



National Audit Office

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**Consultation document**

by the National Audit Office

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Local audit in England  
Code of Audit Practice

Issues paper

**MARCH 2019**

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Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund, nationally and locally, have used their resources efficiently, effectively, and with economy. The C&AG does this through a range of outputs including value-for-money reports on matters of public interest; investigations to establish the underlying facts in circumstances where concerns have been raised by others or observed through our wider work; landscape reviews to aid transparency; and good-practice guides. Our work ensures that those responsible for the use of public money are held to account and helps government to improve public services, leading to audited savings of £741 million in 2017.

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# Introduction

- 1** Local public services account for a significant amount of public spending. In 2017-18, 495 local authorities, local police and local fire bodies were responsible for approximately £54 billion of net revenue spending and 442 local NHS bodies received funding from the Department of Health & Social Care of approximately £100 billion. These local bodies are also responsible for delivering many of the public services local taxpayers rely on every day.
- 2** 'Local audit' is the statutory external audit of these local public bodies, which for local government include local authorities, such as county or district councils, fire and rescue authorities, police and crime commissioners, and chief constables. Local NHS bodies include local NHS trusts, NHS foundation trusts and clinical commissioning groups.
- 3** Each year, local auditors give an opinion on whether local public bodies produce financial statements that comply with reporting requirements and are free from material errors, and conclude whether local public bodies have arrangements to manage properly their business and finances (the conclusion on arrangements to secure value for money).
- 4** Local auditors also have a range of additional reporting powers and duties to provide information or to prompt action in certain circumstances. These are important tools for the auditor to bring attention to issues that need to be addressed, and which require the body to consider and respond to publicly.
- 5** Local audit in England is carried out by private firms, who must be registered by a recognised supervisory body, which in England is the Institute of Chartered Accountants in England and Wales (ICAEW). Seven firms are currently appointed as local auditors to larger local authorities and local NHS bodies in England; three firms are appointed as auditors of smaller authorities (such as town and parish councils, where annual gross income and expenditure is below £6.5 million).
- 6** This consultation document seeks views on the issues relevant to the development of a new Code of Audit Practice (Code). [The Code is published on the National Audit Office website.](#)

**7** Through the 2014 Local Audit and Accountability Act (the 2014 Act), Parliament has made the Comptroller and Auditor General (C&AG) responsible for the preparation and maintenance of the Code, which prescribes the framework within which local auditors in England are required to carry out their statutory responsibilities. Schedule 6 of the 2014 Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, the same day as the powers set out above were transferred from the Audit Commission to the C&AG. The maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come into force no later than 1 April 2020.

## **Timetable and approach**

**Please respond by 31 May 2019.**

**8** In order to determine what changes might be appropriate, we are consulting on potential changes to the Code in two stages:

- Stage 1 involves engagement with key stakeholders and public consultation on the issues that are considered to be relevant to the development of the Code.
- Stage 2 – to be undertaken in the second half of 2019 – involves public consultation on the draft text for the new Code, which will be developed after considering the responses to the consultation at Stage 1.

**9** This document supports Stage 1 of the consultation process. The document follows the structure of the current Code and sets out the issues that have been identified to date that are relevant to each section of the Code. We plan to consult on the draft Code text (Stage 2) during September – November 2019, and to finalise the Code by the end of 2019, ready to be laid in Parliament early in 2020. The new Code would then come into force from 1 April 2020 and would apply to audits of the 2020-21 financial statements.

**10** Under the 2014 Act, the C&AG is required to prepare a Code that embodies what he considers to be the best professional practice with respect to the standards, procedures and techniques to be adopted by local auditors. We are mindful of the current debates in the wider profession about the future of audit. At present these debates are ongoing and so we will keep developments under review to consider what, if any, impact there may need to be on our work to prepare a new Code.

## **Structure**

**11** The consultation document is structured as follows:

- Introduction.
- Background and context.
- Commentary and questions for consultees.
- Appendix One – Auditors’ responsibilities.

## **How to respond**

**12** We have set out in this paper a brief commentary on the issues relevant to the new Code along with consultation questions. A complete list of the questions is also provided in a separate consultation response form.

**13** When answering the consultation questions, it would be very helpful if you could also provide additional explanation and detail where appropriate, to understand the basis for your comments.

**14** Please do not feel that you need to respond to all the consultation questions; we welcome brief or partial responses addressing only those issues where you wish to put forward a view. If there are further observations you would like to make in addition to the questions included in this consultation, however, please feel free to include these in your response.

**15** Please email your response to [lacg@nao.org.uk](mailto:lacg@nao.org.uk).

**16** You can also post responses to us at Local Audit Code and Guidance Team, National Audit Office, Green 2, 157–197 Buckingham Palace Road, London, SW1W 9SP. Tel: 020 7798 7842.

**17** If you need paper copies of this consultation document or the Code please let us know using the email or correspondence address above, or by calling 020 7798 7842, and provide us with your contact details. We will be happy to post copies to you.

