs (UK&I)).

Respective roles of auditors

- 9 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. This standard requires external audit to review internal audit's work, which usually involves them re-performing specific tests as well as more general review.

Table 1 **Respective roles of auditors**

| Internal Audit | External Audit |
|--|---|
| <p>CIPFA's Code of Audit Practice for Internal Audit in Local Government in the United Kingdom 2006 (the Code) 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 should be reported to the Audit and Governance Committee.</p> | <p>To reflect the special accountability attached to public money and the conduct of public business, external audit in local government is characterised by the following 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. |
| <p>Internal Audit's strategy and plan is agreed between internal audit and management and should be approved by the Governance and Constitution 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> |

Areas where external audit are likely to place reliance on internal audit

- 10 Where the work internal audit undertakes 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.
- 11 International Auditing Standard (ISA) 315 sets out the requirement for external audit to understand the audited body and its environment, including internal control. This is a key area where internal audit's work is likely to be relevant to the external auditor. Relevant extracts in relation to ISA 315 are provided in Table 2.

Table 2 ISA (UK and Ireland) 315: Relevant extracts

- | |
|---|
| <ul style="list-style-type: none">• The auditor should obtain an understanding of internal control and the control environment relevant to the audit.• The auditor should obtain an understanding of the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.• The auditor should obtain an understanding of the information system, including the related business processes, relevant to financial reporting. |
|---|

- 12 The objective for external audit is to review the outcomes from internal audit's work each year to determine the extent to which reliance can be placed to meet ISA 315 requirements. There will be limited scope to achieve this in 2009/10, but we are planning to meet this objective for 2010/11 onwards.
- 13 Where external audit rely on internal audit work, this reliance is governed by International Auditing Standard (ISA) 610, relevant extracts of which are reproduced below. This requires external audit to first evaluate internal audit's work to confirm that it is adequate for external audit's purposes. This is likely to involve external audit re-performing some of internal audit's work.

Table 3 ISA (UK and Ireland) 610: Relevant extracts

- The external auditor should consider the activities of internal audit and their effect, if any, on external audit procedures.
- The external auditor should obtain a sufficient understanding of internal audit activities to identify and assess the risks of material misstatement of the financial statements and to design and perform further audit procedures.
- The external auditor should perform an assessment of the internal audit function when internal auditing is relevant to the external auditor's risk assessment.
- When the external auditor intends to use specific work of internal auditing, the external auditor should evaluate and perform audit procedures on that work to confirm its adequacy for the external auditor's purposes.

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- 14** To meet the requirements of the ISA, the Audit Commission requires auditors to undertake a review of internal audit to establish compliance with the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom (2006). We will need to undertake this review in 2009/10.

Co-operation and co-ordination

- 15 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, the protocol covers:
- liaison meetings;
 - external audit reliance on internal audit work;
 - arrangements for sharing documents and information;
 - arrangements for pre-Governance and Constitution Committee liaison; and
 - external audit's review of internal audit's work.
- 16 The principles of co-operation and co-ordination, and suggested agreed actions are set out in Table 4.

Table 4 Co-operation - principles and details

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|--|
| Liaison Meetings |
| Regular meetings should be arranged between the Internal Audit Manager and the External Audit Manager to discuss audit planning (in particular, to avoid unnecessary duplication of planned audit work), audit progress and any other issues of mutual interest. |
| Agreed action <ul style="list-style-type: none"> • Hold regular liaison meetings. • Arrange specific meetings as and when necessary. |
| External audit reliance on internal audit work |
| <p>Internal audit prepares its strategic and annual plans independently, on the basis of its assessment of the risks existing at the Authority. 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, subject to internal audit having complied with internal audit standards when undertaking the work.</p> <p>It is good practice to identify what work external audit will be seeking to place reliance upon during planning. This ensures that the proposed work meets the timetable and requirements to enable external audit to place reliance upon it, for example, that appropriate sampling is used.</p> <p>If following review external audit is unable to rely on internal audit's work because it does not meet the required standard or because it is late, this will result in additional audit work being undertaken by external audit, which may lead to an increased external audit fee.</p> |

External audit reliance on internal audit work

Agreed action

- Internal audit will inform external audit of any changes to or delays to audit work included in the agreed areas of reliance.
- External audit will discuss promptly with internal audit any issues arising that would prevent it from placing reliance on internal audit's work.

Arrangements for sharing documents and information

It will enhance understanding and effectiveness if audit reports and other audit information are shared promptly.

Agreed action

- Internal audit will provide external audit with:
 - final audit reports and associated working paper files;
 - details of any significant changes to the audit plan; and
 - key documents, in particular the terms of reference, audit strategy and audit plan;
 - details of any cases of fraud and corruption at the regular liaison meetings
- External audit will provide internal audit with copies of:
 - final reports; and
 - details of any significant changes to the audit plan
- 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.

Arrangements for pre-Governance and Constitution Committee liaison

It is important that a Governance committee meeting focuses on dealing effectively with the issues set out on the agenda.

Agreed action

- Consider whether prior to a Governance and Constitution Committee meeting, there is a need for auditors to liaise to address any issues that may inhibit an effective Governance and Constitution Committee meeting.

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.
- To determine what reliance can be drawn from internal audit work in relation to the external auditor's Code of Audit Practice responsibilities.
- The Accounts and Audit (Amendment) (England) Regulations 2006 require that an Authority review the effectiveness of the systems of internal audit. This review is the responsibility of the Authority and is not intended to be a review carried out by the external auditor. Guidance on how the Authority discharges this responsibility is available from the Institute of Public Finance.

Agreed action

- External audit will undertake an annual review of the internal audit work that it intends to place reliance upon and a periodic review of internal audit against audit standards.

Appendix 1 – contact details

Table 5 Internal Audit

| | |
|---------------------------------------|--|
| Head of Policy and Performance | Russ Glennon |
| Borough Treasurer and Head of Assets | Lisa Quinn |
| Head of Internal Audit and Compliance | Vivienne Quayle |
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Table 6 Audit Commission

| | |
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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.

Copies of this report

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