

Audit Protocol

Oxford City Council

Audit 2009-2010

November 2009



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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

Aims

- 1 This document sets out the basis for the joint working arrangements between Oxford City Council's Internal Audit Service (IA) and the Audit Commission (AC), as the Council's external auditors. This takes into account the requirements of the Code of Audit Practice 2005 (the Code) for external auditors and the Terms of Reference for Internal Audit (which reflects the Code of Practice for Internal Audit in Local Government).
- 2 The aims of the protocol are:
 - to clarify respective responsibilities for work associated with the internal audit and external audit codes;
 - to develop further a close and effective working relationship;
 - to facilitate the effective co-ordination of our work without impairing the independence and integrity of either party;
 - to formalise those specific areas where co-operation will minimise the overlap of effort and duplication of work and ensure cost effectiveness;
 - to provide an understanding of the results of each others work to inform the scope of future work; and
 - to assist the Audit and Governance Committee to fulfil its responsibility to ensure effective liaison between internal and external audit.

Respective responsibilities

- 3 It is a fundamental principle of the Code that the Council is responsible for putting in place proper arrangements for governance and stewardship of resources. This includes systems of internal control and arrangements for monitoring their adequacy and effectiveness in practice.
- 4 Internal Audit provides an essential element of the Council's arrangements. Their principal responsibility is to meet the professional standards laid down in the Code of Practice for Internal Audit in Local Government, with a focus on identifying and addressing the control risks faced by the Council and providing assurance on the Council's corporate governance arrangements in accordance with the wishes of the Council and the Section 151 officer.
- 5 The primary objective of internal audit is to provide an independent and objective opinion to the Council on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the council's key priorities.

- 6 Under the Code, external auditors have a responsibility to give an independent assessment of:
 - the Council's Financial Statements, including the Annual Governance Statement; and
 - aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 7 The Code requires that external auditors should establish effective co-ordination arrangements with internal audit, and should seek to place the maximum amount of reliance on the work of internal audit whenever possible. There are two key factors that limit the extent of such co-operation:
 - the emphasis of the Audit Commission's audit approach is on ensuring that internal audit meet their own standards and objectives, and not on seeking to influence the internal audit programme for external audit objectives; and
 - external audit cannot delegate any of its Code responsibilities to internal audit.
- 8 Internal and external audit have different roles but many shared objectives. Effective co-operation is essential in order to minimise duplication of effort and maximise the benefits of audit. It should enable both parties to devote more time to the key audit issues and ensure that the Council gets best value from its total audit resource. Both teams are committed to an open and constructive relationship, based on an understanding of each other's roles and approaches to achieving their respective objectives.

Protocol

Planning

- 9 The Audit Commission plan and carry out the audit in compliance with International Standards for Audit (ISAs), relevant extracts of which are given in Appendix 1.
- 10 Both internal audit and external audit will produce annual audit plans based on risk assessment. The timing and scope of work will be discussed in advance in order to ensure the best deployment of respective resources and avoid duplication. Copies of approved audit plans will be exchanged as soon as practicable after approval.
- 11 Progress against the respective plans will be discussed during regular liaison meetings.
- 12 To achieve benefits from co-operation and co-ordination will require commitment and delivery from both parties. The Audit Commission bases its audit plans on the assumption that internal audit share this commitment. In particular, the assumption that internal audit will complete their planned work to an appropriate standard.

Audit areas

Opinion

- 13 The Audit Commission is required to audit the Council's financial statements and to give their opinion, including:
 - whether they present fairly the financial position of the Council and its expenditure and income for the year in question; and
 - whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards.
- 14 In order to comply with ISA315, the Audit Commission need to identify, evaluate, document and test those of the Council's systems that have a material impact upon its financial statements. The Audit Commission will evaluate and seek to place reliance on the work of Internal Audit in order to optimise the use of audit resources.
- 15 The Audit Commission is required to review whether the Annual Governance Statement (AGS) has been presented in accordance with relevant requirements, and to report if it does not meet those requirements or if the statement is misleading or inconsistent with our knowledge of the Council.
- 16 Internal Audit's responsibilities require them to evaluate the effectiveness of the control environment in achieving the organisation's objectives. In part fulfilment of their responsibilities, Internal Audit carry out reviews of systems and key controls, including evaluating and testing those controls. This work is directly relevant to the Audit Commission's responsibilities.
- 17 The Audit Commission will seek to place reliance upon Internal Audit's systems work, provided there is assurance that:
 - adequate sample sizes are used in order to support conclusions and recommendations;
 - samples are selected appropriately to be representative of the population and the period covered; and
 - the work is evidenced and documented in accordance with professional standards.
- 18 Guidance on sample sizes to be used for initial testing is included in Appendix 2. If the auditor finds errors/weaknesses in the initial sampling, consideration then needs to be given to the impact of the error and what, if any, additional audit work is required.
- 19 The Audit Commission will liaise with Internal Audit each year to identify the scope for drawing assurance from their systems work. To be successful this will involve synchronising work timetables. Any Internal Audit work that the Audit Commission plans to make use of will need to be completed before the interim visit. The Audit Commission will then need to consider whether any additional testing will be needed to cover the remaining part of the year.