**18** **We may draw on your responses when explaining how we have acted on the consultation, or if we need to follow up matters raised with some or all other respondents. Therefore your comments will be regarded as public unless you let us know that they should not be. If so, please let us know when you submit your response whether you consider all or part of your submission to be confidential.**

# Background and context

**1** Local service users, taxpayers and others with an interest in the performance of local public bodies want to be confident that those entrusted with public money are properly accountable for their decisions and actions. This is why Parliament has determined through legislation that there should be independent external assurance about how public bodies spend taxpayers' money. Consequently, publicly funded local bodies – such as councils, police bodies, fire and rescue authorities and health bodies – on which local people depend for financially sustainable services are subject to independent audit of their accounts and arrangements for securing value for money.

**2** There continue to be significant developments that impact on how auditors of local public bodies will meet their responsibilities. Auditors need to be able to respond to the challenges that face local public bodies. In recent years, this has been characterised by increasing financial pressures in all sectors and increasing demand for services is challenging both financial and service sustainability. The National Audit Office (NAO) has produced a series of reports that consider the financial pressures on local public bodies, which may be helpful in informing consultation responses. These include:

- [Financial sustainability of local authorities 2018](#);
- [Financial sustainability of police forces in England and Wales 2018](#);
- [NHS financial sustainability](#);
- [Local authority governance](#); and
- [Local auditor reporting in England 2018](#).

**3** It is essential that local public bodies manage their resources well, so that they can achieve their desired outcomes with the resources that are available. Independent external auditors therefore have a key role in supporting effective stewardship, governance and accountability. This role is important at any time, but especially so when available resources are scarce.

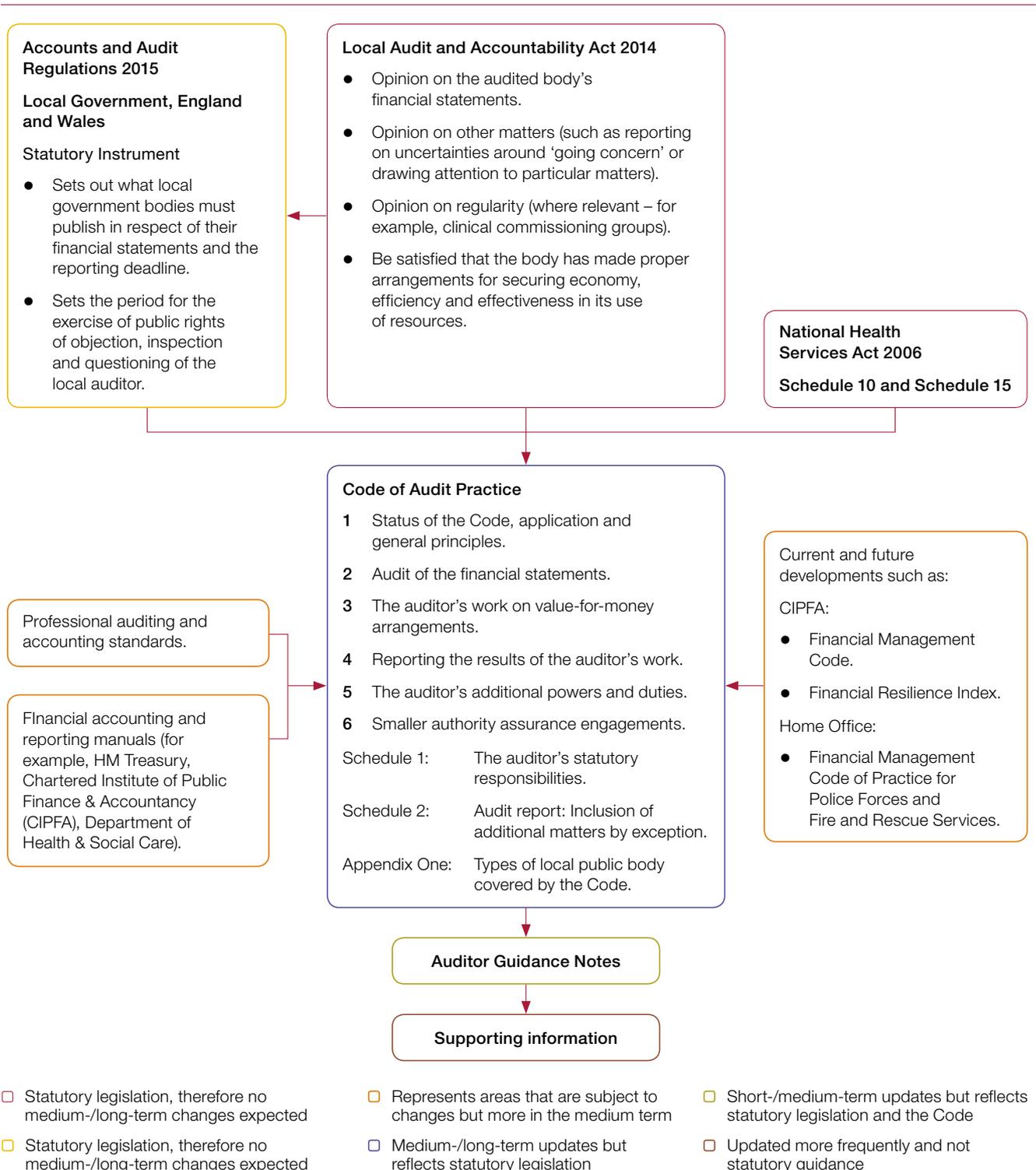
4 Local auditors must comply with the Code of Audit Practice (the Code), but how they apply the Code is influenced by their professional judgement of what is reasonable and appropriate, reflecting the circumstances of individual local public bodies, and having regard to guidance issued by the Comptroller and Auditor General (C&AG). Under the 2014 Local Audit and Accountability Act (the 2014 Act) the C&AG has the power to issue guidance to auditors in respect of their duties under the Code, to which auditors must “have regard”, and also provides other information to auditors, which may be helpful to them in carrying out their work.

