

## **Audit Committee**

**25 February 2021**



### **Head of Internal Audit Annual Opinions: Addressing the Risk of a Limitation of Scope**

**Ordinary Decision**

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### **Report of Stephen Carter, Interim Chief Internal Auditor and Corporate Fraud Manager**

#### **Electoral division(s) affected:**

Countywide

#### **Purpose of the Report**

- 1 To provide Members with information about some recently issued guidance published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in relation to Head of Internal Audit (HIA) Annual Opinions: Addressing the Risk of a Limitation of Scope.

#### **Executive Summary**

- 2 The guidance recognises that the considerable impact of COVID-19 on all public services has raised a question for internal auditors as to whether they will be able to undertake sufficient work to gain assurance during 2020/21 to issue an annual opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. This in turn is one of the sources of assurance that the Council relies on for its annual governance statement.
- 3 While the limitation of any scope will only be formally published in 2021 as part of the HIA's annual report, the guidance addresses the importance of early identification of the risk. It suggests mitigating actions to be taken now to avoid a limited scope where possible. If a limited scope does become necessary, the guidance suggests possible wording to be used in the HIA's report.

## **Recommendation**

- 4 It is recommended that Members note the contents of this report.

## Background

- 5 Recent guidance published by CIPFA in relation to Head of Internal Audit (HIA) Annual Opinions: Addressing the Risk of a Limitation of Scope recognises that the considerable impact of COVID-19 on all public services and has raised a question for internal auditors as to whether they will be able to undertake sufficient work to gain assurance during 2020/21 to issue an annual opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.
  
- 6 While the limitation of any scope will only be formally published in 2021 as part of the HIA's annual report, the guidance attached as Appendix 2 addresses the importance of early identification of the risk. The guidance identifies key requirements for local government bodies and provides mitigating actions to be taken now detailed under the following headings to avoid a limited scope where possible as well as possible wording to be used in the HIA's report if a limited scope does become necessary.
  - Key requirements for local government bodies;
  - Detailed guidance to support implementation;
  - Planning adequate assurance to support the annual opinion;
  - Engagement between the leadership team, audit committee and HIA;
  - Making effective use of internal audit resources;
  - Early identification of a limitation of scope;
  - Understanding the consequences of a limitation of scope; and
  - Suggested wording of the limitation
  
- 7 The HIA has reviewed the guidance to ensure recommended practices are being followed. It is not envisaged that a limitation of scope on the HIA's annual report would be required.

## Next Steps

- 8 Members to be kept informed of any further developments regarding this matter.

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## **Appendix 1: Implications**

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### **Legal Implications**

The Accounts and Audit Regulation 2015 (Part 2, Section 5) states a relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal audit standards or guidance.

Completion of the Annual Internal Audit Opinion ensures compliance with both the Public Sector Internal Audit Standards 2017 and the Accounts and Audit Regulations 2015.

Furthermore, internal audit assists the Corporate Director of Resources in fulfilling their duties under Section 151 of the Local Government Act 1972 which requires each Local Authority to make arrangements for the proper administration of their financial affairs.

### **Finance**

There are no direct financial implications associated with this report.

Internal Audit work has clear and direct effects, through recommendations made, to assist in improving value for money obtained, the probity and propriety of financial administration, and / or the management of operational risks.

### **Consultation**

None.

### **Equality and Diversity / Public Sector Equality Duty**

None.

### **Climate Change**

None.

### **Human Rights**

None.

### **Crime and Disorder**

None.

### **Staffing**

None.

### **Accommodation**

None.

**Risk**

The key risk is that the Chief Internal Auditor and Corporate Fraud Manager is unable to deliver an annual opinion to inform the Annual Governance Statement. To mitigate this risk, a defined process exists within the Service to carry out effective performance management and as such assurance is reflected in reports to the Audit Committee. Any issues with performance would be reported to the Audit Committee where further action would be agreed and overseen.

**Procurement**

None.

## CIPFA Guidance to Internal Auditors and the Leadership Team and Audit Committee of Local Government Bodies

### Head of Internal Audit Annual Opinions: Addressing the Risk of a Limitation of Scope

#### Introduction and rationale for the guidance

The impact of COVID-19 on all the public services has been considerable and for internal auditors it has raised the question of whether they will be able to undertake sufficient internal audit work to gain assurance during 2020/21. This is a key consideration to fulfil the requirement of the Public Sector Internal Audit Standards (PSIAS) for the head of internal audit (HIA) to issue an annual opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. This opinion is in turn one of the sources of assurance that the public body relies on for its annual governance statement.

