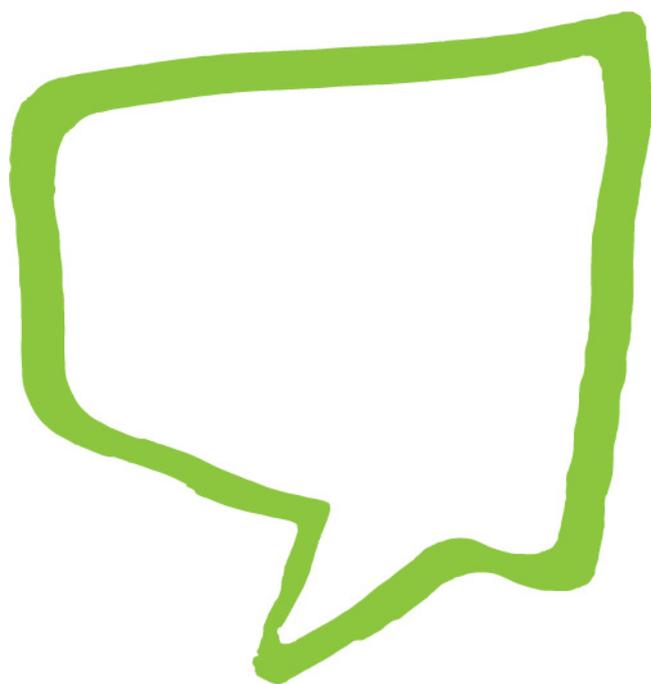


Protocol for liaison between internal and external audit

Uttlesford District Council

Audit 2010/11

September 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 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.
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Introduction

- 1 This document sets out the proposed working relationship between the Audit Commission audit team (referred to as 'External Audit') and the internal auditors of Uttlesford District Council (referred to as 'Internal Audit').
- 2 The purpose of this document is to set out the general approach and principles to be put in place to facilitate the delivery of a managed audit. This will:
 - aid joined-up working;
 - avoid the risk of duplication of audit work; and
 - improve the effectiveness, efficiency and economy of both internal and external audit.
- 3 This document sets out the following:
 - confirmation of the liaison arrangements with Internal Audit;
 - the requirements to be followed in placing reliance on internal audit work and the expectations for reliance on internal audit work;
 - timetable for completion of internal and external audit work;
 - the external audit sample selection approach; and
 - a detailed summary of key controls identified by external audit for the Council's material financial systems.
- 4 These arrangements are subject to regular review by both parties and amendments can be made subject to mutual agreement.

Background

- 5 Uttlesford District Council ('the Council') has a responsibility to put in place proper arrangements for the governance and stewardship of its resources. Internal Audit is an important part of these arrangements. In discharging their responsibilities all Internal Audit providers must comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice for Internal Audit.
- 6 Under the Audit Commission Act 1998 and the Code of Audit Practice the external auditor appointed by the Audit Commission is required in respect of the:
 - financial statements to:
 - be satisfied that the accounts comply with statutory requirements;
 - be satisfied that proper practices have been observed in compiling the accounts; and
 - express an opinion on the statement of accounts;
 - value for money conclusion to:
 - be satisfied that proper arrangements have been made for securing economy, efficiency and effectiveness.
- 7 External audit do not have a role in directing the work of Internal Audit, nor have a role in the quality assurance process of Internal Audit.
- 8 Although internal and external audit carry out their work with different objectives in mind, many of the processes are similar in respect of the review of the controls in place over the Council's financial systems. Therefore, it is appropriate that external and internal audit should work together closely. The Audit Commission emphasises this need for co-operation in a number of its publications:
 - the Code of Audit Practice states that external auditors should 'establish effective co-ordination arrangements with internal audit. Auditors should seek to place maximum reliance on the work of Internal Audit whenever possible';
 - the managed audit concept promotes a more efficient audit by encouraging reliance on the control environment, which includes Internal Audit; and
 - 'It Takes Two' is a good practice guide to assessing and improving co-operation between internal and external auditors.