5 **Appendix One** contains more information about the nature of local auditors’ responsibilities and their additional reporting powers and duties.

### **Scope of the consultation**

6 The Code is a key document setting out how local auditors in England meet their responsibilities under the 2014 Act, but there are limitations to how far it can influence the work required by auditors. For example, while the Code sets out how auditors meet their responsibilities under the 2014 Act, it cannot add to, or take from, the duties on auditors that are set out in the 2014 Act itself.

7 As the Code only relates to the work of local auditors, it also cannot place requirements on local public bodies, such as the format or content of the financial statements. The diagram below sets out the areas which the Code can – and cannot – influence:



## **Purpose of this consultation**

- 8 We are now seeking views on the following issues:
- the developments and issues that you think will impact most on the work of auditors over the coming years;
  - how local auditors' work on the annual accounts should be carried out and reported to both comply with relevant standards and meet reasonable expectations for providing assurance over the financial statements;
  - how local auditors' work on local public bodies' arrangements to ensure economic, efficient and effective use of their resources should be focused to provide meaningful, independent assurance to stakeholders, including local taxpayers;
  - how the Code can best promote local auditor reporting that has the appropriate impact, at the right time and in the right circumstances, to strengthen accountability and support improvement where needed; and
  - whether local auditors will need to develop and make use of different skills or work in new ways to meet your expectations.

# Commentary and questions for consultees

**1** Here we summarise briefly what the purpose of each section is and invite comments through questions to consultees. In each section, we have set out what we understand to be the current issues and challenges most relevant to the Code of Audit Practice (the Code). We are seeking your views on whether you have any specific comments on those issues, including whether there are additional points that should be considered.

**2** We have also included a section on *Potential implications of changes to the Code*. Any significant changes to the nature of the work required under the Code may have implications for the resources and skills that local auditors will need to deploy to meet their responsibilities. We are therefore also seeking your views on the extent to which auditor capacity and capability may need to change.

## **Section One: Status of the Code, application and general principles**

**3** When the 2015 Code was adopted, a clear decision was taken that the Code itself should be principles-based. These take as their starting point long-established and enduring principles of public audit, which are the ‘wider scope’ of public audit; independence; and public reporting. The current Code builds on these key principles as set out below:

- Public accountability: The Code recognises that public audit has a wider scope than just the opinion on the financial statements. In addition to their work on financial statements, local auditors also need to be satisfied that proper arrangements are in place to deliver economy, efficiency and effectiveness, and consider whether they need to use any of their additional public reporting powers to bring public attention to specific issues.
- Integrity, objectivity and independence.
- Transparency and public reporting.
- Professionalism and proportionality.
- Coordination and integration.
- Constructive approach.
- Data security and confidentiality.

**4** Through engagement with stakeholders while developing this issues paper, we have identified broad support for maintaining the principles-based approach through a single Code covering both local government and NHS sectors.

**5** However, we are also aware that the financial pressures in the public sector mean it is increasingly important that when local auditors report findings, and especially when they flag concerns, that their reports have impact and are accessible, especially to people without a finance background.

**6** We have also seen an increase in the exercise of public rights in recent years, with more objections to local authorities' financial statements, including nationally coordinated campaigns where objections to particular issues are made at a number of local authorities.

**7** When auditors consider whether to exercise any additional public reporting powers to flag concerns about local public bodies, or respond to objections to accounts, it is possible for costs to mount significantly. This can be particularly acute at smaller authorities if, for example, a small number of people raise multiple objections. The cost of looking into these is charged to the authority (and therefore the local council taxpayer) and can sometimes exceed the usual annual expenditure of the smallest bodies. We are therefore considering whether the Code's principles should include more emphasis on proportionality, requiring that the auditor consider not only the technical aspects of a particular matter, but also whether the cost to the taxpayer of taking further action or exercising additional reporting powers outweighs the benefits that such action might bring about.

**8** In recent years, local public bodies have increasingly entered into partnerships to deliver services. Such partnerships are often not statutory bodies in their own right, and can include organisations from a range of sectors, including local government, police, fire, NHS and private companies. The aim of the partnership is often to improve services, or deliver savings, so it is important that partnerships are well managed. Local auditors, however, are only able to report on the arrangements in place at the individual body they audit, so gaining assurance over the partnership as a whole can be difficult. Although there are professional restrictions on how much information about individual bodies auditors can share with others, we are considering how these developments might impact on auditors' work under the Code.

9 We are therefore interested in your views on the following:

**Question 1** Do you think a principles-based approach is appropriate for the Code of Audit Practice or should the approach be more prescriptive?

