

# ***Hinckley and Bosworth Borough Council***

Internal audit / external audit  
liaison protocol

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# 1 – Introduction

The purpose of this protocol is to set out arrangements for co-operation and co-ordination of work between internal audit and external audit in relation to Hinckley and Bosworth Borough Council ('the Council'). Internal audit services are provided by Coventry and Warwickshire Audit Services Limited (CW Audit) and external audit services are provided by PricewaterhouseCoopers LLP (PwC).

Both internal audit and external audit have recognised the value that could be gained from working more closely together to provide audit services for the Council. This document has been produced to help clarify respective roles and responsibilities and to provide a framework for communication between internal audit and external audit going forward.

A range of benefits are anticipated from this Protocol including:

- more effective audit provision based on a clearer understanding of respective audit roles and requirements;
- a better informed dialogue on the risks and issues facing the Council leading to more effective focusing of audit effort;
- better co-ordinated audit activity based-on joint planning and communication of needs;
- a better understanding of the results of internal and external audit's work which may inform respective future work plans and programmes; and
- full implementation of the "Managed Audit" concept including maximum reliance on internal audit work.

The Council's Finance, Audit and Performance Committee will have an interest in the way in which internal and external audit work together as part of its primary responsibility to oversee the integrity of financial controls and procedures. We therefore recommend that this Protocol be received and approved by the Finance, Audit and Performance Committee.

# 2 – Respective roles and responsibilities

Internal and external audit have fundamentally different roles and responsibilities, which need to be understood and are summarised below.

## **External audit**

PricewaterhouseCoopers LLP (PwC) are appointed as the independent external auditors of Hinckley and Bosworth Borough Council by the Audit Commission. External audit are responsible for undertaking the external audit in accordance with the Audit Commission's Code of Audit Practice (Local Government), including the audit of the Council's financial statements.

The audit of the financial statements of Hinckley and Bosworth Borough Council in accordance with the Code of Audit Practice requires compliance with relevant International Standards of Auditing (UK & Ireland) issued by the Auditing Practices Board.

At the completion of work on the financial statements audit, external audit issue an audit report to the Finance, Audit and Performance Committee of Hinckley and Bosworth Borough Council. This provides external audit's independent opinion on whether the financial statements give a true and fair view of the Council's gains and losses, cash flows and financial state at the end of the financial year in accordance with the accounting policies. It is also required to issue an opinion on value for money, considering the two criteria of financial standing and securing economy, efficiency and effectiveness in its use of resources.

External audit will liaise with internal audit in order to obtain a sufficient understanding of internal audit activities to assist in planning the financial statements audit and developing an effective audit approach. External audit will wish to place reliance upon certain aspects of the work of internal audit in satisfying their statutory responsibilities as set out in the Code of Audit Practice, for example in forming the value for money opinion. External audit may wish to consider the work of internal audit when undertaking their procedures in relation to the Annual Governance Statement.

## **Internal audit**

CW Audit Services are appointed as the internal auditors of Hinckley and Bosworth Borough Council. One of the main roles of internal audit is to review the systems of internal control in place at the Council and to provide management with a view on their effectiveness. In addition, internal audit also reviews the risk management and corporate governance arrangements in place at the Council.

Internal audit issue their reports to management and the Council's Finance, Audit and Performance Committee.

# 3 – Co-ordination of Internal and External Audit work

Whilst internal and external audit have different roles and responsibilities, both are required to consider many similar matters. As a result, there is often an overlap in the work that internal and external audit are required to undertake and there is therefore a need for cooperation and coordination to ensure that the potential for duplication is minimized and that both internal and external audit plans are achieved and work is undertaken in the most efficient and effective manner.

Set out below are the main areas of coordination and cooperation between internal and external audit expected to be in place at the Council.

## **Planning**

When developing an audit plan, internal audit shall consult with external audit in advance to ensure that they are satisfied with the coverage of areas where they can consider placing reliance on the work of internal audit. Conversely, external audit will accordingly consult with internal audit in advance on any key areas that may impact significantly on internal audit. In this way, both parties will be able to more effectively plan resources for the delivery of work in order to meet their responsibilities. Should gaps be identified in the coverage of key controls on the Council's fundamental financial systems within internal audit's plan, external audit will need to consider the most efficient way in which to gain comfort over the operation of those systems and reduce audit risk to an acceptable level. This comfort may be gained through supplementary work on the key controls not tested, or through extended detailed testing of balances within the Council's financial statements. The outcome of discussions around audit plans will need to be communicated to the Council's Deputy Chief Executive (Corporate Direction) in order to inform the Council of any impact on audit fees.

