



National Audit Office

---

---

# Auditor Guidance Note AGN 03

## Auditors' work on VFM arrangements

Summary of consultation responses

DECEMBER 2015

---

This document is available on  
our website at: <http://ow.ly/VyXEH>

If you have any enquiries regarding this document, email  
[LACG@nao.gsi.gov.uk](mailto:LACG@nao.gsi.gov.uk) or write to us at:

Local Audit Code & Guidance  
National Audit Office  
157-197 Buckingham Palace Road  
Victoria  
London SW1W 9SP  
Tel: 020 7798 5393

© National Audit Office 2015

The material featured in this document is subject to National Audit Office (NAO) copyright. The material may be copied or reproduced for non-commercial purposes only, namely reproduction for research, private study or for limited internal circulation within an organisation for the purpose of review.

Copying for non-commercial purposes is subject to the material being accompanied by a sufficient acknowledgement, reproduced accurately, and not being used in a misleading context. To reproduce NAO copyright material for any other use, you must contact [copyright@nao.gsi.gov.uk](mailto:copyright@nao.gsi.gov.uk). Please tell us who you are, the organisation you represent (if any) and how and why you wish to use our material. Please include your full contact details: name, address, telephone number and email.

Please note that the material featured in this document may not be reproduced for commercial gain without the NAO's express and direct permission and that the NAO reserves its right to pursue copyright infringement proceedings against individuals or companies who reproduce material for commercial gain without our permission.

---

## Contents

Introduction	4
Summary of consultation responses	5
Appendix A - List of respondents	11

---

# Introduction

The Local Audit and Accountability Act 2014 (the Act) provides the legislative basis for the new framework for local public audit following the abolition of the Audit Commission and the repeal of the Audit Commission Act 1998.

The Act makes the Comptroller and Auditor General (C&AG) responsible for the preparation and maintenance of the Code of Audit Practice (the Code), and gives the C&AG the power to issue guidance to auditors in support of the Code, to which auditors must have regard when carrying out their statutory duties for the audit of local public bodies under the Act. The C&AG issues guidance to auditors through the publication of Auditor Guidance Notes (AGNs).

In November 2015, the C&AG published AGN 03, which contains guidance to auditors in respect of their statutory conclusion on local public bodies' arrangements to secure economy, efficiency and effectiveness (value for money, VFM) in their use of resources. The guidance applies to auditors of local authorities, fire and rescue authorities, local police bodies, local health bodies including Foundation Trusts, and other bodies covered by the Act, including smaller authorities (such as town or parish councils) who have opted to produce their accounts in accordance with CIPFA's Code of Practice on Local Authority Accounting in the UK.

Ahead of this, the National Audit Office (NAO), on behalf of the C&AG, conducted a consultation to obtain stakeholder views on a draft AGN. The consultation ran from 5 August to 30 September 2015. This document provides a summary of the responses received and highlights the main changes made to the draft AGN in response to the consultation exercise.

We received a total of 28 responses to the consultation. Appendix A provides a list of respondents.

We are very grateful to those who took the time to participate in the consultation.

# Summary of consultation responses

The consultation document published alongside the draft AGN invited responses to 10 questions addressing the AGN's constituent parts. This summary of consultation responses follows the structure of the AGN and focuses on the main themes and issues arising as a result of respondents' feedback.

## Preface

There was strong support for changes to the approach to represent an evolution to previous requirements, rather than wholesale change, and for a common approach to the auditor's work that applied to all sectors. We considered carefully the views of respondents in respect of the Foundation Trust sector, for whom any changes were likely to be more significant, and felt that the approach contained within the AGN did not place unreasonable additional burden on either auditors or audited bodies.

The provision of guidance to auditors will not fetter their independence. The auditor will remain responsible for the detailed planning and conduct of the audit, and for the professional judgements underpinning their audit conclusions.