Please add any comments to help to explain the basis of your answer.

**Question 2** Are there any principles you think should be added or removed?

Please add any comments to help to explain the basis of your answer.

**Question 3** Do you think it would be beneficial to give more emphasis to some principles over others?

If so, which principles should receive more emphasis?

**Question 4** Do you think a single Code should be retained, or would sector-specific Codes be better?

If separate, what differences between the Codes would you like to see?

**Question 5** How could the Code better support auditors' work on audited bodies' partnerships and joint arrangements?

## **Section Two: Audit of the financial statements**

10 The 2014 Local Audit and Accountability Act (the 2014 Act) requires local auditors to provide the following each year:

- opinion on the audited body's financial statements;
- opinion on other matters (such as reporting on uncertainties around 'going concern' or drawing attention to particular matters); and
- opinion on regularity (where relevant – for example, clinical commissioning groups).

11 To meet their duties in respect of the audit of the financial statements, the current Code requires auditors to comply with auditing standards currently in force (and as may be amended from time to time), having regard to any other relevant guidance and advice issued by the Financial Reporting Council, and the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG).

12 Through engagement with stakeholders while developing this issues paper, we have received strong representation from some finance directors that local auditors focus too much on certain figures in the accounts, such as asset and pension liability valuations that do not directly impact on the organisation's ability to deliver services or the council tax that local authorities need to charge.

**13** These concerns are sometimes expressed in the context of wider questions about the complexity and understandability of financial reporting. Initiatives such as the recent publication by the Chartered Institute of Public Finance and Accountancy (CIPFA) on 'streamlining' local authority accounts demonstrates an understanding that public sector financial statements should set out clearly the information needed by stakeholders. However, the Code itself does not set out the reporting requirements for local authorities, smaller authorities, or local NHS bodies, as it only sets out the requirements on local auditors. Equally, there are international professional standards already in place that set out how external auditors should audit financial statements, and which currently apply equally to audits in both the public and private sectors.

**14** Currently, local public bodies broadly comply with International Financial Reporting Standards (IFRS) and are audited to International Standards on Auditing (ISAs). From a wider perspective, this is an important discipline, which supports the credibility of financial reporting in the public sector as a whole. Maintaining the requirement of auditors to audit to international professional standards reinforces that discipline.

**15** In recent years, the number of local public bodies entering into various arrangements with other organisations (including private companies), and the number looking into 'commercial' activities aimed at generating income streams in future to support the delivery of services is also increasing. When entering into these more 'commercial' activities, the need to account properly for assets and liabilities – including those which do not directly impact on service delivery – is becoming more and more important. Private companies and lenders expect that significant figures, such as assets, and key liabilities, such as pensions, will be properly accounted for to recognised standards.

**16** In our view, therefore, the Code should remain aligned to generally accepted auditing standards to ensure that the professional requirements on local auditors will keep pace with changes in the audit profession. We are also mindful of the requirement for the Code to be based on best professional practice.

**17** We are therefore interested in your views on the following:

**Question 6** **Do you agree the Code should continue to align its requirements with generally accepted auditing standards?**

If not, please explain.

**Question 7** **Are there areas of the audit of financial statements where it is currently difficult or inappropriate to apply generally accepted auditing standards?**

If so, which standards, and why?

### **Section Three: The auditor's work on economy, efficiency and effectiveness of corporate arrangements (value-for-money arrangements)**

**18** In recognition of the requirements for effective public accountability from bodies spending taxpayers' money, the role of the local auditor in the public sector is wider than that in the private sector. Public audit includes consideration of the arrangements local public bodies have in place to manage their business and finances, and to flag concerns where appropriate. The 2014 Act places a specific duty on the local auditor to be satisfied whether the body they are auditing has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. In the current Code, this is referred to as work on arrangements to secure value for money (VFM arrangements).

**19** Auditors currently reach a conclusion each year as to whether they are satisfied that the body they audit has proper arrangements in place to secure value for money. This is achieved by undertaking an assessment of issues that may be a significant risk to their conclusion in three key areas:

- informed decision-making;
- sustainable resource deployment; and
- working with partners and other third parties.

**20** The current approach to the VFM arrangements work risk assessment is to consider 'engagement risk', the risk that the auditor would reach the wrong conclusion about the adequacy of arrangements, rather than specifically considering the risk that any particular arrangement is not adequate.

**21** In undertaking work on arrangements to secure economy, efficiency and effectiveness, the Code currently requires local auditors to:

- undertake sufficient work to be able to satisfy themselves as to whether, in the auditor's view, the audited body has put arrangements in place that support the achievement of value for money. Local auditors are not required to satisfy themselves that the audited body has achieved value for money during the reporting period. Equally, it is not part of the auditor's function to question the merits of the audited body's policy decisions. However, should evidence of poor value for money come to the auditor's attention during the course of the audit, the auditor should consider the implications of this for their work;
- consider what arrangements the audited body is expected to have in place. This should be based on the relevant governance code or framework for the type of local public body being audited, together with any other relevant guidance or requirements; and

**22** The auditor's conclusion should be informed by:

- the audited body's governance statement and any additional reporting by the body on the arrangements it has in place to manage risks to the achievement of value for money through the economic, efficient and effective use of its resources;
- evidence that the audited body's arrangements were in place during the reporting period;
- evidence obtained from the auditor's other work – including previous work on VFM arrangements, work completed as part of the audit of the financial statements and the audited body's response to this work;
- the work of inspectorates and other bodies – where the scope and results are relevant to the auditor's VFM responsibilities. The auditor is not required to quality assure or re-perform the work of others and may use such work to the extent that, in their judgement, it is appropriate to do so; and
- any other evidence source that the auditor regards as necessary to facilitate the performance of their statutory duties.

