

Protocol for the relationship between the Audit Commission and Lancashire County Council's internal Audit Service

March 2011

Introduction

- 1 This protocol sets out how Lancashire County Council's internal Audit Service and the Audit Commission, as its external auditor, work together, and it establishes a framework for coordination, cooperation and exchange of information.

External audit responsibilities

- 2 External audit responsibilities are set out in the Code of Audit Practice, as developed by the Audit Commission and approved by the Houses of Parliament. Under this code the external auditors are responsible for:
 - Expressing an opinion on the council's financial statements; and
 - Reviewing whether the council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 3 In addition under section 28 of the Audit Commission Act 1998, the external auditor is required to certify some claims and returns for grants or subsidies paid by the government departments and public bodies to Lancashire County Council.
- 4 When completing its work on the financial statements the external auditor is required to comply with International Standards on Auditing (ISA), as adapted for application in the UK and Ireland. The external auditor is required by these ISAs, amongst other things, 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;
 - Identify the risks of material misstatement in the financial statements whether arising from fraud or error; and
 - Plan and carry out tests of controls and/ or detailed transactions to address those specific risks as well as the underlying inherent risks.

Internal audit responsibilities

- 5 CIPFA's Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006 defines internal audit as:

'An assurance function that provides an independent and objective opinion to the organisation on the control environment (comprising governance, risk management and internal control) 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.'

- 6 The internal Audit Service is therefore required to formulate an annual risk-based plan of work which is directed to providing assurance over, amongst other internal controls, the systems that produce material figures in the council's financial statements: these systems control areas of significant financial risk to the council. The internal Audit Service is similarly obliged to provide an annual opinion to the council on its governance and risk management arrangements, which will inform the external auditor's work.
- 7 There is therefore a natural alignment of internal audit work with external audit.
- 8 This Code of Practice also sets out the professional standards the council's internal Audit Service is required to meet in relation to, amongst other things, independence and ethics, due professional care, and planning, undertaking and reporting internal audit work.

The external and internal audit relationship

- 9 In the interests of overall efficiency and effectiveness, the Audit Commission seeks to maximize its reliance on the work of the council's Audit Service, most commonly in relation to the council's core financial systems, but also in other areas where this is possible. The internal Audit Service seeks to provide whatever support is necessary and appropriate to the Audit Commission.
- 10 ISA 610 refers specifically to 'considering the work of internal audit' and requires external auditors to:
 - Review the Audit Service to confirm that it meets, as a minimum, the requirements of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006. This will provide assurance that work is to a standard and can be relied on to inform external audit conclusions;
 - Review whether the Audit Service is effective;
 - Review (and seek to place reliance on) specific pieces of internal audit work, where that work covers areas relevant to their external audit objectives; and
 - Evaluate the work of the Audit Service, where external auditors intend to use internal audit work to inform their conclusions. This may involve re-performance of a sample of work, testing similar items or observing internal audit work in progress.
- 11 When the Audit Commission has undertaken a formal review of the Audit Service, it will discuss its findings with the head of internal audit and provide an agreed report to the council.
- 12 The Audit Service will take account of the work undertaken by the external auditor in assessing the framework of assurance available to the council.
- 13 Both sets of auditors share with each other their risk assessments of the council and their related work programmes. This informs each others' risk assessments and helps to identify opportunities for reliance on work planned to be carried out by the internal Audit Service.
- 14 Regular liaison meetings are programmed to facilitate this and both sets of auditors share working papers and reports as needed.

- 15 In undertaking work that the Audit Commission will wish to use to support its external audit opinion on the council's financial statements, the internal Audit Service will:
- Ensure that the sample methodology and sample sizes are sufficient for the external auditor's purpose and cover as much of the financial period as possible (whilst recognising that the work should be completed within the financial period); and
 - Provide access to the working papers and supporting documentation necessary for the external auditor to assess this work in detail.
- 16 Both internal and external audit will ensure that whenever documentation is obtained from the other auditor, it will be returned promptly and, if used in any published document, will be appropriately cited.