Audit areas

- 20 The Audit Commission has developed a three year cyclical testing strategy which, delivered with the co-operation of Internal Audit, will help to minimise the duplication of work. The Audit Commission will agree in advance the controls that have to be tested on each system identified. The following have been identified as key financial systems:
- General ledger
 - Payroll
 - Accounts payable – includes OBS/City works
 - Housing Benefit (Academy)
 - Housing Rents
 - Council Tax (I-World)
 - NNDR (I-World)
 - Car Park Income
 - Accounts Receivable & Income Receipting
 - Asset Register
 - Treasury Management.

Fraud

- 21 The Council will notify Internal Audit and the Audit Commission promptly of all frauds and any cases of corruption and any fraud cases of particular interest or complexity. If appropriate, the Audit Commission will offer support and assistance to Internal Audit in investigating significant frauds.
- 22 In the event that the Audit Commission suspect a fraud, the case will be passed over to the control of Internal Audit who will then be expected to oversee the investigation of the case and keep the Audit Commission informed of progress. The Audit Commission reserve the right to retain control over a fraud investigation, although this is only likely in exceptional circumstances.

Use of Resources

- 23 The Audit Commission will keep Internal Audit informed of any forthcoming performance and inspection work and its scope, so that Internal Audit can plan their work appropriately. Internal Audit will highlight any value for money or use of resources considerations in their reports.
- 24 The Audit Commission has a responsibility in relation to the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. One source of assurance for this work is the Council's whole system of internal control as reported in the Annual Governance Statement. The Audit Commission will work with Internal Audit to support their role in contributing to this process, and will seek assurance about the overall control environment from their work, particularly as reported in their annual report to the Council.

Other work areas

- 25 The following additional areas of Internal Audit activity may also be relevant to the Audit Commission's work:
- ad hoc investigations into suspected fraud or corruption;
 - reviews of systems development and replacement; and
 - any work undertaken to inform the Councils' Annual Governance Statements.

Liaison arrangements

- 26 Liaison meetings will be held regularly and these are likely to be at least quarterly to fit in with key Audit and Governance Committee meetings.
- 27 Standard agenda items for liaison meetings are likely to include:
- update of progress against Internal Audit and Audit Commission plans;
 - issues affecting delivery of plans;
 - reports finalised since last meeting;
 - key findings and emerging issues from current work;
 - IA involvement in systems development work etc; and
 - details of special investigations and sensitive issues.

Audit documents and reporting

- 28 The Audit Commission have to satisfy themselves that Internal Audit's work meets required standards and can be relied upon for assurance on the council's control arrangements. Reviewing relevant files is an essential step in this process. Internal Audit has agreed to provide the Audit Commission with access to their records and reports upon request. Internal Audit and the Audit Commission use the same electronic recording system which will facilitate the ready exchange of information.
- 29 The Audit Commission will evaluate and seek to place reliance on the work of Internal Audit in order to optimise the use of audit resources. Expectations in terms of documentation, testing requirements and timetables for work will be agreed in advance.

Review of Internal Audit

- 30** The Audit Commission will undertake a comprehensive review of Internal Audit at least every three years. This will assess Internal Audit against CIPFA's Code of Internal Audit Practice. In the intervening years, the Audit Commission will rely on the previous triennial review (assuming that it was satisfactory) and confirm that there have been no significant events to affect the validity of the previous assessment. The Audit Commission will also review the adequacy of Internal Audit as part of their annual Use of Resources assessment to establish whether the Council has a sound system of internal control.
- 31** In addition to the above, the Audit Commission will undertake detailed reviews of specific pieces of work upon reliance will be placed. This will encompass a review of the audit file to assess the scope of the work and the adequacy of sample sizes, standards of evidence and documentation, quality assurance and reporting. This may involve re-performing some tests, or testing an additional sample, if deemed appropriate.
- 32** The Audit Commission's conclusions from all of this work will be discussed with officers and summarised in reports to the Council.

Appendix 1 – Extracts from relevant International Standards for Audit (ISAs)

- ISA 315: The external auditor should assess the risks of material misstatement in the councils' financial statements through gaining an understanding of the council and its environment and of those controls and risk management arrangements that are relevant to ensuring the councils' affairs are presented fairly in their accounts.
- ISA 330: When, in accordance with paragraph 108 of ISA (UK and Ireland) 315, the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk and the auditor plans to rely on the operating effectiveness of controls intended to mitigate that significant risk, the auditor should obtain the audit evidence about the operating effectiveness of those controls from tests of controls performed in the current period.
- ISA 610: The external auditor should consider the activities of internal auditing and their effect, if any, on external audit procedure. 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.
- ISA 240: In planning and performing the audit to reduce audit risk to an acceptably low level, the auditor should consider the risks of material misstatements in the financial statements due to fraud. The auditor should make inquiries of management, internal audit, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. The auditor should obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.

Appendix 2 – Sample sizes which impact on opinion work

Control type	Frequency of control	Sample size
Manual or high risk automated	Quarterly	2
	Monthly	2
	Weekly	5
	More than weekly	20
Low risk automated		1

Fully automated controls need far less testing as IT is inherently consistent. Where controls are automated and operate in a within a low risk IT environment, only a sample of 1 is required. Where the IT environment is not low risk then the same sample sizes should be used as for manual controls.

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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