Planning and liaison

- 9 To facilitate effective planning and liaison between the two parties to the agreement; namely the Audit Commission and Internal Audit, the following communications will take place:
- liaison meetings as and when required;
 - provision of the respective Audit Plans and discussion of them prior to finalisation;
 - informing other parties of changes in the respective internal or external audit approach compared to the agreed Audit Plans, including delays to the scheduled/expected work plan;
 - sharing of all final audit reports arising as a result of work performed;
 - provision of the annual reports/letters;
 - notification of fraud investigations and alerts initiated on a timely basis; and
 - notification of significant concerns regarding the internal controls or financial performance of the Council.
- 10 Internal Audit will also provide the following upon request in respect of specific audit assignments:
- terms of reference;
 - risk analysis; and
 - detailed working papers.
- 11 In addition, Internal Audit will also provide the Annual Internal Audit Report and the Head of Internal Audit Opinion.
- 12 The key points of contact will be as follows:

| Name | Position | Organisation | E-Mail address |
|------------------|------------------------|-----------------------------|-----------------------------------|
| Sheila Bronson | Internal Audit Manager | Uttlesford District Council | sbronson@uttlesford.gov.uk |
| Gary Belcher | Audit Manager | Audit Commission | g-belcher@audit-commission.gov.uk |
| Francesca Palmer | Team Leader | Audit Commission | f-palmer@audit-commission.gov.uk |

Placing reliance on the work performed by Internal Audit

- 13** In accordance with International Standard on Auditing (ISA) (United Kingdom and Ireland) 610, in order to place reliance on the work performed by Internal Audit the external auditor is required to:
- Obtain a sufficient understanding of internal audit activities to assess risks of material misstatement; and
 - Perform an assessment of the internal audit function to determine the use of internal audit when making risk assessments, reviewing:
 - Organisational status
 - Scope of function
 - Technical competence; and
 - Due professional care.
- 14** Under IAS (UK&I) 315 the external auditor is required to understand how the audited body monitors internal controls. Internal audit is a key element of the control environment and review of internal audit work therefore assists in compliance with this standard.
- 15** Where reliance is sought on the work of internal audit it is necessary to:
- review;
 - evaluate; and
 - perform independent audit procedures on that work in order to confirm that the work is adequate to rely upon.
- 16** In assessing the adequacy of an individual piece of internal audit work it will be necessary to assess whether:
- it has been undertaken by staff with sufficient knowledge, skills and ability;
 - it has been properly supervised, reviewed and documented;
 - the conclusions reached are appropriate in the circumstances, and any reports prepared are consistent with the results of the work performed;
 - the internal auditor obtained sufficient appropriate audit evidence to be able to draw their conclusions; and
 - any exceptions or unusual matters have been properly resolved.

Placing reliance on the work performed by Internal Audit

- 17** In assessing the conclusions made by Internal Audit it will be necessary to ensure that the sampling techniques used ensure coverage over the whole of the financial year. Other factors to consider in relation to the sample size will be:
- the frequency of the control; and
 - whether it is a manual or fully automated control.
- 18** The sampling approach adopted by external audit is set out in Appendix 1.
- 19** The degree to which reliance can be placed on the work of Internal Audit is also affected by the timing and/or completion of the audit assignment. In order for external audit to be able to place reliance on the work on Internal Audit, the timetables detailed within Appendix 2 must be adhered to.
- 20** Internal Audit also needs to be compliant with CIPFA's Code of Practice for Internal Audit.

Audit work performed

- 21** External audit's overall responsibilities are set out in the background section and cover the two key areas of the:
- financial statements; and
 - value for money conclusion.