### ***Question 1 – Do you agree with the proposal to align the approach with that of an assurance engagement designed to give reasonable assurance, consistent with the principles of the International Framework for Assurance Engagements?***

Respondents were supportive of the AGN being aligned more closely to a recognised professional framework, in this case the International Framework for Assurance Engagements; and, in particular, International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. However, a significant number of respondents were concerned that adoption of ISAE 3000 may have unintended consequences in terms of the work auditors would be required to do – and regulators may expect to see – to evidence compliance with the standard. Consequently, a number of respondents also expressed concern that this could lead to an increase in audit fees.

A small number of respondents suggested that an approach designed to provide 'limited assurance' may be more appropriate. However, given the statutory requirement for auditors to be satisfied that proper arrangements are in place in respect of arrangements to secure VFM, we concluded that the approach had to be designed to provide reasonable assurance.

In response to these concerns, we reviewed references to ISAE 3000 in the draft AGN and updated the text to make it explicit that the auditors' work on VFM arrangements is carried out under the Code. While we drew on some of the principles of ISAE 3000 in designing and developing the guidance, auditors are only expected to comply with the requirements set out in the AGN itself.

Whilst we acknowledge that reporting requirements vary across the sectors covered by the guidance, we believe that even though the auditor's statutory conclusion at NHS bodies will be reported by exception only, auditors will be providing reasonable assurance overall to NHS bodies through their other reporting channels, such as reports to those charged with governance. We have clarified that where auditors have no issues to report, they should confirm this in the "matters on which we report by exception" section of their opinion on the financial statements.

Having considered the views of respondents with regard to pressure on fees, we remain of the view that the approach contained within AGN 03 should not, in itself, lead to an increase in audit fees.

***Question 2 – Do you have any comments on the scope of proper arrangements as described in the draft AGN? If you think the scope of proper arrangements could be improved, please provide details.***

Generally, respondents felt that the scope of proper arrangements set out by the descriptors in the AGN was appropriate and comprehensive. But, some respondents were concerned that the scope of arrangements should not be turned into a 'checklist' of areas that auditors were expected to cover.

A number of respondents felt that the scope of arrangements should also include reference to data quality issues, and we received a number of specific suggestions in respect of various aspects of the wording of the descriptors.

A small number of respondents felt that reference to working with partners and other third parties would extend the scope of auditors' current approaches and place pressure on fees.

In considering the issues raised, we reviewed the descriptors setting out the scope of proper arrangements, and rephrased them in line with suggestions received where we felt that they represented an improvement to the draft text. In respect of data quality, we concluded that the existing references to 'relevant and reliable financial and performance information' and 'reliable and timely financial reporting information' sufficiently covered the aspects of data quality. Local bodies' arrangements to ensure data quality underpin properly informed decision making.

We strengthened references in the AGN and the accompanying supporting information to make it clear that auditors' work in the areas covered by the descriptors should be driven by their assessment of risks at each individual body, and auditors should not adopt a blanket 'checklist' approach to considering arrangements.

In respect of comments suggesting that the scope of proper arrangements has been increased by introducing an explicit reference to working with partners and other third parties, we believe that working in partnership with other organisations, either through mutual support or as part of a contracted service, has been embedded in public bodies' ways of working for some time. We do not believe that consideration of arrangements in this area, where those arrangements are significant or present a risk, is new to the approach.

***Question 3 – Do you have any comments in respect of the approach to the auditor’s risk assessment?***

Several respondents expressed a view that the draft AGN was not sufficiently clear in setting out what constituted an adequate risk assessment. We were also asked to provide further clarification on how auditors should define ‘materiality’ in respect of VFM arrangements work and to be explicit about whether auditors were expected to identify significant risks at every audit.

In response to these points, we expanded the guidance on the auditor’s risk assessment to set out more clearly how we would expect auditors to approach their risk assessment, and we have provided references in supporting information to sources that may be appropriate for auditors to draw upon. It is possible that for many audited bodies, the auditor will identify no significant risks, and the final AGN is explicit that auditors are *not* expected to raise a significant risk at every audit. Auditors should, however, ensure that where they conclude there are no significant risks, they have adequately documented their judgement to support this.

In respect of comments about materiality, we reviewed the draft AGN and have removed reference to materiality, so that auditors’ judgements are solely in respect of the significance of the issue to the overall criterion. The concept of significance is defined in the Code.

