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**REPORT TO:** Members Library Service

**MEETING DATE:** November 2021

**BY:** Service Manager – Internal Audit

**SUBJECT:** CIPFA Internal Audit Engagement Opinions: setting common definitions

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## **1 PURPOSE**

- 1.1 To inform Councillors of the intention to implement the CIPFA recommended Internal Audit Engagement Opinions common definitions from November 2021.

## **2 RECOMMENDATION**

- 2.1 That Councillors note that the Internal Audit service will be adopting the recommendations of the attached CIPFA publication Internal Audit Engagement Opinions: setting common definitions (Appendix A). This will reduce the number of opinions from 5 to 4, being: Substantial Assurance, Reasonable Assurance, Limited Assurance, No Assurance.

## **3 BACKGROUND**

- 3.1 The professional practice of internal audit within public sector bodies across the UK was consolidated into a single set of overall standards, the Public Sector Internal Audit Standards (PSIAS) in April 2013. Whilst the standards are now consistent across the public sector, there is no common practice, and little guidance available, regarding how best to report the overall results of internal audit work at the end of each engagement.
- 3.2 In 2019 CIPFA's special interest group identified a range of current reporting practice and opinions in use by different internal audit providers across the UK public sector. The exercise included 52 organisations across the public sector including small in-house internal audit teams, large shared services, external commercial audit firms and specialist assurance providers.
- 3.3 In February 2020 CIPFA published the results of this exercise in Internal Audit Engagement Opinions: setting common definitions (Appendix A). The results of exercise highlighted that 84.6% of public sector internal audit providers were utilising 4 level opinions and only 7.7% the 5 level opinions used by the Council Internal Audit team.

- 3.4 Whilst CIPFA recognised that a rating system without a middle rating ignores the normal standard distribution ('bell curve') of how well managed most services are. It was highlighted that four-level rating forces the auditor to give an opinion 'one side of the line' and explicitly above or below average (positive or negative); this helps organisations to understand if the area is doing 'well' or 'badly'. In addition, the main external regulators responsible for rating most public services all make use of a four-scale system. There may be an advantage of consistency if internal audit also use a four-scale rating.
- 3.5 It has been decided that we should adopt the recommended Internal Audit engagement opinions. The result is that we shall move from our 5 engagement opinions shown in Appendix B to the opinions shown in Appendix C starting from all Internal Audit Work completed against the 2021/22 Internal Audit Plan and reported from November 2021 onwards.
- 3.6 Reports will start to be finalised for the November 2021 Audit & Governance Committee using the new grading structure.

#### **4 POLICY IMPLICATIONS**

- 4.1 None

#### **5 INTEGRATED IMPACT ASSESSMENT**

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

#### **6 RESOURCE IMPLICATIONS**

- 6.1 Financial - None
- 6.2 Personnel - None
- 6.3 Other - None

#### **7 BACKGROUND PAPERS**

- 7.1 None

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<b>DATE</b>	November 2021

Internal Audit Engagement Opinions:

# setting common definitions



## **About CIPFA**

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our members and trainees work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

# \ introduction

It is current practice in public sector internal audit teams to provide a summary opinion as part of the final report on internal audit engagements. Currently there is no standard definition or terminology for engagement opinions and it is for each head of internal audit to determine an appropriate methodology.

As organisations in the public sector increasingly work collaboratively with other public bodies, senior managers and audit committee members can find themselves receiving reports from more than one set of internal auditors. There have been questions or challenges to auditors about the consistency of use of their opinions because different terminology was being used. CIPFA's Internal Audit Special Interest Group reviewed existing practices and considered the case for a common approach.

This briefing examines the case for standardising the terminology and definitions used in engagement opinions and recommends a set of opinions and supporting definitions for internal audit teams to use. It focuses on engagement opinions not the annual opinion of the head of internal audit.

# \ background

The professional practice of internal audit within public sector bodies across the UK was consolidated into a single set of overall standards, the Public Sector Internal Audit Standards (PSIAS) in April 2013. PSIAS has been successful in ensuring consistency and has assisted in the training of internal audit staff and in supporting their movement across different parts of the sector, eg moving from health to local government.

Whilst the standards are now consistent across the public sector, there is no common practice, and little guidance available, regarding how best to report the overall results of internal audit work at the end of each engagement.

