

Audit Progress Summary up to 13 September 2006 AC 15 06/07

NB: Only significant work reported

Report to this meeting

- Annual governance report (to follow w/c 18-9-06)

Reports finalised since last meeting

- The internal and external audit relationship (updated protocol – attached)
- HR audit – follow-up work (not attached)
- Planning inspection (not attached)

Work in progress

- Final accounts audit 2005/06 (substantially complete)
- VFM conclusion (substantially complete)
- Data quality audit
- Grant claims work/certification
- Devonport regeneration community partnership review
- Investigating complainant issues
- Monitoring group attendance

Steve Brown,
Audit Manager
13 September 2006

The Internal and External Audit Relationship

Plymouth City Council

Audit 2005-2006

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports to the Council

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 members or officers. They are prepared for the sole use of the audited body.

Auditors accept no responsibility to:

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

Copies of this report

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Summary Report

Introduction

- 1 A successful relationship between Internal and External Audit is a key part of the Managed Audit. This report sets out the key conditions for achieving the necessary relationship, drawing upon the Audit Commission document – The Managed Audit 2002 Update.

Creating the right framework for co-operation

- 2 Internal and External Audit need an appropriate framework to deliver their combined contribution to the Managed Audit. External auditors are required to comply with the Code of Audit Practice and, as part of their general approach to the audit, to ‘establish effective co-ordination arrangements with Internal Audit’. They are also required by the Auditing Practices Board International Standard on Auditing (ISA) 610:
 - to obtain a sufficient understanding of internal audit activities to identify and assess the risks of material misstatement of the financial statements and perform further audit procedures;
 - to perform an assessment of the internal audit function when internal auditing is relevant to the external auditor's risk assessment; and
 - when intending to use the work of internal audit to evaluate and perform audit procedures on that work to confirm its adequacy for the external auditor's purposes.
- 3 Internal Audit is expected to comply with the appropriate professional standards, CIPFA’s Code of Practice for Internal Audit in Local Government, or Institute of Internal Auditors standards.
- 4 But the Managed Audit goes beyond such formal requirements. It is based on the willingness and ability of all involved to co-operate and communicate openly for mutual benefit. Specifically for Internal and External Audit, important factors are:
 - audit commitment;
 - audited body commitment;
 - understanding each other’s roles; and
 - partnership working.

What needs to happen in practice

- 5 There are a number of factors that are essential to helping Internal and External Audit get the most out of working together.

Communication

- 6 Internal and External Audit should establish clear and open lines of communication that produce two-way dialogue and meaningful discussion. In addition to regular meetings, each side should inform the other as soon as possible of any matter that might impact on the audit work planned.
- 7 Of particular importance is the need to provide feedback, for example after a joint project, or following External Audit's review of Internal Audit's work. This includes reporting, where appropriate, to the committee charged with governance in order to engage those with governance responsibilities.
- 8 Periodic meetings take place and will continue between Plymouth City Council IA and AC auditors. Two-way feedback occurs in meetings and as part of the AC assessment of Internal Audit.

Sharing risk-based assessments

- 9 Audit effort should be directed towards the areas of highest risk, assessed in relation to the relevant objectives and responsibilities of Internal and External Audit. The different remits of Internal and External Audit mean that they will need to perform their own risk assessments, but comparing the outcomes should mean that both benefit from the different perspective, and helps build the knowledge base of both sides.
- 10 Both audit teams should produce their own plans based on risk, taking into account their respective objectives and the intentions of the other wherever possible. The plans may initially overlap and, if this occurs, to avoid duplication there needs to be a discussion on the detailed requirements and agreement on a way forward. Generally, it is expected that the AC approach under strategic regulation will be higher level. However a significant exception to this is likely to be the audit of systems and here a co-operative approach is essential.

Quality of work

- 11 Both sides need to maintain a consistently high quality of work, enabling each to plan with confidence to use the projects in each other's plans. Addressing training needs, giving proper direction and supervision and ensuring work is subject to prompt review and objective reporting, all help to achieve this.
- 12 The Audit Commission require External Audit to assess Internal Audit on at least a triennial basis against the CIPFA Code of Practice for Internal Audit in Local Government (although Use of Resources assessments may be required more frequently). The last full review was in 2003/04. The next is due for 2006/07.

Documentation and evidencing work done

- 13 External Audit's work should meet the necessary standard of documentation and evidencing as set out in ISA 230 and 500 respectively. The Audit Commission's guidance for auditors requires that 'Audit records should be sufficiently complete and detailed to provide an experienced auditor, with no previous connection with the audit, with an understanding of the work performed and the basis of the decisions take. Internal Audit should meet the similar standards set out, for example, in the Internal Audit Manual for Local Government'.
- 14 To meet the requirements of ISA 610, external audit will review the work of internal audit, evaluating and performing audit procedures on that work to confirm its adequacy.

