

Agenda Item No: 8

Report No: 23/14

Report Title: Joint Audit Arrangements between Lewes District Council and BDO 2013/14 to 2014/15

Report To: Audit and Standards Committee Date: 27 January 2014

Ward(s) Affected: All

Report By: Head of Audit and Performance

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Purpose of Report:

- 1 To seek Councillors' approval of the draft revised protocol that sets out the joint audit arrangements between LDC and BDO.**

Officers Recommendation(s):

- To note the contents of the report.
- To approve the draft revised protocol between LDC and BDO (Appendix 1).

Reasons for Recommendations

- To ensure that there is the most efficient use of the available audit resources it is important that there is effective communication between internal and external audit. The draft revised protocol sets out the ways in which internal and external audit will manage the working relationship in the period up to the end of the current external audit contract in March 2015.

Background

- The December 2007 meeting of the Audit Committee approved the protocol that set out the joint audit arrangements between LDC and the external auditors PKF for the period 2007/08 to 2011/12. Since then, internal and external audit have worked in accordance with the protocol to ensure that their respective services have been as integrated as possible.
- The original protocol was set up to run for the period of the initial contract with PKF. This contract has been extended to the end of 2014/15, at which time a new contract will be let. The proposed new protocol will run up to the end of the current contract.

4 In addition to the need to extend the protocol for the period of the current contract, there have been a number of other developments which mean that the original protocol required updating. These developments include:

- The merger of PKF with BDO in February 2013, and the operation of the new merged entity under the BDO brand.
- The introduction of the Public Sector Internal Audit Standards (PSIAS) that became effective on 1 April 2013.
- Revisions to the international standards on (external) auditing issued by the Financial Reporting Council (FRC) in 2013. The FRC sets UK standards for accounting, auditing and actuarial work, and the recent revisions require the relationship between internal and external audit to fully reflect the independence of internal audit. The result is that internal audit will determine the scope and content of reviews of the key financial systems.

Revised Protocol

5 The draft revised protocol is attached at Appendix 1. The document has been prepared by Internal Audit at Lewes, and agreed by BDO. The protocol outlines the roles and responsibilities for internal and external audit, and sets out the ways in which the parties will cooperate to maximise the effectiveness of the overall approach to audit.

Financial Appraisal

6 There are no financial implications arising from this report.

Risk Management Implications

7 The risk assessment shows that if the Audit Committee does not ensure proper oversight of the adequacy and effectiveness of Internal Audit there is a risk that a key aspect of the Council's control environment will not comply with best practice standards.

Legal Implications

7.1 There are no legal implications arising from this report.

Sustainability Implications

8 I have not completed the Sustainability Implications Questionnaire as this report is exempt from the requirement because it is an internal monitoring report.

Equality Screening

9 This report involves no key decisions and therefore screening for equality impacts is not required. However, if Internal Audit notes equalities issues during their work these will be raised with the Equalities Officer to ensure the appropriate equality impact screening is carried out.

Background Papers

10 None

Appendices

Appendix 1 – Protocol for Joint Audit Arrangements between Lewes District Council and BDO 2013/14 to 2014/15.

Appendix 1

**Protocol for Joint Audit Arrangements
between Lewes District Council and
BDO
2013/14 to 2014/15**

Contents

- 1 Introduction
- 2 Scope and responsibilities
- 3 Planning
- 4 Reviewing the work of Internal Audit

1 INTRODUCTION

- 1.1 The Audit Commission continues to encourage appointed auditors to work to ensure that audit work is being effectively targeted, thereby seeking to reduce the time spent on the external audit. In addition, Audit Committees are increasingly keen to ensure that the services of internal and external audit are as integrated as possible, in order to maximise the effectiveness of the overall approach to audit operated within their organisation.
- 1.2 To ensure that the audit approach is integrated there is a need for effective communication between internal and external audit, such that that there is the most efficient use of the available audit resources. This will also provide external audit with the opportunity to place as much reliance as possible on the work of internal audit in the discharge of the auditor's duties under the Audit Commission's Code of Audit Practice (the Code).