As with all plans there may be times when due to unforeseen circumstances, for example staff vacancies, slippage may occur. Performance against audit plans should be reported to the Council's Finance, Audit and Performance Committee and form part of discussions between internal audit and external audit. Action to rectify any slippage, such as acquiring additional staff resource should be identified. Under the managed audit external audit could undertake agreed additional work outside of the plan.

## **Timing of coordination**

Regular and open communication between internal and external audit is essential to achieve effective cooperation. Senior members of the internal and external audit teams will meet during the year to discuss the audit process and any specific matters arising from audit work. These meetings will include a discussion of how well the cooperation and coordination is working and whether any changes and / or improvements are required. A timetable for the liaison and coordination of work is set out in Appendix A.

Outside of the timetable external audit will need to be informed of any significant matters and major frauds. Similarly, external audit will ordinarily inform internal audit of any significant matters which may affect internal audit's work.

## **Sharing reports**

As internal and external audit both receive the papers of the Finance, Audit and Performance Committee meetings of Hinckley and Bosworth Borough Council, reports and findings will generally be shared through these meetings. Internal and external audit will also share their full final reports and findings with each other on an ongoing basis.

## **Review of Internal Audit**

External audit will undertake a review of internal audit each year and communicate any findings from

this review to the Finance, Audit and Performance Committee by exception.

In addition, external audit is also required to review the arrangements for the provision of internal audit services in accordance with ISA 610 (UK&I) (Considering the Work of Internal Audit) if reliance is to be placed on the work of internal audit.

**Reliance on the work of Internal Audit**

External audit will assess the reliance to be placed on internal audit work each year and communicate the findings to the Finance, Audit and Performance Committee.

As well as considering the overall arrangements for the provision of internal audit services, ISA 610 (UK&I) also requires external auditors to evaluate the work of internal audit in order to be able to place reliance on this work and to reduce the scope and / or extent of their audit procedures. The basis of external audit’s review will be to establish compliance with internal audit standards, this protocol and completion of a checklist for individual reviews. This will involve reviewing internal audit working papers and re-performing some of the work and / or undertaking complementary testing.

External audit will inform internal audit which areas they intend to place reliance on and typically this involves a review of the internal audit plan for the year and the scope and extent of work to be undertaken by internal audit on each system. Internal audit will then be informed of any concerns about the planned scope and extent of their work and a timetable will be agreed for the detailed review of the work of internal audit.

As a minimum, external audit will seek to place reliance on internal audit work covering the following areas:

- financial ledger system;
- budgetary control;
- bank, cash and treasury management;
- income and debtors;
- creditor payments and ordering;
- stock and stores;
- council tax and NNDR
- HRA Income & Expenditure
- payroll; and
- fixed assets and capital accounting.

For the above systems it is envisaged that key controls will be examined annually by internal audit. However, internal audit may wish to include some or all of the above as part of a risk-based three year rolling programme. Key controls should ordinarily be used as the basis of the audit plan. Limited scope reviews should be agreed as part of the annual planning process.

External audit will provide internal audit with a list of the key controls within each of these reviews that External Audit would wish to place reliance on. In addition, external audit will provide internal audit with documented guidance on the nature and scope of testing that they would expect internal audit to perform on these controls, in order for external audit to be able to place reliance on internal audit’s work.

External audit will carry out their review of internal audit’s work in the second half of February in each financial year. They will formally feed back the findings of their review to internal audit at the quarterly liaison meeting in March / April each year. Initial comments on significant findings will be fed back to internal audit verbally following the review of files.

To complete the review, internal audit will agree to provide external audit with access to their working papers and will discuss the work and the findings with external audit.

Where external audit conclude that they are unable to place reliance on the work of internal audit, external audit will communicate this to the Deputy Chief Executive (Corporate Direction), internal audit and the Finance, Audit and Performance Committee so that the cost implications of external audit having to undertake additional testing can be assessed.