**23** Auditors must use professional judgement to determine the extent of work necessary to support their conclusion on VFM arrangements and document the results of their consideration. Where the auditor identifies risks that have the potential to cause the auditor to reach an inappropriate conclusion, the auditor should document their planned response, informed by discussion of these risks with the audited body. The auditor should document the results of their work conducted in response to identified risks.

**24** The auditor's work should be designed to provide them with sufficient assurance to enable them to report as appropriate to conclude as to whether, in all significant respects, the audited body has (or has not) put in place proper arrangements to secure value for money through economic, efficient and effective use of its resources for the relevant period. However, NHS bodies' auditors report only by exception, where they are not satisfied with arrangements.

**25** Where required, the auditor should report their conclusion on the audited body's arrangements having regard to specific reporting criteria. These are currently set out in guidance. The current overall criterion is to be satisfied whether:

“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.”

Comptroller and Auditor General, *Auditor Guidance Note 3: Auditors' Work on Value for Money (VFM) Arrangements*, National Audit Office, November 2017.

**26** From engagement with stakeholders to date, we believe that the overall approach to work in this area is seen as proportionate and focuses attention on key areas of risk, such as effective decision-making, sustainable resource deployment, and working with partners and other third parties.

**27** However, greater financial pressures in local public bodies are driving organisations to look for more innovative ways to finance their operations and limit their reliance on central government grants. Local public bodies are increasingly working in partnership with a range of other public and private organisations, as well as exploring activities such as investing in commercial properties to generate additional streams of income.

**28** It is important that organisations have robust governance and financial management arrangements in place that enable them to manage the increased risks that more commercialised and other innovative ways of working can represent. Sector-led developments such as CIPFA's Financial Management Code and Resilience Index and the Financial Management Code for local police bodies are helping local bodies address these challenges. We have sought views in Question 5 of this consultation about how the Code might better support auditors' work on partnerships and other joint arrangements.

**29** Given the developments highlighted above, the independent assurance provided by the local auditor is crucial, both to provide assurance to the body itself, but also to local taxpayers and stakeholders more widely. It is vital that reporting by auditors in this area is clear in terms of the extent of the assurance being provided, and includes sufficient information to enable local public bodies to respond to the issues identified by strengthening their arrangements.

**30** We have identified that reference to the term 'value for money' is not always well understood, given that the focus of the auditor's work is *on arrangements to deliver economy, efficiency and effectiveness*. We are therefore considering whether it may be more appropriate to use alternative terminology to make clearer that the auditor's focus is on the arrangements the body has in place, such as those in respect of financial management, planning or forecasting, the adequacy of bodies' arrangements for medium-term financial planning, and financial governance in a wider sense, such as audit committee effectiveness.

**31** In respect of the focus on arrangements, there have been suggestions that the work should also confirm whether they are working in practice and delivering the desired outcomes.

**32** We are also aware from local bodies' feedback that they feel the output from auditors' work in this area often does not add to their knowledge or understanding of the risks and issues they are facing, and that they would find more commentary around both current and emerging issues helpful. In order to provide such additional commentary, auditors would need to look at some risks in more detail and consider risks that may not meet the current definition of a 'significant' risk, but nevertheless represent a concern to local auditors and local public bodies. This could provide an opportunity for bodies to act sooner and strengthen their arrangements.

**33** We are therefore interested in your views on the following:

**Question 8** **What are the key issues that you think the Code and NAO guidance for this area of work will need to be able to address in the coming years?**

Please add comments to help to explain the basis of your answer.

**Question 9** **Are you content that the current terminology 'VFM arrangements conclusion' adequately describes the nature of the work undertaken and the conclusion?**

If no, what would be a more informative description?

**Question 10** **Do you think the current, risk-based, approach to arrangements work focuses the auditor's attention in the right areas?**

If no, how should the focus of auditors' work change?

**Question 11** **Do you think the Code should allow auditors to look in more detail at work in areas that may not meet the current definition of a 'significant' risk, but nevertheless represent a concern to local auditors and local public bodies?**

If so, on what basis should auditors determine how and where to focus their work, consistent with their responsibilities as auditors?

## **Section Four: Reporting the results of the auditor's work**

**34** Local auditors undertake a key role in providing local bodies, local people and other stakeholders with independent assurance about their financial statements and arrangements to manage their business and finances. It is therefore essential that the way this is reported to local bodies – and to the public – is as effective and transparent as possible and promotes local improvement. The expectations set out in the Code also need to be flexible to allow auditors to reflect local circumstances, and to recognise that specific reporting requirements vary between the local government and health sectors, and between types of local NHS body.

