



National Audit Office

Consultation response

by the National Audit Office

Local audit in England
Code of Audit Practice

Issues paper: Consultation
response

JULY 2019

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 (NAO) helps Parliament hold government to account for the way it spends public money. It is independent of government and the civil service. The Comptroller and Auditor General (C&AG), Gareth Davies, 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 government is delivering value for money on behalf of the public, concluding on whether resources have been used efficiently, effectively and with economy. The NAO identifies ways that government can make better use of public money to improve people's lives. It measures this impact annually. In 2018 the NAO's work led to a positive financial impact through reduced costs, improved service delivery, or other benefits to citizens, of £539 million.

Contents

Introduction 4

Background and context 5

Summary of consultation responses 7

Appendix One

Respondents to the consultation 26

Links to external websites were valid at the time of publication of this report. The National Audit Office is not responsible for the future validity of the links.

If you have any enquiries regarding this document, please email: lacg@nao.org.uk
Alternatively, please write to us at:

Local Audit Code and Guidance Team
National Audit Office
Green 2
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7842

Twitter: @NAOorguk

Introduction

1 The Local Audit and Accountability Act 2014 (the 2014 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 work. 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 and a new Code needs to be laid in Parliament in time for it to come into force no later than 1 April 2020.

2 In March 2019, the C&AG published an *Issues paper* seeking views on the issues relevant to the development of the next Code of Audit Practice. The document formed Stage 1 of a two-stage consultation process. Stage 2 will be undertaken in late summer/autumn of 2019 and involve public consultation on the draft text for the new Code, which will be developed after considering the responses to the consultation at Stage 1.

3 This document provides a summary of the responses received to the questions set out in the *Issues paper*. We received a total of 41 responses to the consultation. Appendix One provides a list of respondents. During the consultation period we also met with a range of stakeholders to inform further our understanding of the issues being raised.

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

Background and context

Scope of the consultation

1 The Code is a key document setting out how local auditors in England meet their responsibilities under the 2014 Act. Local public services account for a significant amount of public spending, delivering many of the public services local taxpayers rely on every day. Much of this money is raised through taxation, so public audit is wider in scope than that of the private sector. Taxpayers, national bodies and other stakeholders reasonably expect that the auditor will be able to provide assurance over whether the accounts have been properly prepared and are free from material error, and whether the body has proper arrangements in place to manage its business and finances. Through the principles set out in the Code, local auditors are expected to have regard to this wider scope by maintaining their independence, acting proportionately and efficiently, and reporting effectively to the public.

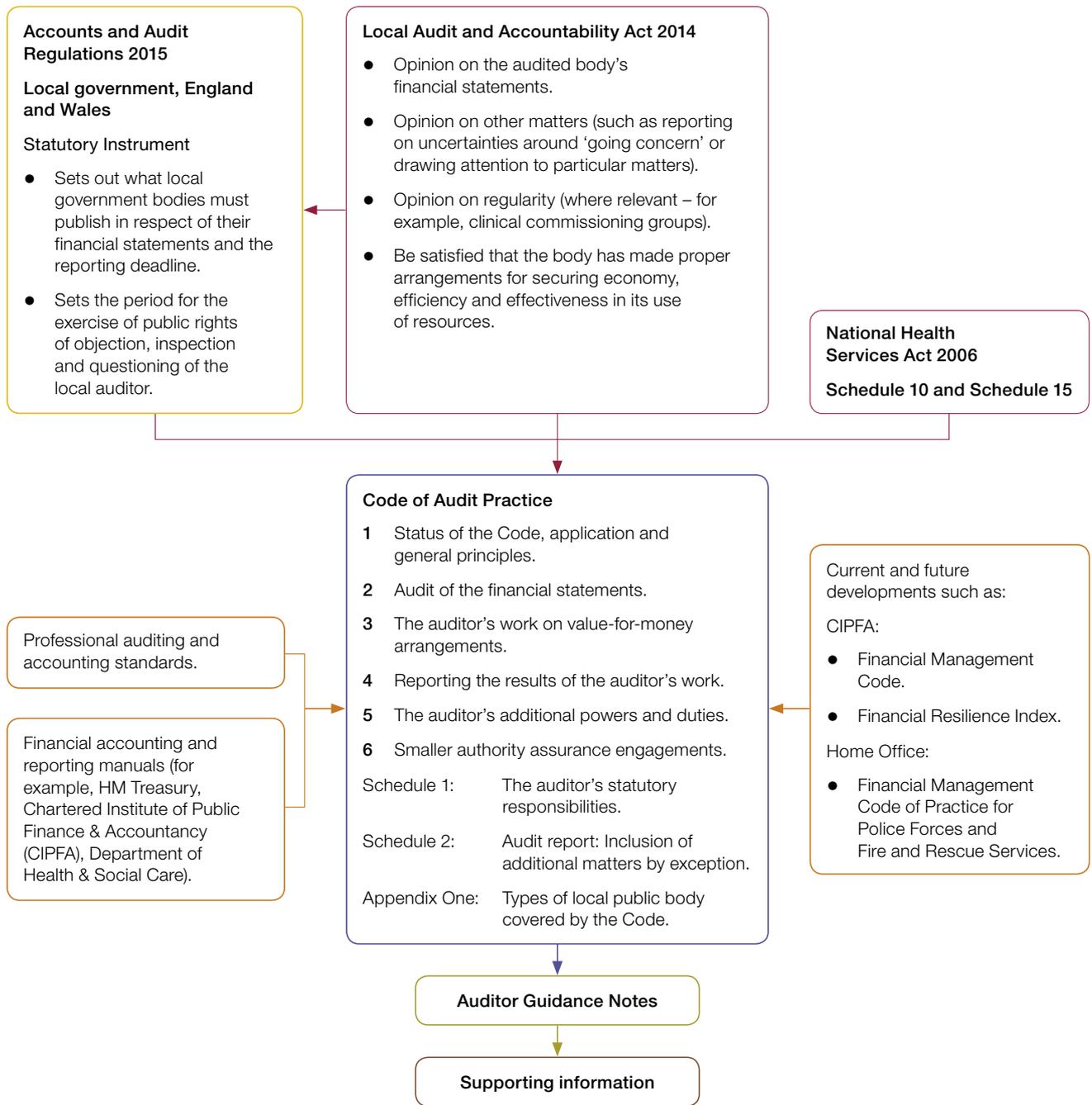
2 There are, however, limitations to how far the Code can influence the work auditors undertake. For example, while the Code sets out how auditors meet their responsibilities under the 2014 Act, it cannot add to, or take from, the duties on auditors that are set out in the 2014 Act itself. As the Code 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 overleaf sets out the areas which the Code can – and cannot – influence.