The approach at Lewes District Council

- 1.3 BDO, as the Audit Commission's appointed external auditor for Lewes District Council, will work with internal audit to ensure the work is completed as efficiently as possible.
- 1.4 In developing the external Annual Audit Plan for Lewes District Council, BDO has made some assumptions about the quality and appropriateness of the work of internal audit and the level of reliance that may be placed on it. These assumptions have been reflected in the level of fees that have been set by the Audit Commission.
- 1.5 This protocol has been produced to provide some structure to the working relationship between internal and external audit, and seeks to:
 - emphasise the independence of internal audit and establish the respective areas of responsibility.
 - clarify areas of cooperation in planning the audit, reviewing internal audit work and reporting.
 - ensure effective communication and coordination, and to further enhance the audit approach, maximising the potential for reliance to be placed on work undertaken.
 - help reduce any unnecessary overlap of audit effort.

2 SCOPE AND RESPONSIBILITIES

Code of Audit Practice

- 2.1 External audits in Local Government are carried out in accordance with the *Code of Audit Practice* (the Code) issued by the Audit Commission. The main area of overlap in the work of Lewes District Council and BDO that arises from the Code centres on the responsibility of BDO to express an opinion on whether the financial statements present fairly the financial position, income and expenditure for the year under audit.

- 2.2 In carrying out this work BDO is required to consider the consistency of the disclosures in the Annual Governance Statement to evidence provided by the organisation and knowledge of the client.
- 2.3 This involves evaluating the key controls within the organisation's financial systems, with particular focus on assessing whether the controls in place are suitably designed and operating as intended in order to mitigate significant risks and prevent material misstatements within the accounts.

Public Sector Internal Audit Standards (PSIAS)

- 2.4 The internal audit service carried out in accordance with the Public Sector Internal Audit Standards (PSIAS) and the Accounting and Audit Regulations (2011). All Local Authorities should make provision for internal audit in accordance with these standards.
- 2.5 Internal Audit at Lewes District Council undertakes annual reviews of the key financial systems to provide assurance, for the purposes of the Annual Governance Statement, that appropriate financial controls are in place and that associated risks are sufficiently mitigated. The results of this work are made available to BDO for the purposes of the assessment of the reliability of the financial systems.
- 2.6 Internal audit at Lewes District Council investigates all reported cases of fraud, impropriety or misconduct involving financial and/or internal control issues, and reports to senior management and the Audit and Standards Committee as appropriate. (*) (**). The Head of Audit of Performance reports on the internal control environment, including the arrangements to prevent and detect fraud, for the purposes of the Annual Governance Statement.
- 2.7 In a coordinated exercise with BDO, internal audit carries out testing for the annual audits of Housing Benefits and Non Domestic Rates subsidy grant claims

(*) The investigation of cases of Benefits and Council Tax fraud are carried out by the Fraud Investigation Team in Revenues and Benefits.

(**) The review and investigation of matters relating to the Members' Code of Conduct are carried out by the Audit and Standards Committee on the basis of reports from the Corporate Head – Legal and Democratic Services acting in the role of Monitoring Officer.

Assurance Overlaps

- 2.8 There are areas of responsibility and review where the work of external and internal audit overlap, particularly with respect to the review of the effectiveness of internal controls.
- 2.9 Under an integrated audit approach, the detailed review of the effectiveness of internal controls and the strength of the arrangements for the prevention and detection of fraud is usually undertaken by internal audit. The external auditor should then be able to place reliance on this work in order to be able to assess the strength of the overall control environment, to obtain sufficient evidence of the effectiveness of specific internal controls, and to assess the impact of any reported frauds on the financial statements.

- 2.10 Other areas where the work of internal Audit may be used by external audit to assist in its review and assessment of particular issues include:
- review of fraud and corruption, including any annual surveys completed for the Audit Commission, NFI data matching and the preparation of AF70s.
 - any reviews of value for money type projects that would assist with the auditor's assessment of the Council to ensure the achievement of economy, efficiency and effectiveness in the use of resources.

3 PLANNING

- 3.1 In planning its audit work, BDO gives regard to the strategic plan and annual audit plan of internal audit in terms of the:
- coverage of key financial systems.
 - coverage of other areas of audit risk under the Code.
- 3.2 The sections below highlight the key mechanisms for achieving this:

Joint working arrangements for Planning and Liaison

Planning

- Internal audit will liaise with BDO during preparation of the annual audit plan to provide information on planned audit coverage, methodologies, timing of work and staffing arrangements.
- The internal audit annual audit plan will be largely based on an assessment of risk, taking account of the organisation's risk register, but will also include consideration of all the key financial systems at the Council.
- The timing of internal audit work on the key financial systems will be scheduled so as to ensure maximum coverage of the audit year, and the testing included within the internal audit work will examine transactions taken from throughout the audit year.
- Planning of internal audit's reviews will include coverage of a range of key control objectives for the individual key financial systems.
- Internal audit's planned testing programmes to be advised to BDO so that external audit is aware of the extent and scope of coverage.
- There will be prompt communications between internal and external audit where there are issues with the coverage/depth of internal audit review such that there may not be coverage of key controls, or where there is a need to vary the coverage of work in order to meet new requirements or address unforeseen events.

