

By: David Tonks, Head of Audit and Risk  
To: Governance and Audit Committee – 30 November 2010  
Subject: EFFECTIVENESS OF INTERNAL AND EXTERNAL  
AUDIT LIAISON  
Classification: Unrestricted

---

**Summary:** This paper summarises the effectiveness of the liaison arrangements between External and Internal Audit

## **FOR ASSURANCE**

---

### **Introduction**

1. The requirement for Internal Audit and External Audit to liaise in an effective way is recognised by the professional guidance within both disciplines. The potential efficiencies that can be realised when this liaison is effective can be high, both in terms of avoided external audit fees, but also in relation to a reduced audit burden for finance and other front line staff. For this reason the Committee's revised terms of reference include the responsibility for the Committee to annually assess the co-operation between External and Internal Audit.

### **Professional requirements**

2. It is important to understand that both functions have very different remits. Internal Audit is an independent assurance function within the Council, whereas External Audit is responsible for giving an independent opinion on the Council's financial statements and a conclusion on its arrangements for securing economy efficiency and effectiveness in its use of resources.
3. Although overall remits differ, it should be possible for internal and external auditors to rely on each other's work, subject to the limits determined by their responsibilities. The CIPFA code of practice for Internal Audit requires that:
  - It is possible for Internal Audit and External Audit to rely on each other's work.
  - There are regular meetings between the Head of Internal Audit and the External Audit Manager.
  - Internal and external audit plans are co-ordinated.
4. External Audit's work is governed by the International Standards on Auditing (ISAs). In particular ISA 610 requires External Audit to
  - gain 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.
5. ISA 610 is clear that effective internal auditing will often allow a modification in the nature and timing, and a reduction in the extent of audit procedures performed by the external auditor. However it also states that the external auditor may decide that internal auditing will have no effect on external audit procedures. In coming to a conclusion whether to rely on the work of internal audit, the

external auditor usually makes an assessment of internal audit's organisational status, the scope of the function, technical competence of the team and the due professional care in place.

### **Current practice**

6. External Audit's evaluation of Internal Audit has been positive over recent years and no concerns across the four criterion set out in ISA 610 have been raised. There are regular meetings between the two sections to co-ordinate plans. In 2010/2011 Internal Audit completed (or will complete) three specific reviews on behalf of the External Auditors:
  - Year end closedown (in place for the last three financial years)
  - Pensions contributions
  - Pensions investment income
7. This year Internal Audit has also sought to place reliance on the work of External Audit in relation to medium term financial planning, and External Audit will share its control documentation to support the system mapping work that Internal Audit are currently completing.

### **Conclusion and next steps**

8. Liaison between Internal Audit and External Audit is in place, and there is some reliance placed on the work on Internal Audit by the External Audit team. However, it is obvious that there is potential to enhance the liaison between the two sections. For example, authority wide reviews such as Corporate Governance, Risk Management and Performance Management could be utilised by the External Auditors to better inform their risk assessment of the Council
9. At present Internal Audit spend 320 days (around 20% of the overall audit plan) reviewing the Councils financial systems. If required, aspects of this work could be tailored to provide the assurance required by External Audit in relation to financial systems and accounts, whilst at the same time providing the required assurance to the Council in relation to Internal Control. It should also be possible for the Internal Audit section to deliver specific reviews to address some of the risks identified by External Audit.
10. Both Internal and External Audit are starting to consider their plans for the 2011/2012 year. The Head of Audit and Risk has agreed with the Audit Commission to seek greater synergy between the two audit plans, and it is hoped that this will be reflected in the plans presented for approval by the Committee next year.

### **Recommendations**

11. Members of the committee are asked to
  - Note the current level of liaison between Internal and External Audit and the intent to improve the liaison between as part of the annual planning.

**David Tonks**  
**Head of Audit and Risk**  
**Ext: 4614**