Purpose of the consultation

3 In the *Issues paper*, we sought views on:

- the developments and issues likely to 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.

4 We have received positive feedback on the two-stage approach to developing the Code that we have adopted. We have considered carefully the views of respondents in respect of the points drawn out from the *Issues paper* and this will inform the development of the draft Code.



- Primary legislation, therefore no medium-/long-term changes expected
- Secondary legislation, therefore no medium-/long-term changes expected

- Represents areas that are subject to changes but more in the medium term
- Medium-/long-term updates but reflects statutory legislation

- Short-/medium-term updates but reflects statutory legislation and the Code
- Updated more frequently and not statutory guidance

Summary of consultation responses

1 The *Issues paper* invited responses to 21 questions across the range of auditors' responsibilities under the Code. This summary of responses follows the structure of the *Issues paper* and focuses on the main themes arising as a result of respondents' feedback.

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

2 When the 2015 Code was adopted, the C&AG decided that the Code itself should be principles-based, which takes as its starting point long-established and enduring principles of public audit. These principles are the 'wider scope' of public audit; independence; and public reporting.

3 Through our initial engagement with stakeholders when developing the *Issues paper*, we identified broad support for maintaining the principles-based approach through a single Code covering both NHS and local government sectors (including police and fire).

4 We identified that financial pressures in the public sector mean that it is increasingly important 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.

5 We have also seen an increase in the exercise of local electors' rights to inspect and object to local authority accounts 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.

6 We were therefore interested to hear from respondents whether they agreed with a principles-based Code, but also whether the current principles were the right ones and whether any needed further emphasis.

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

7 There was strong support for the Code remaining principles-based. Respondents generally said that a more prescriptive Code could limit auditors' ability to make judgements in the light of local circumstances and risked the introduction of a 'tick box' approach to audit work.

8 Respondents also stressed, however, the need for a principles-based Code to be supplemented with more detailed sector-specific guidance to set out further expectations of how the principles should be applied.

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

9 Responses did not suggest entirely new principles to include but did highlight that some existing principles could be strengthened or drawn out more fully. These included:

- **Proportionality:** There was a recognition that auditors need to ensure that their responses to issues are proportionate. Local public bodies vary considerably in size and complexity, and respondents said auditors should give clear consideration to this when undertaking their work.

Comments with respect to proportionality were particularly focused on the exercise of auditors' additional powers (Section Four of the Code), where costs can rise very quickly – costs that ultimately are met by the local taxpayer. This issue was identified by respondents as being particularly acute at smaller authorities, such as town and parish councils, where the costs of considering an objection to the authority's accounts can quickly increase and possibly even exceed the authority's annual precept.