Financial statements

- 22** A risk based approach is used in external audit's work on financial systems. As part of this approach, external audit assesses the level of reliance that can be placed on the controls of the material systems that input into the financial statements. For each of those systems it is necessary to test key controls to ensure that they have been:
- designed and implemented to prevent and detect material misstatement; and
 - operating effectively throughout the accounting period.
- 23** External audit's audit programme has been planned assuming an agreed level of reliance on the Internal Audit work programme for the following material systems:
- General ledger;
 - Cash and bank;
 - Debtors/Accounts receivable;
 - Creditors/Accounts payable;
 - Fixed assets;
 - Payroll;
 - Housing rents;
 - Business rates;
 - Housing benefits;
 - Council tax;
 - Treasury management;
 - Pension costs; and
 - Housing repairs.
- 24** In addition, reliance will also be sought on the other detailed work supporting the Annual Internal Audit Report and the Head of Internal Audit Opinion.

Audit work performed

- 25** The external auditor also has responsibilities in respect of fraud under ISA (UK&I) 240. External audit will review and seek to place reliance on the work of Internal Audit in the following areas in part fulfilment of my responsibilities for:
- assessing the risk of fraud; and
 - monitoring the implementation of actions resulting from the findings of the National Fraud Initiative.
- 26** Appendix 3 sets out the material financial systems and associated key controls external audit has identified as requiring testing in 2010/11. Where Internal Audit has been able to accommodate the testing of these controls in their audit plan, external audit will seek to place reliance on the work performed by Internal Audit. The audit fee for 2010/11 assumes this to be the case. If these are not tested, external audit will need to perform additional work to gain the audit assurance required for the opinion on the Council's financial statements. This is likely to result in additional audit fee.
- 27** The key controls identified are those in operation at the start of the 2010/11 year. It is recognised that these may change, and in the event that they do, the protocol will be updated as and when revised key controls are identified.

Value for money conclusion

- 28** The external auditor is currently required under the Code of Audit Practice to be satisfied that proper arrangements have been made for securing economy, efficiency and effectiveness. The nature and extent of this work is currently subject to review. Once this is clarified the extent to which Internal Audit work may be relied upon will be assessed and added to this protocol.

Appendix 1 – External audit sample selection approach

Sample sizes

In relation to controls, the following sample size ranges are used:

Table 1 Sample sizes

| Frequency of control | Sample size |
|----------------------|-------------|
| Annual | 1 |
| Quarterly | 2 |
| Monthly | 2 |
| Weekly | 5 |
| Daily | 20 |
| Multiple times a day | 20 |
| Automated control | 1 |

Documentation of sample sizes

In all cases, the justification for the sample sizes chosen for testing should be documented.

Choosing a sample

Sample sizes should be chosen from across the whole financial year, up to the date of testing, to ensure that appropriate consideration is given to whether the control is in place and working effectively over this period.

Appendix 1 – External audit sample selection approach

Identification of errors

If errors or uncertainties are identified within the controls testing undertaken an extended sample should be chosen for testing to focus further on the specific area of risk identified.

Appendix 2 – Timetable of audit work

Timetable

Where Internal Audit have included control testing for the systems highlighted in Appendix 3 in their 2010/11 audit plan, work will be undertaken on the controls in the named material financial systems in two stages:

Stage 1

Internal audit will test controls on the material financial systems on the first three quarters of the 2010/11 financial year, finalising reports by the end of December 2010. This work will then be reviewed by external audit in January 2011; and

Stage 2

Top-up testing will need to be performed in March 2011 to ensure that controls for the whole year are tested. External audit will perform this work as the majority of top-up testing will involve year end controls which external audit would normally test to inform the post statements testing strategy.

External audit will liaise with Internal Audit prior to performing this top-up testing in order to minimise any duplicated effort.

Appendix 3 – Summary of material systems and key controls to be tested in 2010/11

29 The following tables summarise the material systems and the respective key controls identified by external audit as to be tested in 2010/11 and the sample sizes to be applied.