CIPFA recognises that local government bodies are struggling with considerable challenges and are having to make difficult decisions on how best to use their available staff and financial resources to meet critical needs. However, the professional and regulatory expectations on local government bodies to ensure that their internal audit arrangements conform with PSIAS have not changed. In this difficult situation, heads of internal audit will need to consider whether they can still issue the annual opinion or whether there will need to be a limitation of scope. A limitation of scope arises where the HIA is unable to draw on sufficient assurance to issue a complete annual opinion in accordance with the professional standards. This is an issue not only for the HIA but also for the leadership team and the audit committee who normally rely on that opinion. It may also have wider consequences for stakeholder assessments of the organisation.

While the limitation of scope will only be formally published in 2021 as part of the HIA's annual report, this guidance addresses the importance of early identification of the risk. It suggests mitigating actions to be taken now to avoid a limited scope where possible. If a limited scope does become necessary the guidance suggests possible wording to use in the report.

#### Status of the CIPFA guidance

This guidance is prepared by CIPFA for internal auditors working in or for local government in the UK. CIPFA is the Relevant Internal Audit Standard Setter (RIASS) for local government and works with the other UK RIASS<sup>1</sup> to mandate the PSIAS across the public sector. This guidance has been shared with the other RIASS and other members of the Internal Audit Standards Advisory Board including the Chartered Institute of Internal Auditors. Other sectors should look to the appropriate RIASS for guidance.

This guidance is a sector specific requirement for local government in the UK.

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<sup>1</sup> The Relevant Internal Audit Standard Setters are: HM Treasury in respect of central government; the Scottish Government, the Department of Finance Northern Ireland and the Welsh Government in respect of central government and the health sector in their administrations; the Department of Health and Social Care in respect of the health sector in England (excluding foundation trusts); and the Chartered Institute of Public Finance and Accountancy in respect of local government across the UK.

## Key requirements for local government bodies

The key requirements that heads of internal audit, leadership teams and audit committees should follow are set out below and are supported by additional explanation.

1. The HIA should plan to obtain sufficient assurance to support the annual opinion, taking into account both internal audit work and other sources of assurance. The reliance the HIA is placing on other sources of assurance should be disclosed in the overall opinion.
2. The HIA, leadership team and audit committee should review and discuss internal audit capacity where there are concerns and develop an action plan to mitigate the risk.
3. The HIA should make best use of their audit resources to maximise assurance.
4. Where the HIA considers that a limitation of scope is likely, the leadership team and audit committee should be advised promptly. The HIA should set out the likely consequences assessed and advise on remedial action to avoid a limitation of scope.
5. The HIA annual report should contain a clear explanation of any limitation of scope along with its causes and plans to address the situation going forward.
6. Where the HIA annual report and opinion contains a limitation of scope the authority should state this in the annual governance statement.

## Detailed guidance to support implementation

### Planning adequate assurance to support the annual opinion

Just as in more normal times the HIA should plan audit work to ensure that sufficient assurance will be available to support the annual opinion. This guidance will not go into details about risk-based audit planning but it emphasises that the professional requirements of PSIAS have not changed. It is likely that internal audit plans will be more fluid than normal as a result of the impact of the pandemic on the organisation. Head of internal audit should already have agreed new audit priorities to cover the new risks and changes from the impact of COVID-19 and that work will provide support for the annual opinion.

CIPFA recognises that the impact of COVID-19 and the capacity of the organisation to respond will vary as a result of a number of factors. Alongside direct internal audit work the HIA can also place reliance on other assurance providers, as set out in PSIAS 250. However it is important to recognise that the quality and availability of that other assurance may also be impacted adversely by the pandemic in some organisations. These factors are likely to be beyond the control of the HIA.

The factors impacting on the availability of assurance from internal audit and other sources of assurance include:

- the changing risks and impacts on the organisation itself
- whether key governance, risk management and internal control arrangements have deteriorated or been maintained
- changes to the resource base of internal audit, whether staff or budget related
- demands on internal audit for any advisory or non-audit support that will not directly support the HIA opinion
- operational disruptions that impact on the access of internal auditors to key staff, information or systems resulting in greater inefficiency and reduced outputs.

Where an organisation has adopted a comprehensive assurance framework then this may be used by the HIA to support the opinion, if those other sources of assurance are demonstrated to be robust. CIPFA's [Financial Management Code](#) (FM Code), which is applicable to all UK local government bodies, has

assurance as one of its key principles. Principle C of the FM Code clearly sets out the responsibility of the leadership team to establish and support appropriate arrangements:

The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.