### **Timetable for completion of Internal Audit work**

Internal audit will aim to complete and have issued draft reports for their work on the significant key financial systems reviews agreed between internal and external audit, by the end of January each financial year, with the remainder having completed fieldwork by the end of March. This will enable external audit to review internal audit's work on a timely basis and to factor the results of their assessment of internal audit's work into the external audit approach at the planning stage. This will ensure that the most effective audit approach is developed and will help to avoid duplication of audit effort.

### **Top Up Testing**

Internal audit will perform top up testing where further assurance is needed or where specific risks are identified and this is agreed with the Deputy Chief Executive (Corporate Direction). This will both increase the reliance that external audit can place on internal audit's work and increase the assurance given to management over the systems in question.

### **Sample Sizes**

To enable full reliance by external audit on internal audit's work the sample size guidance in Appendix B should be followed.

Where items are found not to be relevant to the test or control objectives or where items could not be located, additional items will be selected in their place to ensure that the initial agreed sample size is tested unless an exception is clearly recorded. Samples should be selected from a relevant population and as far as is practical across the current year in order to provide assurance that systems are operating effectively throughout the year. The sample selection methodology and the population size should be clearly documented for all tests.

### **Working Papers**

There should be a clear audit trail on all internal audit files with all working papers cross referenced. International Standards for Internal Auditors require auditors to obtain and record sufficient relevant evidence to support their conclusions and to demonstrate the adequacy of evidence obtained to support professional judgements.

Specifically there should be:

- evidence that where statements have been made by staff when interviewed as part of key controls testing, these statements are evidenced by testing;
- evidence that all issues raised in supporting working papers have either been reported or have been satisfactorily resolved and therefore do not need to be reported;
- a clear trail from all issues raised in reports back to supporting working papers;
- evidence of a review of all working papers and reports by a senior auditor;
- evidence of how review points have been raised, addressed and cleared; and
- collection and documentation of the responses given by Council officers to all issues reported by internal audit so that agreed actions may be followed up by internal audit and the timely implementation of agreed actions monitored by the Finance, Audit and Performance Committee.

## **The Managed Audit**

When seeking to cooperate and coordinate their work, internal and external audit both recognise that neither party specifically undertakes any work on behalf of the other.

However, under the Managed Audit approach and in accordance with best practice for cooperation and coordination between internal and external audit, external audit will seek to ensure that the work of internal audit is sufficient to provide the necessary assurances to the Council over the operation of its systems of internal control and that the work can also be used during the external audit process.

However, in choosing to rely on the work of internal audit, external audit recognise that the work has been undertaken for the Council and that internal audit do not owe them a duty of care.



# Appendix A – Protocol timetable

The following table sets out a framework timetable for the actions set out in this protocol:

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Internal audit present the Audit Plan to Finance, Audit and Performance Committee													
Liaison meetings													
Internal audit deadline for completion of key systems reviews													
PwC review internal audit's work on key systems													
Internal audit Annual Report to Finance, Audit and Performance Committee													
PwC present Audit Plan for following year to Finance, Audit and Performance Committee													
PwC present ISA260 report to Finance, Audit and Performance Committee													

# Appendix B – Sample size guidance

External audit will need to ensure that where testing is performed by internal audit, the sample sizes are met as described in the table below and cover the full financial year. External audit has agreed to provide internal audit with a listing of these controls that internal audit may want to consider in their reviews. In return internal audit has agreed to cover these controls in the key systems reviews and top up the testing on these controls shortly after the end of the financial year to meet the sample sizes identified in the table below.

<b>Frequency of control</b>	<b>Equivalent annual population size</b>	<b>Number of items to test</b>
Annual	1	1
Quarterly	4	2
Monthly	12	2 to 5
Weekly	52	5, 10, 15
Daily	250	20, 30, 40
Multiple times per day	>250	25, 45, 60

# Appendix C – Key controls

## Key Controls

We have included in the tables below, for each review, details of key control objective PwC would anticipate being tested by Internal Audit in order for reliance to be placed on their findings for the following reviews:

- Payments and Creditors;
- Income and Debtors;
- Payroll;
- Fixed Assets;
- Financial Ledger;
- Budgetary Control;
- Bank, cash and treasury;
- Council tax & NNDR;
- HRA Income & Expenditure.