Table 2 **General ledger**

| Reference | Key control | Frequency of control | Sample size |
|-----------|---|----------------------|-------------|
| GLKC1 | All data input to the ledger from feeder systems is subject to control and agreement. | Monthly | 2 |
| GLKC3 | All journals are reviewed and authorised by a senior officer other than the staff member who raised the journal. | Daily | 20 |
| GLKC6 | Control account reconciliations are reconciled regularly, reviewed and authorised by a senior officer other than the staff member who prepared the reconciliation. | Monthly | 2 |
| GLKC8 | Ensure bank and cash reconciliations between the cash book and bank statements are reconciled monthly, and are reviewed and authorised by a senior officer other than the staff member who prepared the reconciliation. | Monthly | 2 |
| GLKC9 | Ensure the ledger does not allow unbalanced journals to be processed. | Automated | 1 |

Table 3 Bank and cash

| Reference | Key control | Frequency of control | Sample size |
|-----------|---|--------------------------------|-------------|
| CASHKC3 | Ensure that both daily and monthly reconciliations are completed between the sources of cash received and the cash receipting totals per ICON. These should be evidenced as prepared and reviewed accordingly. | Daily recs Monthly recs | 20 2 |
| CASHKC5 | Ensure bank and cash reconciliations between the cash book and bank statements are reconciled monthly, and are reviewed and authorised by a senior officer other than the staff member who prepared the reconciliation. Covered by GL KC8 noted in table 2 above. | Monthly | 2 |

Table 4 Business rates (NNDR)

| Reference | Key control | Frequency of control | Sample size |
|-----------|--|----------------------|-------------|
| NNDRKC1 | Ensure that a reconciliation between the VO report and NNDR system is performed monthly, and is evidenced as prepared and reviewed. | Monthly | 2 |
| NNDRKC4 | Ensure a senior officer checks the parameters within the NNDR system are set up correctly and evidence of this check is kept on file. | Annually | 1 |
| NNDRKC9 | Ensure the cash receipting system and the direct debits are reconciled to the NNDR system monthly, evidenced as prepared and reviewed. | Monthly | 2 |
| NNDRKC10 | NNDR debt collection rates are monitored monthly and an aged debtor analysis is prepared to inform this process. | Monthly | 2 |

Appendix 3 – Summary of material systems and key controls to be tested in 2010/11

| Reference | Key control | Frequency of control | Sample size |
|-----------|---|----------------------|-------------|
| NNDRKC14 | Ensure the NNDR system is reconciled to the ledger. | Daily | 20 |

Table 5 Council tax

| Reference | Key control | Frequency of control | Sample size |
|-----------|---|----------------------|-------------|
| CTKC1 | Ensure that a reconciliation between the VO report and council tax system is performed monthly, and is evidenced as prepared and reviewed. | Monthly | 2 |
| CTKC4 | Ensure a senior officer checks the parameters within the council tax system are set up correctly and evidence of this check is kept on file. | Annually | 1 |
| CTKC9 | Ensure the cash receipting system and the direct debits are reconciled to the council tax system monthly, evidenced as prepared and reviewed. | Monthly | 2 |
| CTKC10 | Council tax debt collection rates are monitored monthly and an aged debtor analysis is prepared to inform this process. | Monthly | 2 |
| CTKC12 | Ensure the NNDR system is reconciled to the ledger. | Daily | 20 |

Table 6 Creditors

| Reference | Key control | Frequency of control | Sample size |
|-----------|---|----------------------|-------------|
| APKC1 | The purchase order information is reviewed and authorised by requesting officer's line manager. | Daily | 20 |
| APKC2 | Ensure the delivery note is matched to the goods received and evidence of this is kept on file. | Daily | 20 |

Appendix 3 – Summary of material systems and key controls to be tested in 2010/11

| Reference | Key control | Frequency of control | Sample size |
|------------------|--|-----------------------------|--------------------|
| APKC3 | Ensure the invoice is checked, coded, and authorised by the appropriate department. | Daily | 20 |
| APKC5 | Invoice is allocated a unique code by Integra, and the entry of a duplicate item is prevented automatically by the system. | Automated | 1 |
| APKC6 | Input batch report is run and checked to invoices by a second member of exchequers. | Daily | 20 |
| APKC7 | Purchase daybook run is reconciled to the general ledger creditors control account. | Daily | 20 |

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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