The CIPFA [Statement on the Role of the Head of Internal Audit](#) also emphasises the responsibility of the leadership team for establishing wider frameworks of assurance and accountability.

### Engagement between the leadership team, audit committee and HIA

The PSIAS require regular communication and engagement with the leadership team and audit committee on the development of the internal audit plan (PSIAS 2010 and 2020), its execution (PSIAS 2060) and the results of the audit engagements (PSIAS 2400). Each organisation will have its own agreed arrangements in place that will also take into account the terms of reference of the audit committee. The CIPFA [Position Statement on Audit Committees in Local Authorities and Police](#) (2018) sets out the responsibility for the audit committee to provide oversight of the independence, performance and professionalism of internal audit.

PSIAS 2030 requires the HIA to ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan. If the HIA believes that the level of agreed resources will impact adversely on the provision of the internal audit opinion, the consequences must be brought to the attention of the leadership team and audit committee promptly. The CIPFA *Statement on the Role of the Head of Internal Audit* is clear that to perform their role effectively the HIA must lead and direct an internal audit service that is resourced appropriately, sufficiently and effectively (Principle 4).

It is the responsibility of the organisation's leadership team to provide the HIA with the resources, expertise and systems necessary to perform their role effectively. Therefore it is essential for there to be meaningful engagement between the HIA, leadership team and audit committee. If the HIA has concerns about the quantity or calibre of internal audit resources available or there are other operational barriers to the delivery of the audit plan, they should assess the impact and likely consequences for the annual opinion and work with the leadership team and audit committee to find solutions to bridge the gap.

### Making effective use of internal audit resources

When delivering the risk-based audit plan the HIA, supported by the leadership team, should make every effort to make best use of available internal audit resources over the remainder of the year. Possible actions could include:

- Streamlining audit processes to increase capacity.
- Narrowing the focus of audit scopes to examine only key risks
- Filling vacant audit posts, whether permanently, on a temporary basis or buying in audit expertise from an external provider.
- Exploring opportunities for internal secondments or other support for the audit team from non-internal audit staff who can nevertheless undertake some internal audit work.
- Evaluating any requests for advisory work and prioritising assurance work and advisory work that supports the annual opinion.
- Avoiding diversion of internal audit staff on to counter fraud work, or other non-core audit work, beyond that which is already accommodated within the plan.
- Increasing communication with client services to help ensure good co-operation from client services and avoid unnecessary delays in undertaking engagements.



Where the internal audit service provides services to partner bodies or on a commercial basis then agreements in place may provide little scope to amend resourcing in the short term.

### Early identification of a limitation of scope

A limitation of scope arises where the HIA is unable to draw on sufficient assurance to issue a complete annual opinion. This should not be confused with an adverse opinion, which arises when sufficient work has been completed to enable the HIA to conclude that arrangements are not adequate and effective.

There are three possible scenarios for a limitation of scope:

1. The HIA has obtained insufficient assurance across each of the three aspects of the opinion: governance, risk management and internal control, and is therefore unable to issue an opinion.
2. The HIA has obtained insufficient assurance across one of the three aspects of the opinion. The limitation of scope will be restricted to that aspect only.
3. The HIA has obtained insufficient assurance across a significant subset of risk or area of operation that is material. An example might be where there were significant engagements set out in the plan that the audit service could not complete.

Where one of these situations is a risk then the HIA should take steps to inform the leadership team and audit committee of it as soon as possible and identify the underlying reasons. As part of the discussions with the leadership team and audit committee the HIA should identify the following:

- the extent of limitation of scope that is likely
- the reasons for limitation being necessary
- remedial steps planned or sought to minimise the extent of the limitation
- consequences of not addressing the risk that a limitation of scope will impact on the opinion.

### Understanding the consequences of a limitation of scope

The primary consequence is that the leadership team and those charged with governance do not receive independent assurance that the framework of governance, risk management and control is adequate and effective. Without this assurance the organisation should consider the risk of significant control weaknesses, inefficiencies or poor performance remaining unidentified. In addition, opportunities for improvement may be lost. While internal audit can only offer reasonable assurance, not a 100% guarantee, the presence of that reasonable assurance is rightly valued.