PSIAS defines an “*Engagement Opinion*” as:

*“The rating, conclusion and/or other description of results of an individual internal audit engagement, relating to those aspects within the objectives and scope of the engagement.”*

PSIAS standard 2410 requires audit reports to include the engagement’s objectives, scope and results. Standard 2410.A1 specifies the following where opinions are used:

*“Final communication of engagement results must include applicable conclusions, as well as applicable recommendations and/or action plans. Where appropriate, the internal auditors’ opinion should be provided. An opinion must take into account the expectations of senior management, the board and other stakeholders and must be supported by sufficient, reliable, relevant and useful information.*

**Interpretation:**

*Opinions at the engagement level may be ratings, conclusions or other descriptions of the results. Such an engagement may be in relation to controls around a specific process, risk or business unit. The formulation of such opinions requires consideration of the engagement results and their significance.”*

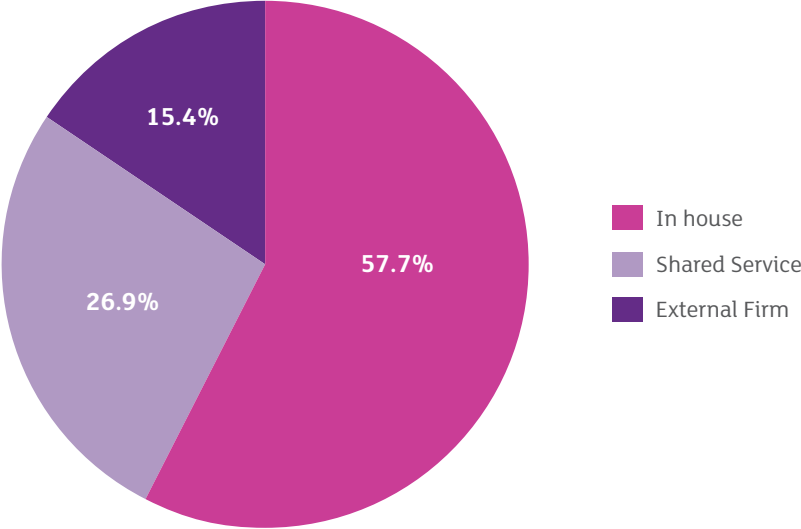
Beyond standard 2410.A1 however, PSIAS gives no guidance around how best to articulate or rate audit opinions. The briefing *Delivering Internal Audit Findings*, IIA (UK), in 2018 provided some examples of engagement opinions used by internal audit teams and CIPFA is aware that many internal audit teams have shared practice between themselves in this area previously.

## Analysis of engagement opinions

CIPFA’s special interest group identified a range of current reporting practice and opinions in use by different internal audit providers across the UK public sector. The exercise included 52 organisations across the public sector including small in-house internal audit teams, large shared services, external commercial audit firms and specialist assurance providers. The results were analysed alongside a review of professional and regulatory practice and standards.

The 52 providers included all the main types of internal audit provider (see Figure 1) and encompassed internal audit provision to all parts of the public sector. Whilst the number of external firms comprised the smallest group (eight organisations), these firms are responsible for delivering internal audit services to hundreds of public bodies.

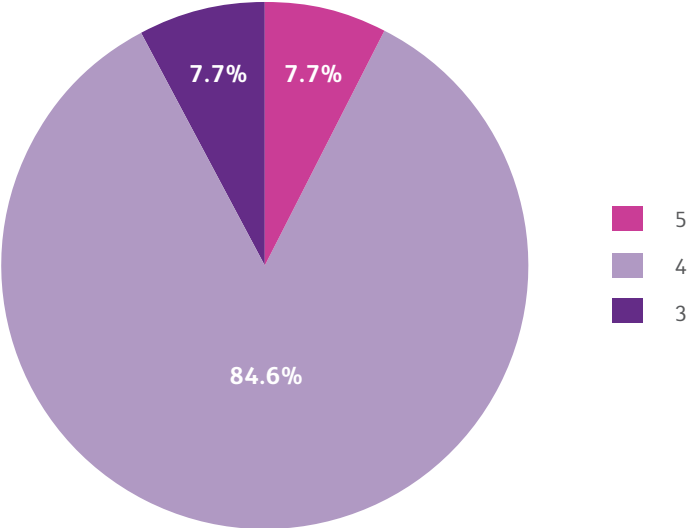
Figure 1: Type of Internal Audit Provider



**Opinion levels in practice**

Whilst having an engagement level opinion is not mandated by PSIAS, all of the internal audit providers in the sample chose to provide some form of rating or overall opinion. By far the most common practice was four possible levels of opinion on the engagement see figure 2. The opinion levels in use the organisations are summarised in Annex A.

Figure 2: Number of Opinion Levels



A four-level opinion rating was in use by 44 of the internal audit providers. When looking at the type of internal audit provision, the lowest proportion of four-level opinions in use was by in-house teams (83%). The only type of provider to use a three-level opinion was in-house services (four of the 30



in-house teams). All other internal audit providers used four-level opinion ratings, with the exception of one of the eight commercial audit firms, one of the 30 in house teams and two of the 14 shared service providers, who use five-level ratings.

