

By: Robert Patterson, Head of Internal Audit
To: Governance and Audit Committee – 25th January 2017
Subject: **Effectiveness of Internal and External Audit Liaison**
Classification: Unrestricted

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

FOR ASSURANCE

Introduction

1. The requirement for Internal and External Audit to liaise in an effective way is recognised by professional guidance within both disciplines. Effective liaison can reduce the audit burden for finance and other front line staff. For this reason the Committee's Terms of Reference includes the responsibility for the Committee to annually assess the co-operation between Internal and External 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 to secure value for money through economic, efficient and effective use of its resources.
3. Although their 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.
4. External Audit's work is governed by the International Standards on Auditing (ISAs). In particular ISA 610 requires External Audit to:
 - Determine whether, and to what extent, to use specific work of the internal auditors; and
 - If using the specific work of the internal auditors, to determine whether that work is adequate for the purposes of the audit.
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, objectivity and 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. In particular their July 2016 audit findings report contained positive observations over the adequacy of internal audit arrangements. There are regular meetings between the two teams to share, discuss and co-ordinate plans. The liaison

arrangements are documented within a protocol shown at Appendix 1 to this report.

7. The independent external quality assessment of internal audit in 2016 by the Institute of Internal Auditors also evaluated good standards of work with full compliance with professional standards including integrated working with external audit.
8. External and internal work wherever possible is co-ordinated to reduce duplication and promote effective working wherever possible.
9. The 2016/17 Internal Audit plan contains a number of core financial reviews, which are regularly reported back to the G & A Committee. Internal Audit ensures that Grant Thornton are informed of the findings and outcomes from these audits and they can use any of this material to help plan and inform their own external audit work.
10. In addition the work that the Internal Audit section completes to provide core assurance e.g. Corporate Governance, Risk Management, and performance management is utilised by the External Auditors to inform their risk assessment of the Council.

Conclusion and next steps

11. Liaison between Internal Audit and External Audit is in place and working effectively. Reliance is placed on the work of Internal Audit by the External Audit team where this is relevant.
12. Both Internal and External Audit are starting to consider their plans for the 2017/18 year (for external audit this is in relation to the 2016/17 financial statements). This will be reflected in the plans presented for approval by the Committee in April next year.

Recommendations

13. Members of the Committee are asked to note this annual update on liaison arrangements between Internal and External Audit for assurance and the protocol at Appendix 1.

Appendices

Appendix 1 KCC Internal Audit – External Audit Protocol

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Internal Audit – External Audit Protocol for Kent County Council

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Introduction

The protocol sets out the key principles and procedures underpinning the working relationship between Kent County Council Internal Audit team and the Council's external auditors, Grant Thornton. It establishes a framework for coordination, cooperation and exchange of information.

The protocol is based on the understanding of International Standards on Auditing (ISA), in particular ISA 315 (Identifying and assessing risks of material misstatement through understanding the entity and its environment) and ISA 610 (Using the work of internal auditors).

Principles

ISA 315 states the internal audit function is likely to be relevant to the audit of the financial statements if the nature of their work relates to the entity's financial reporting. ISA 610 recognises external audit and internal audit have different objectives and priorities. The external auditor has the sole responsibility for the opinion on the financial statements and using the work of internal audit does not impact on this responsibility in any way. Therefore the external auditor needs to consider how and whether it is appropriate to place reliance on the work of internal audit.

Procedures

Together internal audit and Grant Thornton will:

- Meet on a quarterly basis to share and discuss audit plans, update and review issues identified through on-going or planned work, review progress and exchange key findings. Such discussions will inform the Grant Thornton audit approach.
- Liaise to identify and exchange knowledge of emerging or identified key risk areas.
- Use the meetings to ensure reporting lines to the Governance and Audit Committee are clear and information provided is clear and timely.

Grant Thornton will:

- Advise internal audit of the financial systems we consider are key to the production on the financial statements.
- Share testing strategies with internal audit on a timely basis to maximise the scope to ensure effective and efficient use of resources for both parties.
- Share details of our approach as requested.

Internal audit including the fraud team will:

- Provide details to Grant Thornton of fraud above £10,000 and details of any identified or potential cases of corruption.
- Provide Grant Thornton with appropriate access to working papers and relevant documents, and with electronic access to published internal audit reports on key financial systems which may impact upon on the audit approach.
- Share its approach to systems audit work and associated documentation with Grant Thornton.

Way forward:

This protocol has been discussed and agreed with the Head of Internal Audit. The protocol will be reviewed annually and updated to reflect changes to internal audit standards and the ISAs.



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