***Question 4 – Do you agree that the illustrative risks included in the AGN are helpful? If yes, are there any further illustrative examples of significant risks that could usefully be included?***

Respondents were broadly supportive of the inclusion of illustrative risks, and offered suggestions of other issues that might also reasonably be included in the AGN. A small number of respondents asked for more guidance in terms of the procedures auditors would be expected to undertake in response to significant risks, including, where risks related to medium term financial planning, a clear indication of the time period which auditors were expected to consider.

In response to these comments, we expanded the illustrative significant risks where we felt the suggestions were relevant to the scope of auditors’ work under the AGN. For example, we expanded references to outsourcing to include transfer to alternative delivery models, such as formal partnerships, mutuals, social enterprises, or joint ventures. We took the view that it would not be possible to prescribe procedures that auditors should undertake in response to significant risks, since the local circumstances underlying the identified significant risks would be likely to vary considerably. Consequently, we also felt it would be inappropriate to stipulate a time period in respect of auditors’ consideration of financial planning issues, since this would need to be appropriate to the nature of the issue being considered; the impact of a budget gap could vary depending on whether the gap was next year or in three years’ time, whereas a major debt restructuring might need to be considered over a thirty year period.

***Question 5 – Do you have any comments on the wording of the overall criterion against which the subject matter will be evaluated?***

Respondents were generally supportive of the overall criterion.

Some respondents felt that the criterion was not explicitly focused on ‘arrangements’, giving rise to the risk that auditors could get drawn into making judgements about the appropriateness of policies and outcomes. Several respondents also questioned whether the drafting of the

criterion, in the present tense, could confuse readers of the auditor's report, since the conclusion is in respect of the arrangements that were in place in the previous financial year.

A small number of respondents felt that reference to 'taxpayers and local people' in the criterion excluded service users who were not local to the area, and suggested 'service users' as a more appropriate description.

In response to these comments, we amended the wording of the overall conclusion to refer explicitly to the arrangements at the body, and put the criterion into the past tense to make it clearer that it relates to a previous period. The final AGN includes the following overall criterion:

**In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.**

We did not amend the criterion to refer instead to service users, as we felt that through the various mechanisms of local and national, direct and indirect taxation, service users would generally be covered by the existing wording.

***Question 6 – Do you have any comments on the proposed sub-criteria which link to the description of proper arrangements in the draft AGN? If you think the sub-criteria could be improved, please provide details.***

Respondents were generally supportive of the sub-criteria. However, some respondents raised concerns about the impact that the sub-criteria might have on auditors' work and fees. Concerns included the following:

- The reference to decision making should include consideration of whether decisions were 'rational'
- The sub-criteria do not allow for consideration of 'direction of travel' in bodies' performance
- The sub-criteria generate additional work by effectively setting out a work programme, requiring the auditor to conclude on each of the sub-criteria and in terms of the overall criterion
- The sub-criteria extend the scope of the work beyond that which was previously undertaken by auditors
- The sub-criteria and descriptors suggest that audited bodies will need to produce evidence files that link to each element

On balance, we concluded that adding a reference to 'rational' decision making was unnecessary given the explicit reference in the overall criterion to 'properly informed decisions'. In respect of 'direction of travel', we felt that it was important to retain the binary nature of the conclusion, in that proper arrangements were either in place, or they were not in place during the year. We have, however, drawn auditors' attention to the range of reporting options that are available to them in addition to the conclusion itself, and suggested that auditors may wish to use some of these to reflect issues such as improvements which have taken place since the end of the financial year covered by the conclusion.

We feel that the AGN is clear that while the sub-criteria and descriptors set out what is in scope, auditors are only expected to undertake work in areas where their risk assessment identifies significant risks. There is no expectation that auditors should undertake detailed work in all of the areas setting out the scope, unless their risk assessment demonstrates that this is necessary.

We have reviewed the scope of the work as set out in AGN 03 and compared it with that set out under the previous Audit Commission and Monitor guidance. While the AGN places a different emphasis on some areas compared with previous guidance, we do not feel that the guidance requires auditors to consider anything that would not have fallen within the scope of the previous frameworks.