**35** When organisations fail, or encounter significant difficulties, people often ask what the auditors were doing during the period leading up to the failure. Auditors therefore need to ensure that where they are identifying risks and issues, that they are drawing attention to them promptly and clearly, so that bodies can take appropriate corrective action and the executive can be held to account.

**36** The Code can play an important role in setting the expectations for when and how local auditors report issues to the bodies they audit. One way the Code could do this would be by introducing explicit principles of effective reporting, to make clear the expectations that local auditor reporting should:

- report on a timely basis, clearly, concisely and objectively without fear or favour;
- when reporting in public, use language that readers will understand;
- use the most appropriate form of reporting available in the expectation that audited bodies ensure that the report is sufficiently prominent and accessible to people when published;
- set out to whom the report is addressed, the period to which it relates, its date, its purpose and the relevant duty or power under which the auditor is issuing it;
- reflect the wider scope of public audit by covering the range of audit responsibilities under the Code, which therefore includes reporting the auditor's judgements on significant risks in respect of VFM arrangements;
- be open and transparent about the scope and nature of the work carried out, significant risks and judgements such as the application of materiality, key findings, and, where appropriate, the type and level of assurance that the report provides across the range of audit responsibilities under the Code; and
- if making recommendations, be clear about what actions the audited body should take and when.

**37** Reporting requirements under the current Code are as set out in the table below:

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### Annual reporting requirements

Audit planning report	A report setting out the auditor's overall approach to the audit, including drawing attention to any significant risks identified as part of the planning process.
Report to those charged with governance	A report to those charged with governance in the organisation (often the audit committee) setting out the auditor's main findings, including details of errors that have been identified during the course of the audit. The report is usually issued shortly before the auditor concludes the audit.
Auditor's report	<p>The auditor issues a report to be published with the body's financial statement containing their opinion on whether the accounts give a true and fair view of the organisation's financial statements, and their conclusion as to whether the body had proper arrangements in place during the year to secure value for money; at local NHS bodies, auditors only include this conclusion where they are not satisfied that proper arrangements were in place.</p> <p>Auditors of clinical commissioning groups conclude whether income and expenditure are in accordance with relevant laws and regulations (the <i>regularity opinion</i>).</p> <p>Auditors also report other matters by exception, such as where there are concerns about the body's ability to continue to operate as a 'going concern' for the following 12 months, or if the information included in the Annual Governance Statement is inconsistent with the auditor's knowledge of the organisation.</p>
Statement on consolidation schedules (where relevant)	The accounts of local bodies are also consolidated into larger group accounts, such as those of the Department of Health & Social Care, or for the Whole of Government Accounts (WGA) process. Auditors therefore report whether schedules that feed into these processes are consistent with the audited financial statements.
Annual Audit Letter (where relevant)	<p>Under the Code, auditors issue an Annual Audit Letter (AAL) each year. The Letter is intended to be a public document and explains the main findings from the audit using non-technical language so that it is accessible to a wider audience.</p> <p>At NHS foundation trusts, auditors are not required to issue an AAL, but may do so by agreement with the trust.</p>
Audit completion certificate	At the end of the audit, the auditor certifies completion. This means that the auditor has discharged all of their responsibilities under the 2014 Act and the Code. Once the certificate is issued, the auditor can no longer exercise any powers in respect of that audit year.

### Other reporting, which can take place at any stage, where appropriate

Communication on specific elements of work	Auditors sometimes issue interim reports to update local bodies on their progress, or where there are specific matters they wish to flag during the year.
Public interest reports (PIRs) and 'Statutory' recommendations	Auditors can use these to draw public attention to an issue, as they require the audited body to discuss and respond publicly.
Referrals to the Secretary of State (health bodies)	Local auditors can make a referral to the Secretary of State where a body is about to take a decision or enter into a transaction that the auditor believes would be unlawful.

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**38** Through engagement with stakeholders while developing this issues paper, initial feedback suggests that reporting on local public bodies can, and should, go wider than the minimum 'basic' audit reporting of opinion and VFM arrangements conclusion. The inclusion of more meaningful information, including highlighting more clearly emerging risks that could impact the body over the medium term, would be considered helpful.

**39** It is clear from feedback that timeliness of reporting is also valued. When a conclusion on arrangements to secure value for money has been delayed, that value is reduced. This can especially be the case where, for example, a qualified conclusion is issued and refers to weaknesses that existed two or three years ago.

**40** The NAO's recent report on *Local auditor reporting in England 2018* identified that while auditors exercise their additional reporting powers, they do so infrequently. Auditors' additional reporting powers, such as issuing a statutory recommendation or public interest report (PIR), are not covered by international auditing standards, and so the Code and supporting guidance sets out the expectations and framework within which these powers are used. To support auditors further in this area, the Code could set stronger expectations about the use of these powers, such as when auditors would be expected to issue a statutory recommendation (which could, for example, be to accompany a qualified VFM arrangements conclusion).