Other consequences to consider:

- The organisation will need to highlight the limitation in its annual governance statement when referring to the HIA opinion
- Where the reason for the limitation also results in significant non-conformance with PSIAS during the year, then the HIA must report that as part of the quality assurance and improvement programme (QAIP) (PSIAS 1320). The results of the QAIP must be included in the annual report (PSIAS 2450). CIPFA's view is that if the limitation of scope is so significant that the HIA cannot provide an annual opinion that fulfils the PSIAS requirement then it is likely that there are other areas of non-conformance. Taken as a whole the internal audit service may no longer conform with PSIAS.
- The internal audit team is only able to state that they conform with the PSIAS if the results of the QAIP can demonstrate that. So if the last EQA concluded that the service conformed, but this year's QAIP demonstrates that the internal audit service does not, then it cannot claim to conform with PSIAS. Non-conformance should be considered for inclusion in the annual governance statement.

- Non-conformance with the PSIAS should also be taken into account when assessing the strength of assurance and the organisation's compliance with the CIPFA FM Code.
- If the internal audit service bids for or supplies its services to other organisations or partner bodies then losing conformance with the standards may have commercial consequences.
- The organisation's external auditor may take the limitation on the audit opinion or non-conformance with PSIAS into account when reviewing overall governance arrangements under the value for money or best value scope of the external audit. Different external audit arrangements apply across the UK and audit committees may wish to discuss this matter with their local auditors to understand the consequences.
- Internal audit will have a smaller than anticipated knowledge base to support future audit planning. The HIA will need to consider the implications for planning and resources as a consequence.
- Outside bodies who may have looked to the internal audit opinion as evidence for the organisation's sound governance may draw adverse inferences from the reported opinion.

### Suggested wording of the limitation

In the annual report the HIA should detail the impact of COVID-19 on internal audit and the underlying causes of the limitation of scope. It should set out steps taken to mitigate or compensate, for example where additional reliance has been placed on other assurance providers.

The PSIAS do not specify the wording to use for the opinion section within the annual report but it should be clearly linked to the PSIAS requirement of *the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control*. The suggested wordings below apply when there is a need to accommodate a limitation of scope.

Type of limitation	Suggested wording
<p>The HIA has obtained insufficient assurance across each of the three aspects of the opinion: governance, risk management and internal control, and is therefore unable to issue an opinion.</p>	<p>The results of the work carried out by internal audit, taken together with other sources of assurance, are not sufficient to support an HIA annual opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. This opinion is a requirement of PSIAS.</p> <p>The results of internal audit work concluded during the year and a summary of where it is possible to place reliance on the work of other assurance providers is presented in the annual report but this does not result in a comprehensive opinion.</p> <p>This limitation of scope has arisen because of... [reasons]</p> <p>To avoid similar limitations in future the HIA plans to... [actions].</p>
<p>The HIA has obtained insufficient assurance across one of the three aspects of the opinion: governance, risk management and internal control. The limitation of scope will be restricted to that aspect only.</p>	<p>The results of the work carried out by internal audit, taken together with other sources of assurance, are not sufficient to support an HIA annual opinion on the overall adequacy and effectiveness of the organisation's framework of [specify one of governance, or risk management or control].</p> <p>The results of internal audit work concluded during the year and a summary of where it is possible to place reliance on the work of other assurance providers in respect of [governance or risk management or control] is presented in the annual report but this does not result in an opinion on this aspect.</p> <p>[The HIA can then present their opinion on the remaining two aspects required.]</p> <p>This limitation of scope has arisen because of... [reasons]</p> <p>To avoid similar limitations in future the HIA plans to... [actions].</p>
<p>The HIA has obtained insufficient assurance across a significant subset of risk or area of operation that is material.</p>	<p>The HIA opinion on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control is [set out opinion].</p> <p>The HIA opinion however must exclude [specify area excluded] as there is insufficient assurance available for the HIA to offer reasonable assurance.</p> <p>This limitation of scope has arisen because of... [reasons]</p> <p>To avoid similar limitations in future the HIA plans to... [actions].</p>

Note it is possible for the HIA to separate out their annual opinions on governance, risk management and control if it is more meaningful to do so. This might arise for example where one aspect was significantly weaker than the other.

### **Ensuring there is a robust plan for future years**

The HIA, leadership team and audit committee should work together to ensure that internal audit will be sustainable in 2021/22 and onwards. Specifically, they should ensure that the HIA can develop a risk-based plan that will support the annual opinion. Regular reporting and monitoring should take place to ensure that achievement of the plan is on track.

Where the organisation has identified weaknesses in any assurance arrangements beyond internal audit then the leadership team should develop appropriate improvement plans and the audit committee should monitor these regularly.

For further information please contact Diana Melville, Governance Advisor CIPFA

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**Approved by the Public Financial Management Board, CIPFA  
19 November 2020**