Sharing files

- 15 External Audit must satisfy itself that Internal Audit's work is appropriate, and reviewing relevant files is an essential step in the process. Should Internal Audit request access to External Audit files, care will be needed to comply with the statutory restrictions on disclosure of information by external auditors, and each case needs to be considered individually. However, AC auditors will make every effort to meet requests for information.

'No surprises' reporting

- 16 It makes sense for each audit team to be aware in advance of the main messages in each other's reports. This avoids conflicting messages, and also acts as a useful additional check on the factual content of reports. AC auditors will continue to consult with IA when starting work where there is possible overlap and, in those cases, again before issuing draft reports, where appropriate. We will provide copies of final reports when requested or via audit committee.

Possible areas of co-operation

- 17 The extent of Internal and External Audit co-operation will vary according to the remit given to Internal Audit, but potentially common areas of Code work are set out at Appendix 1.
- 18 However, the Commission considers that the audited body should only direct internal audit resource away from its risk-based plan following a detailed assessment of the impact of doing so. One common instance where audited bodies direct internal audit is when they try to avoid incurring what are perceived to be additional external audit costs, but this can be at the expense of a higher risk piece of work that internal audit has to drop from its programme.
- 19 The need for audited bodies to develop a framework to support its framework of control and the role of Internal Audit in this mean that, in reality, Internal Audit will need to carry out evaluations of major systems and annual testing to evidence that controls are operating satisfactorily for the SIC.

The key actions needed to co-ordinate the audit

- 20 In summary, there are a number of key actions for management, Internal and External Audit to take if they are to make the most of the opportunities offered by integrating the work of the audit functions. These are set out below.

Internal Audit	Audited Body	External Audit
Understand External Audit's role and objectives.	Ensure Internal Audit's role is clear, and that it has sufficient resources to achieve its objectives.	Understand Internal Audit's role and objectives.
Plan to meet statutory and professional objectives, and review planned work programme with External Audit to avoid duplication.	Look at the options for Internal Audit provision to ensure the highest quality is being achieved.	Plan to meet Code objectives, making use of Internal Audit's work wherever possible.
Report without fear or favour to the appropriate person/committee, and co-ordinate timing and content of reports with External Audit.	Provide Internal Audit with appropriate reporting lines within the governance structure.	Share reporting intentions with Internal Audit and co-ordinate timing and content.
Participate proactively in the partnership.	Ensure that Internal Audit's independence is not compromised, and that it is not required to carry out non-audit work.	Enter into a real partnership – for example, do not seek to 'instruct' Internal Audit or create a 'one-way' relationship.
Plan work on a risk basis to ensure that the highest priority work is delivered to ensure credibility.	Provide Internal Audit with necessary status.	Provide feedback to help ensure continuing improvement.
Adopt a 'no surprises' approach to reporting by ensuring that each party is aware of issues to be raised.	Critically review the achievement of co-operation between the audit functions.	Adopt a 'no surprises' approach to reporting.

The way forward

- 21 We will continue to review and refine existing arrangements as part of our regular liaison meetings and working arrangements at various levels. Any problems and/or opportunities to improve the arrangements will be developed through these meetings.

Appendix 1 – Areas for audit co-operation

Code area	Potential Internal Audit work that External Audit could use	Notes
Opinion	<ul style="list-style-type: none"> • Checks on year-end returns (for example, from departments) to ensure compliance with standards and procedures. • Internal financial control work may be used for opinion purposes when applying ISA 315 'Obtaining an understanding of the entity and its environment and assessing the risks of material misstatement'. 	See 'Opinion Audits 2005/06 - Systems Approach' July 2005.
Use of resources	<ul style="list-style-type: none"> • Application of use of resources reviews (generated by the Commission, the External Auditor or Internal Audit). • Follow-up previous recommendations. 	
Performance information	Detailed work to check systems for compilation and also calculations.	
Best value Performance Plans	Various potential roles identified by the AC.	See AC publication 'An Inside Job'.
Legality of financial transactions	Review of procedures to ensure legality of significant transactions and support SIC assertions.	
Financial standing	Review of internal financial control and specifically robustness of short, medium and long-term budgetary procedures.	See above - systems.

10 The Internal and External Audit Relationship | Appendix 1 – Areas for audit co-operation

Code area	Potential Internal Audit work that External Audit could use	Notes
Systems of internal financial control	Review of financial systems leading to conclusion on internal financial control.	See above - systems.
Standards of financial conduct, and the prevention and detection of fraud and corruption	Investigatory role and dealing with whistle blowing.	
Grant claims	Audit of grant claims which fall below the threshold for AC audit. Audit other claims in accordance with Audit Commission certification instructions.	See Letter to CFOs April 2004 and associated literature.