The information below includes details of the expected key control in each area. This is not an exhaustive list, and PwC anticipate that Internal Audit will undertake other tests of controls in order to conclude on an overall level of assurance for each review.

### Payments and Creditors

What controls are in place to ensure that adequate segregation of duties exist between ordering, receiving cash, making cash payments and updating the general ledger?
Is access to the ordering, invoice processing and general ledger system restricted by appropriate controls?
What control ensures that invoices are matched to orders? And matching to GRNs? What is the process for payments where the invoice does not match the order or GRN? What controls ensure this process is followed?
What controls ensure that invoices are authorised by an appropriate officer?
What control ensures that the invoice data on the creditor payments system is transferred to the general ledger completely and accurately?
What controls prevent duplicate payments from being made?
What controls ensure that all payments are authorised prior to payment?
What control is in operation to ensure that access to the cash payments system (cheques, BACS, DDs cash payments) is restricted?
What control ensures that creditor payments data is transferred to the general ledger correctly?
Monitoring controls may include the following exception reports which are prepared for review by managers including: <ul style="list-style-type: none"> <li>• Incorrect payments made</li> <li>• Unvalidated invoices reports</li> <li>• Disputed invoices</li> <li>• Goods/services delivered but not invoiced</li> <li>• Duplicate invoices</li> </ul>
What evidence is in place to demonstrate that exception reports are reviewed or other key monitoring controls are in place such that action is taken to address exceptions on a timely basis?

## Income and Debtors

What controls are in place to ensure that adequate segregation of duties exist between: preparation of orders, raising of invoices, cash receipting, cash recording, depositing income and general ledger maintenance?
Is access to the income system and related data records restricted?
What control ensures that the activity recording system and income systems are reconciled?
What controls ensure that invoices are processed accurately, completely and only once?
What controls ensure that invoices are matched to evidence of goods or services being provided?
What control ensures that adjustments to invoices (e.g. credit notes) are authorised by an appropriate official?
What control ensures that data is transferred from the income system to the general ledger accurately and in the correct financial year?
What control is in operation to ensure that access to the cash receipting system is restricted?
What control ensures that receipts are recorded against the correct debtor accounts?
What control ensures that unmatched receipts are corrected in a timely manner?
What controls ensure that action is taken in respect of overdue payments?
What controls ensure that write-offs are approved by an appropriate officer?
Monitoring controls may include the following exception reports which are prepared for review by managers including: <ul style="list-style-type: none"><li>• Credit balances on accounts</li><li>• Significant write-offs</li><li>• Age debt listings</li><li>• Recovery action against outstanding debts</li></ul> What evidence is in place to demonstrate that exception reports are reviewed or other key monitoring controls are in place such that action is taken to address exceptions on a timely basis?

## Payroll

What controls are in place to ensure that adequate segregation of duties exist between supervision, time keeping functions, payroll processing, authorisation of payrolls, performance of bank reconciliations and maintaining the general ledger?
Is access to the payroll processing system, cash payments system (cheques, BACS, DDs,) and related data records restricted?
Are changes to employee standing data reviewed and approved by an appropriate officer?
What control ensures that new starters entered are genuine employees and their details accurate?
What controls ensure that all leavers are captured, and their leaving dates accurate?
What control ensures that gross pay and deductions from pay (e.g. PAYE, NI, superannuation, and charitable deductions) are calculated correctly?
What control ensures that data is transferred from the payroll system to the general ledger accurately and in the correct financial year?
What controls ensure that correct payments are made to the right employee?
What controls are in place to identify and resolve overpayments?
What control ensures that all payments are authorised by an appropriate official prior to payment?
Monitoring controls may include the following exception reports which are prepared for review by managers including: <ul style="list-style-type: none"><li>• Starters and leavers</li><li>• Overtime work</li><li>• Gross to net calculations and other key ratios</li><li>• Payments over specified levels.</li></ul>
What evidence is in place to demonstrate that exception reports are reviewed or other key monitoring controls are in place such that action is taken to address exceptions on a timely basis?