### Opinion descriptions in practice

The survey results identify a wide range of language and terminology currently in use by different internal audit providers reporting across the public sector. The results also identify clear 'common' practice however, with the following four-level opinion ratings being far more widespread than any others:

- Substantial
- Reasonable
- Limited
- No or None

The 'pros and cons' of different levels of opinion

Advantages and disadvantages can be put forward for using each of the three, four or five-level opinion ratings. The main arguments can be summarised as follows:

- A five-level rating allows for greater differentiation than fewer levels, and can help audit committees and management to better understand the level of assurance being given.
- A four-level rating forces the auditor to give an opinion 'one side of the line' and explicitly above or below average (positive or negative); this helps organisations to understand if the area is doing 'well' or 'badly'.
- The 'middle' option available within three or five-level ratings creates the risk of becoming (or being seen to be) an easy or default choice. This creates a risk that the middle opinion might be given on occasions simply to avoid a difficult discussion.
- A rating system without a middle rating ignores the normal standard distribution ('bell curve') of how well managed most services are. In reality there are inevitably many audits undertaken on areas which turn out to be 'average', with maybe a few examples of good practice but also with a few weaker areas. Having no middle option creates the need to describe such results either positively or negatively, with the assigning of such opinions inevitably giving rise to some of the most prolonged debate; there is a risk that this can lead to discussions about audit terminology, rather than the substance of the audit report.
- The main external regulators responsible for rating most public services all make use of a four-scale system. There may be an advantage of consistency if internal audit also use a four-scale rating.

# the case for standardising opinions across internal audit in the public sector

There are a number of clear advantages to introducing common practice for reporting opinions on internal audit engagements. These include:

- The use of a standard opinion and underlying definition would increase confidence amongst audit committee members and managers that the engagement opinion issued is consistently applied.
- It would assist the sharing, comparability and understanding of assurances across public bodies. This would be of benefit to audit committees, managers and also other auditors (both internal and external).
- It would support audit committee members and senior managers in their understanding of audit reports. In particular those who sit on more than one public sector audit committee, or who receive reports from different auditors in relation to partnerships and joint ventures would find the consistency of benefit.
- It would support the training of internal audit staff, helping to drive up the quality and consistency of audit opinions, and facilitate staff moving across different internal audit teams.
- It would reduce disruption when changing internal audit provider. If the new provider applies a different approach to assurance ratings it results in audit committee members and managers having to learn and understand different terminology.

The principal arguments against adopting standard opinion levels are that this might constrain innovation in the profession, or may not suit the particular needs of an organisation or its audit team.

Overall CIPFA considers that the advantages outweigh the disadvantages.

## Establishing robust definitions to support the opinion

To be meaningful an engagement opinion should be understandable to the user and consistently applied. The underlying definition of the opinion is therefore critical. Further analysis was therefore undertaken to review the definitions in use across the sector.

The detailed assurance definitions for each of the four most common gradings were identified, comparing terminology used in the reporting practice of 33 different internal audit providers. These included large and small in-house teams, shared services and large specialist firms responsible for servicing clients across all parts of the public sector.

There is a wide variety of different definitions and language currently in use by different internal auditors to define the same headline level of assurance. As there is no standard terminology, practitioners have developed their own definitions over time.

If the work of internal audit is undertaken in compliance with PSIAS then it would seem most appropriate for internal audit opinions to directly relate back to the PSIAS defined scope of internal

audit. The work of internal audit is defined in PSIAS as being to: “evaluate and improve the effectiveness of risk management, control and governance processes.” (Definition of Internal Auditing, PSIAS 2017) This should be reflected in the definitions of the engagement opinions. A number of organisations were found to have adopted this approach in their definitions already.

## Recommended definitions for engagement opinions

Based on analysis of this existing practice, and taking into account the PSIAS definition of internal audit, standard definitions for internal audit assurance over an engagement, are proposed to be:

- Substantial Assurance
  - “A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.”
- Reasonable Assurance
  - “There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.”
- Limited Assurance
  - “Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.”
- No Assurance
  - “Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.”

In applying the most appropriate level of opinion the internal auditor will use their professional judgement, based on the results of the audit, consideration of risk and consequences of areas of weakness for the organisation.

# \ recommendations

Heads of internal audit working in or for public sector organisations are recommended to adopt the standard definitions for their engagement opinions. CIPFA and its Internal Audit Special Interest Group consider that the advantages of doing so outweigh any disadvantages.

In introducing the change there will need to be explanation to users of engagement reports and members of the internal audit team and this should be planned effectively. For example it may be easier to make the change at the start of the financial year so that all engagement opinions for the year are reported on a consistent basis.

The use of the standardised definitions is recommended but is not mandated. If the head of internal audit or their clients do not consider that it is appropriate to adopt them then there is no obligation to do so. CIPFA would however encourage heads of internal audit to discuss this with their audit committees.