In respect of expectations placed on audited bodies, there is no expectation that bodies should be required to put together comprehensive files mapping their arrangements to the scope set out in the AGN. We have amended the AGN to ensure that this is clear.

***Question 7 – Do you think that the expanded section on reporting will help audited bodies to get more value out of the work auditors undertake on vfm arrangements?***

Respondents were generally supportive of reporting sections in the draft AGN. However, some respondents were concerned that references to ‘expanded’ in terms of reporting implied that auditors would be required to report more than previously, which could have implications for audit fees.

To clarify, the references in the consultation document to ‘expanded’ sections on reporting relate to the AGN itself containing more information on the reporting options available to auditors, and more information about what auditors would be reporting at different stages of the audit. The AGN does not place any new reporting requirements on auditors that are not already required under the Code or relevant auditing standards.

***Question 8 – Do you agree that enhancing guidance about the relevant considerations for auditors when deciding whether to issue a qualified or an unqualified conclusion will help improve consistency and ensure that relevant issues are reported?***

Responses generally expressed a view for auditors to achieve consistency as far as possible. Several responses called for the guidance to include a set of example scenarios setting out what kind of conclusion (unqualified, qualified “except for”, or adverse) would be appropriate in a range of circumstances.

A key element of the approach set out in the AGN is that auditors’ work should be risk-based and proportionate, focus on the key risks at audited bodies, and take account of local context. Given this aim, we do not feel it is possible to set out a range of scenarios as part of statutory guidance that would adequately cover the range of judgements auditors would need to make.

We want to promote consistency between auditors, and will establish a network facilitated by the NAO, where auditors can come together to discuss the principles behind complex judgements.

***Question 9 – Do you agree with the proposal to maintain the supporting information separately from the statutory guidance set out in the draft AGN?***

Respondents were generally in agreement with this proposal, and sector-specific supporting information is now available on the NAO website, alongside the AGN.

Some respondents asked for the supporting information to include further detailed guidance, clearly defining the terms used in the AGN and setting out the level of compliance expected and the point at which issues should lead to qualification, while others were concerned that the supporting information could be taken as introducing additional requirements over and above those set out in the AGN.

In response, we reviewed both the AGN and the supporting information and clarified the status of both.

The AGN is the only document containing guidance to which auditors should have regard. The supporting information is intended to provide additional sector-specific context and make auditors aware of sector developments and reference sources that may be helpful to them in undertaking their risk assessment.

Nothing in the AGN, or in the supporting information, is intended to place any requirements on bodies over and above the requirements already placed on them by the appropriate relevant authorities.

There is no expectation that auditors should work through the supporting information and consider all of the issues referred to within it.

***Question 10 - Are there any other ways in which you think that the guidance could be further strengthened or improved?***

A number of respondents commented that it would be important to ensure that the regulators who will be responsible for reviewing the quality of work done under the AGN are fully aware of the new approach and the requirements.

The NAO is working closely with the relevant regulators to ensure that they are fully aware of the both the content of the C&AG's guidance and the thinking behind it.

## **Appendix A - List of Respondents**

- 1 BDO LLP
- 2 Brighton and Hove Council
- 3 Chartered Institute of Public Finance and Accountancy
- 4 Deloitte LLP
- 5 Department for Communities and Local Government
- 6 East Sussex Fire and Rescue Authority
- 7 Ernst & Young
- 8 Fire Finance Network
- 9 Grant Thornton UK LLP
- 10 Healthcare Financial Management Association
- 11 Home Office
- 12 Institute of Chartered Accountants in England and Wales
- 13 KPMG
- 14 Local Government Association
- 15 Mazars LLP
- 16 Monitor
- 17 Moore Stephens
- 18 Police and Crime Commissioner for Cheshire
- 19 Public Sector Audit Appointments Ltd
- 20 PwC LLP
- 21 Society of County Treasurers
- 22 Society of District Treasurers
- 23 Society of London Treasurers
- 24 Suffolk local authorities – joint response
- 25 Trust Development Authority

In addition to the above, we received responses from three further bodies, who wished their comments to remain confidential.



National Audit Office

Design and Production by NAO Communications