**41** In relation to work on the VFM arrangements conclusion, an auditor can currently issue either an 'except for' or an 'adverse' qualified conclusion, where they are not satisfied with the arrangements in place. 'Except for' conclusions relate to weaknesses in arrangements in specific areas, such as poor financial planning or failure to manage a significant contract properly. 'Adverse' conclusions relate to weaknesses that are so widespread or extensive in their impact that the auditor is not satisfied that proper arrangements are in place. Examples of adverse conclusions include financial planning failures that are so significant that the body is in severe financial difficulty, or serious weaknesses in the quality of key services. It is the auditor's decision whether to issue an 'except for' or an 'adverse' conclusion. We are aware that this can be interpreted as implying that 'except for' qualifications are less serious, and therefore somehow less significant. In our view, any qualification is a significant matter and should be taken seriously. It is therefore important that the reporting of 'except for' qualification issues makes this clear.

**42** We are therefore interested in your views on the following:

**Question 12** **Do you think the information that is currently reported publicly by auditors helps local taxpayers understand the key issues and hold local bodies to account?**

If no, what would improve this?

**Question 13** **How could local reporting add more value to the audit for local public bodies and taxpayers?**

**Question 14** In the section on the auditor’s work on economy, efficiency and effectiveness, we explained that the auditor reports their overall conclusion against the criterion of whether they are satisfied that “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”. Do you think a single, overall criterion for reporting the adequacy of arrangements enables auditors to effectively communicate relevant issues, or would a number of more specific criteria be more effective?

If so, what sort of criteria would be helpful?

**Question 15** Do you think the options of ‘adverse’ and ‘except for’ conclusions to report weaknesses enables auditors to effectively communicate relevant issues?

If not, please explain your answer and how auditor reporting could be improved.

**Question 16** How could the results of audit work on economy, efficiency and effectiveness be reported more effectively and clearly?

### **Section Five: The auditor’s additional powers and duties**

**43** Auditors’ additional powers and duties are set out in the 2014 Act and reflect the wider scope of public audit. They involve:

- giving electors the opportunity to raise questions about the accounts;
- considering and deciding upon objections received in relation to the accounts;
- considering applying to the court for a declaration that an item of account is contrary to law;
- considering whether to issue an advisory notice; and
- considering whether, if appropriate, to make an application for judicial review.

**44** As we explained in the section on the principles underpinning the Code, the exercise of these powers can be an important tool in raising the profile of significant issues and promoting change, but it can also lead to significant additional costs, which are met by local bodies themselves. The impact of additional costs is particularly acute at smaller authorities, where any exercise of additional powers significantly increases the auditor's fees and can, in a few cases, amount to a sum that is equal to, or even in excess of, a smaller authority's annual budget. The exercise of additional powers and duties is at the auditor's discretion, based on their professional judgement. When determining whether to exercise any of their additional powers and duties, the Code currently sets out the following considerations which are considered to be relevant:

- the significance of the subject matter;
- whether there is wider public interest in the issues raised;
- whether the substance of the matter has been considered previously by the body's auditor;
- whether the substance of the matter falls within the scope of work conducted by an inspectorate or other body; and
- the costs of dealing with the matter, bearing in mind that these are borne by the taxpayer; and in the case of objections, the rights of both those subject to objection and of the objector.

**45** Through engagement with stakeholders while developing this issues paper, we have identified that it may be helpful for the Code to set out clearer expectations of auditors both in terms of when their powers might be used (as explained in the previous section on reporting), and about applying the principle of proportionality, particularly at smaller authorities.

**46** One area of auditors' work that often leads to a need to consider whether to exercise additional powers is when auditors need to consider objections from electors. In Question 3 we asked whether certain principles should receive more emphasis in the Code. This is one area of auditors' work where we are considering whether giving greater emphasis to how auditors might reasonably apply the principle of proportionality to deciding what action to take in response to an objection may be helpful, but this needs to be balanced with a recognition that public inspection and objection rights are important. Any changes to the Code should not result in weakening public rights, where they are being exercised reasonably.

**47** We are also aware that there can sometimes be a considerable period of time between an auditor receiving an eligible objection and their determination as to whether they will consider it, which can be frustrating for objectors, and for local bodies who may find it more difficult to budget for the likely costs of any work.

48 We are therefore interested in your views on the following:

**Question 17** Do you think the Code should include more with respect to when auditors might be expected to use their additional powers?

If so, which areas would this be most useful?

### **Section Six: Smaller authority assurance engagements**

49 Under the 2014 Act and supporting regulations, local auditors undertake work at smaller authorities:

- in compliance with the relevant parts of this Code; and
- in accordance with any procedures specified in guidance issued by the NAO on behalf of the C&AG (This is [Auditor Guidance Note 02](#)).

50 Smaller authorities are those whose annual gross expenditure is below £6.5 million. Examples of smaller authorities include town and parish councils, parish meetings, and internal drainage boards.

51 For smaller authorities, local auditors undertake a limited assurance review, rather than a full audit. To support a limited assurance review, audit firms follow specified procedures set out in guidance by the C&AG, and report only where matters have come to their attention that indicate the smaller authority has not complied with its accounting and governance requirements. Similarly, auditors of smaller authorities do not issue a VFM arrangements conclusion, although they still consider whether evidence has come to their attention that a body did not have adequate arrangements to secure economy, efficiency and effectiveness. Auditors would then report exceptionally on the issue where they found serious weaknesses.