CIPFA would recommend that they disclose the basis for not adopting the ratings in their annual report as this is the place where the overall engagement opinions for the year are generally reported.

## Feedback

CIPFA would welcome feedback on the use of definitions from both internal auditors and users of audit reports. We will keep this area under review and consider whether any issues or innovations in the practice of internal audit require a future change to the recommended definitions.

Please send any comments to [diana.melville@cipfa.org](mailto:diana.melville@cipfa.org).

## Acknowledgements

CIPFA would like to thank members of the Internal Audit Special interest Group for their work on developing this briefing. In particular Michael Townsend who conducted the research and analysis.

# detailed survey results

		Number of internal audit providers using the rating/descriptor			
	Rating/descriptor used	Total	4 Levels	5 levels	3 levels
<b>Top rating:</b>	Substantial	21	19		2
	High	11	7	3	1
	Good	6	6		
	Full	3	2	1	
	Significant	2	2		
	Effective	2	2		
	Green	2	1		1
	Strong	1	1		
	1	1	1		
	Low risk (green)	1	1		
	Assurance	1	1		
	Satisfactory	1	1		
	<b>Total</b>	<b>52</b>	<b>44</b>	<b>4</b>	<b>4</b>
<b>Bottom rating:</b>	No/None	26	22	4	
	Limited	7	5		2
	Unsatisfactory	4	4		
	Minimal	2	2		
	Poor	2	2		
	Low	2	1		1
	Red	2	1		1
	Fundamental weakness	1	1		
	Unsound	1	1		
	Unacceptable	1	1		
	Inadequate	1	1		

		Number of internal audit providers using the rating/descriptor			
	Rating/descriptor used	Total	4 Levels	5 levels	3 levels
	Little	1	1		
	4	1	1		
	Critical risk (red)	1	1		
	<b>Total</b>	<b>52</b>	<b>44</b>	<b>4</b>	<b>4</b>
<b>Above middle ratings:</b>	Reasonable	16	16		
	Satisfactory	7	7		
	Substantial	7	3	4	
	Moderate	3	3		
	Adequate	2	2		
	Medium	2	2		
	Effective with opportunity to improve	2	2		
	Significant with some/minor improvements	2	2		
	Qualified	1	1		
	Considerable	1	1		
	Good	1	1		
	Sound	1	1		
	2	1	1		
	Partial	1	1		
	Amber	1	1		
<b>Total</b>	<b>48</b>	<b>44</b>	<b>4</b>	<b>0</b>	
<b>Middle Ratings (3 or 5 levels):</b>	Moderate	3		2	1
	Reasonable	1		1	
	Adequate	1		1	
	Acceptable	1			1
	Satisfactory	1			1
	Amber	1			1
	<b>Total</b>	<b>8</b>	<b>0</b>	<b>4</b>	<b>4</b>

		Number of internal audit providers using the rating/descriptor			
	Rating/descriptor used	Total	4 Levels	5 levels	3 levels
<b>Below middle ratings:</b>	Limited	28	24	4	
	Partial	5	5		
	In need of improvement/ improvement required	3	3		
	Reasonable	2	2		
	Moderate	2	2		
	Low	1	1		
	Some	1	1		
	High risk (orange)	1	1		
	Insufficient	1	1		
	Weak	1	1		
	Unsatisfactory	1	1		
	3	1	1		
	Red/Amber	1	1		
	<b>Total</b>		<b>48</b>	<b>44</b>	<b>4</b>



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# Appendix B Current Engagement Definitions

Levels of Assurance	Definition
<b>Substantial Assurance</b>	There is a sound system of internal control designed and operating in a way that gives a reasonable likelihood that the objectives will be met.
<b>Reasonable Assurance</b>	Whilst there is a sound system of internal control, there are minor weaknesses, which may put some of the objectives at risk or there is evidence of non-compliance with some of the controls, which may put some of the objectives at risk.
<b>Moderate Assurance</b>	The system of internal control is broadly reliable, however there are a number of weaknesses, which put some of the objectives at risk or there is evidence that the level of non-compliance with controls put some of the objectives at risk.
<b>Limited Assurance</b>	Weaknesses in the system of internal control are such as to put the objectives at risk or the level of non-compliance puts the objectives at risk.
<b>No Assurance</b>	Control is generally weak leaving the system open to error or abuse, or there is significant non-compliance with basic controls, which leaves the system open to error or abuse.

# Appendix C Revised Engagement Opinions

Levels of Assurance	Definition
<b>Substantial Assurance</b>	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.
<b>Reasonable Assurance</b>	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
<b>Limited Assurance</b>	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.
<b>No Assurance</b>	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.