## Fixed Assets and capital contracts

What controls are in place to ensure that adequate segregation of duties exist between selecting capital projects, administering tenders, awarding contracts and payment to contractors?
What control ensures that payments to contractors are properly authorised?
Do comprehensive and up to date standing orders and standing financial instructions exist for the award and administration of contracts?
What control is in place to ensure the capital programme is appropriately authorised?
What controls are in place to ensure that all disposals of fixed assets are identified and processed on the fixed asset register?
What controls are in place to ensure that the existence of Council assets is checked - e.g. fixed asset verification?
What controls are in place to approve capital spend?
Is the fixed asset register reconciled to the general ledger?
Is spend against the capital programme adequately monitored through the year? Is progress reported effectively?
What controls are in place to ensure that access to the fixed assets register is appropriately restricted?

## Financial Ledger

What controls are in place to ensure that adequate segregation of duties exist between maintenance of the feeder systems, maintenance of the general ledger and control of budget setting?
What control ensures that reconciliations between major feeder systems and the general ledger are carried out on a regular basis?
Are reconciliations between major feeder systems and the general ledger reviewed by an appropriate officer and reconciling items cleared?
What control ensures that access to the general ledger system is restricted?
What control ensures that changes to standing data on the general ledger are authorised appropriately?
Are journals subsequently numbered?
What control ensures that all journals are appropriate and have been authorised?

## Budgetary Control

What control ensures that access to the budget monitoring system is restricted?
What control ensures that budgets are reviewed and approved by an appropriate officer / forum/ the Council?
What control ensures that all budgets are issued to Budget Managers on a timely basis?
What control ensures that data included on the budget reports is accurate and complete?
What control ensures that significant over or under spends are highlighted and investigated by departmental officers in respect of the budget reports? What action is taken in respect of over and under spends by departmental officers?
What evidence is in place to demonstrate that budget exception reports are reviewed and action taken on a timely basis to address exceptions raised? What control ensures that significant over and under spends at the department level are reported appropriately to a higher level?

## Bank, Cash and Treasury

What controls exist to ensure that the movements in the bank accounts agree to the cashbook and general ledger system (e.g. bank reconciliations)?
What controls ensure that management are monitoring their cash position on a regular basis (e.g. cash flow monitoring) to identify shortfalls or investment opportunities?
What control ensures that all investments and borrowings are appropriately approved?
What control ensures that investments comply with the Council's treasury management and investments policy?
Reconciliation between management spreadsheet (detailing transactions) to general ledger, bank account/statements and third party confirmation. i.e. control to ensure that the general ledger is accurate and complete.
What controls are in place to ensure that adequate segregation of duties exist between authorising transactions, recording transactions, payment of cash and general ledger maintenance?

### Council Tax & NNDR

What controls are in place to ensure accurate, complete and timely Council Tax/ NNDR bills are raised?
What controls are in place to ensure that properties and valuation bands are included and updated in the Council Tax/ NNDR register?
What controls are in place to ensure that discounts and exemptions are authorised and subsequently applied?
What controls are in place to ensure that non-recoverable debts are written off?
What controls are in place to monitor payments and to take prompt action against non- payment?
What controls are in place to ensure that write-offs are authorised before being processed?
What controls are in place to ensure the information as per the Academy system reconciles to the General Ledger and cashbook?

### HRA Income & Expenditure

Is the housing rents system reconciled to the general ledger and cashbook?
What controls are in place to ensure that the rent charge parameters are input correctly?
What controls are in place to ensure that jobs performed by the in house team are appropriately authorised?
What controls are in place to ensure the decision as to whether a given job is a capital one or a repairs one is appropriate?
Is the housing repairs system reconciled to the general ledger?
What controls are in place to ensure that job costing is appropriate?
What controls are in place to ensure that any materials ordered by Housing Repairs just before or at the year end and relayed to Finance on a timely basis to ensure the appropriate accruals are raised in the accounts?

*In the event that, pursuant to a request which Hinckley and Bosworth Borough Council and CW Audit LLP has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this document, it will notify PwC promptly and consult with PwC prior to disclosing such report. Hinckley and Bosworth Borough Council and CW Audit LLP agree to pay due regard to any representations which PwC may make in connection with such disclosure and Hinckley and Bosworth Borough Council and CW Audit LLP shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Hinckley and Bosworth Borough Council and CW Audit LLP disclose this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.*

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