Liaison

- BDO and internal audit will have three formal liaison meetings during the year as follows:
 - February, to discuss audit plans and risk areas.
 - June, to discuss feedback from external audit's interim review
 - September, to discuss audit progress and key issues/risks arising.

- BDO and internal audit will also maintain regular informal contact to advise each other of any significant new developments and key issues arising.
- Internal audit will liaise with departments to ensure necessary access to information for internal audit and BDO in line with the mutually agreed start dates for external audit work.

4 REVIEWING THE WORK OF INTERNAL AUDIT

- 4.1 In order to determine the reliance that can be ultimately be placed on the work produced by internal audit BDO will undertake a review of the documentation that they may be seeking to place reliance on. This review will include some re-performance testing of internal audit work to determine the quality and adequacy of the testing performed, the sufficiency of the evidence retained to support the conclusions made and the appropriateness of the those conclusions.
- 4.2 The sections below highlight the standards that will be applied to ensure that these aims can be achieved.

Review of key financial systems and grant claim transaction testing

Internal Audit's review

System documentation and walkthrough

- For each of the key financial systems internal audit's working papers will document the actual key controls in place within the identified key financial systems.
- For each of the key controls in place within the key financial systems, internal audit will obtain 'walkthrough' evidence to support the operation of the control in practice (this evidence may be taken from the sample of controls tested for effectiveness) and consider whether the control achieves its intended objective, and this evidence will be retained on file.

Effectiveness testing

- Internal audit will carry out detailed testing of the key controls which have been identified as requiring effectiveness testing in the Audit Test Programme for each key financial system.
- Internal audit samples will be selected so as to:
 - Achieve maximum coverage of the financial year being audited.
 - Cover all significant income and expenditure streams.
- A minimum sample of 20 (pro-rated downwards for populations below 100) will be tested to ensure the effectiveness of each existing control. Any auditor judgements on increases to these sample sizes will be documented.
- The population source, population size (estimated if necessary) and method of sample selection will be documented.

- Full supporting evidence for at least one of the sample reviewed for effectiveness testing (where there was a successful result) will be retained on file. This may be the same documentation as that retained for the walkthrough tests.
- Copies of the full supporting documentation that evidence all failures of the effectiveness of the control will also be retained.
- Sufficient details of the sample items that evidence the correct operation of the control will be documented so that the individual transactions can be identified.
- Test documentation will be referenced to supporting evidence and will detail its source and which specific part of the supporting evidence establishes the test's conclusion.
- Where errors in the effectiveness of a key control are identified, further audit work will be done to ascertain whether the errors are isolated or systemic. Where it is deemed that there has been a systemic breakdown in effectiveness, an assessment of the impact of that control breakdown on the system output will be performed.
- Every test will include its own individual conclusion.
- Notes from discussions with officers will state the officer consulted, the date of the discussion and the outcome.
- There will be a clear audit trail from the test conclusions through to the matters raised and recommendations contained in the draft report.
- All of the required internal audit documentation will be made available for review on the notified dates for external audit review of key financial systems.

Effectiveness of internal audit

- The Head of Audit and Performance carries out an annual review of the effectiveness of internal audit, with the results independently reviewed by the Director of Finance and reported to the Audit and Standards Committee.

External audit review of internal audit's work

- BDO will carry out its review of internal audit work during the dates agreed for external audit review of key financial systems.
- BDO will also review the annual effectiveness review carried out by the Head of Audit and Performance for use in the review of the Annual Governance Statement.
- Upon completion of any review of internal audit work BDO will feed back any issues arising, and assess the potential for remedy and the impact of any matters not easily rectified.
- BDO will assess the impact on the audit of areas where the work of internal audit does not satisfy the requirements of external audit, and will discuss and agree the way forward in these areas.

Reporting

- BDO will provide feedback to internal audit on the results of their reviews of key financial systems before finalisation of BDO's report.
- Unless significant issues are identified that impact on the audit of the financial statements, external audit reports will not duplicate recommendations already raised by internal audit but will, where applicable, emphasise matters deemed to be of particular significance in the main body of the report.