52 Through engagement with stakeholders while developing this issues paper, we have identified there is broad agreement with the use of the specified procedures approach, and that the limited assurance review is proportionate to the risks at this type of local public body.

53 We are therefore interested in your views on the following:

**Question 18** Do you think the current approach set out in the Code to undertake work at smaller authorities under specified procedures will enable auditors to continue to respond to the challenges at smaller authorities?

If no, how should the approach be adapted?

**Question 19** Do you think the current approach to considering economy, efficiency and effectiveness at smaller authorities is appropriate and proportionate to the size of the bodies being reviewed?

If no, what would you like to change?

## **Section Seven: Potential implications of changes to the Code**

**54** The NAO has no remit in setting audit fees, but we are conscious that the content of the Code, and any changes made to it may impact on the work auditors need to do, the resources and skills that firms need to deploy on the audit, and potentially the fee required to fund this work. Therefore, we are interested in views about how auditors' capability and capacity might need to change to audit the financial statements and undertake their wider work on arrangements for securing economy, efficiency and effectiveness.

**55** We therefore welcome views on the following:

**Question 20** **Do you think local auditors have the appropriate capacity and capability to meet their responsibilities and to respond to the issues set out in this consultation?**

If no, how should auditors' capacity and capability be strengthened?

### **General comments**

**Question 21** **Are there any other ways in which you think that the Code could be further strengthened or improved?**

# Appendix One

## Local auditors' responsibilities

### Figure 1

#### Local auditors' responsibilities

##### Local auditors have a range of reporting responsibilities each year

Opinion on the financial statements	<p>Local auditors need to be satisfied that local bodies have prepared their financial statements properly and they give a true and fair view of the financial position. This means that the financial statements faithfully represent the financial performance and position of the body and are free from any misstatements that could affect the views or decisions of users.</p> <p>Local auditors must comply with International Standards on Auditing.</p>
Opinion on regularity	<p>Auditors of clinical commissioning groups must conclude whether or not income and expenditure is in accordance with relevant laws and regulations.</p>
Reporting on 'going concern'	<p>Auditors must report where they have concerns about the body preparing its financial statements as a 'going concern'. An organisation prepares accounts as a 'going concern' when it can reasonably expect to continue to function for the foreseeable future, usually regarded as at least the next 12 months.</p>
Emphases of matter	<p>Auditors may also decide to draw attention to an issue that they consider readers of the financial statements should be aware of.</p>
Conclusion on arrangements to secure value for money in the use of resources	<p>Local auditors must conclude whether bodies have made proper arrangements for securing value for money. This means that local auditors need to consider a wider range of issues than just the statement of accounts.</p> <p>Having proper arrangements in place means making well-informed decisions that allow them to deliver their services sustainably, and working effectively with partners and other third parties.</p> <p>The auditor's focus is on the arrangements bodies have in place. They do not conclude on whether the body provided value for money.</p>

Source: Comptroller and Auditor General, *Local auditor reporting in England 2018*, Session 2017–2019, HC 1864, National Audit Office, January 2019

**Figure 2**

## Additional powers applicable to different sectors

Additional powers	Type of local public body			Description
	Local government bodies	NHS trusts and clinical commissioning groups	NHS foundation trusts	
Public Interest Report	✓	✓	✓	Local auditors must consider whether there are any matters they need to draw explicitly to the public's attention via a Public Interest Report, such as failure to manage a major project. It imposes additional requirements on the local body, including holding a public meeting to consider the report and publishing a formal response.
Statutory Recommendation	✓	✓	N/A	At all local bodies other than NHS foundation trusts, local auditors also have powers to issue 'Statutory Recommendations', such as recommending a local authority produces more detailed and realistic savings plans. These are similar to Public Interest Reports and also require formal, public consideration and response, but they are addressed to the local body rather than the public.
Application to a court	✓	N/A	N/A	Where an auditor concludes that an item of account (an item of income or expenditure) is unlawful, the auditor can apply to the court for a declaration that the item of account is unlawful. For example, an auditor might do this when they believe that a council has spent money that it did not have legal powers to spend.
Advisory Notice	✓	N/A	N/A	Where an auditor believes that a local body is about to take a decision or enter into a transaction that the auditor believes would be unlawful, the auditor has power to issue an advisory notice. This requires the body to reconsider the issue and prevents it from making any further decision or taking any action for up to 21 days.
Judicial review	✓	N/A	N/A	Local auditors can seek a judicial review of decisions made by local public bodies, where they consider that the body may have acted unlawfully. To date, this power has never been exercised.
Section 30 referral	N/A	✓	N/A	The 2014 Local Audit and Accountability Act requires local auditors to make a referral to the Secretary of State where the body is about to take a decision or enter into a transaction that the auditor believes would be unlawful. Examples include a clinical commissioning group exceeding the expenditure limit set by NHS England or an NHS trust failing to break even.
Schedule 10 referral	N/A	N/A	✓	In the case of NHS foundation trusts, local auditors make a referral to the regulator where the trust is about to take a decision or enter into a transaction that the auditor believes would be unlawful.

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