- **Professional scepticism and challenge:** The expectation that auditors will apply an appropriate degree of professional scepticism when approaching their work is an accepted element of professional auditing standards. It was suggested that it would be helpful for the Code to include an explicit reference to extend this expectation to cover work on arrangements to secure economy, efficiency and effectiveness, and assure the taxpayer that this is a key consideration in auditors' work.
- **Public accountability and acting in the public interest:** The 2015 Code refers to the "wider scope" of public audit. Several respondents suggested that this concept would be strengthened if it were focused more on the importance of the local auditor's role in ensuring public accountability for the management of public money, and in ensuring that auditors had regard to consideration of the public interest when carrying out their work. These comments were particularly linked to others in the *Issues paper* related to the exercise of auditors' additional powers, such as deciding whether to consider objections to local authority accounts, and whether to exercise additional reporting powers, such as issuing a Public Interest Report (PIR). There was also a view that auditors should clearly demonstrate that they add value or have an impact in the work that they do, for example providing commentary on issues likely to affect audited bodies over the medium term.

- **Public Reporting:** A suggestion that the principles of effective reporting as currently set out in the Auditor Guidance Notes on reporting should be elevated to the Code in order to give them greater emphasis.

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

10 While some respondents believed that the principle of proportionality should have more emphasis, respondents generally indicated that all principles should be considered to be equally important. This was because the principles would apply differently in different circumstances, and that it was therefore more important that auditors acted in accordance with all the principles, applying them appropriately to particular situations.

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

11 Respondents generally agreed that a single Code should be retained. Some respondents said that there may be circumstances when additional guidance should be issued to address any areas where there are distinct differences between sectors, but most acknowledged that the National Audit Office's (NAO's) current approach of supplementing the Code with sector-specific guidance where required was the best way of reflecting any such differences.

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

12 Respondents acknowledged that this is an area where activity is increasing, in terms of the number and complexity of arrangements in place. While it was clear that there was a role for the NAO through its Code and guidance to respond to this trend; there was a range of views as to how this might be achieved.

13 Some respondents argued that the Code should be more prescriptive in setting out how auditors should approach their work, especially where partnerships consist of non-statutory arrangements involving a range of local public and private organisations. Respondents were also clear, however, that an individual auditor's role should be in relation to the authority's engagement with the partnership, and not to go wider. Others agreed that this issue goes wider than local audit, and government more widely needs to consider how best to obtain assurance in this area, given that auditors are appointed to individual entities.

14 Where respondents identified a role for the Code, the most common suggestion was that the Code should emphasise through its principles the need for auditors to act constructively in respect of work at partnerships and joint arrangements and coordinate their work where possible to minimise duplication. This could then be supported through additional statutory guidance supporting the Code if necessary.

NAO response to Section One

15 Having considered the comments received during the consultation, we propose to maintain a single Code supported by sector-specific guidance to clarify expectations in particular areas and allow flexibility for adapting to any future changes.

16 We will review the current principles and consider strengthening references to those relating to proportionality, professional scepticism and acting in the public interest to help explain the importance of the wider scope of local public audit, and we will consider whether elements of existing auditor guidance on reporting should be elevated to the Code.

17 Outside the Code, we will reflect on what further we can do to enhance our guidance to auditors in respect of their approach to considering partnerships and other joint arrangements. We will engage with relevant authorities (for example, regulators and government departments) on the wider issue of supplementing the assurance from local auditors, such as providing further guidance/clear expectations of individual bodies in relation to the financial governance of partnerships.

Section Two: Audit of the financial statements

18 The 2014 Act sets out the requirement for local auditors to give an opinion on the body's statement of accounts. To meet their duties, 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 (FRC), and the NAO on behalf of the C&AG.

19 Through engagement with stakeholders while developing the *Issues paper*, we received representation that auditors do not focus their attention on those balances which some finance directors consider to be most important. We also received strong representation from other stakeholders that the principle of maintaining the link to international auditing standards was an important principle that should remain and is consistent with the requirement in the 2014 Act for the C&AG to ensure that the Code is based on best professional practice. We are also mindful of the wider debate within the audit profession (such as the Brydon review),¹ and the importance of the Code being able to keep pace with any subsequent developments.

20 We therefore sought to understand, through the *Issues paper*, how stakeholders more widely viewed the issues.

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

21 There was strong agreement overall from respondents that the Code should continue to align its requirements with generally accepted auditing standards.

¹ The Brydon review is an independent review, led by Sir Donald Brydon, which will look at the quality and effectiveness of audit and make recommendations for change if considered appropriate.

22 However, a significant minority of respondents noted, especially with regard to local government audits, that this results in auditors focusing considerable amounts of resource on auditing figures in the financial statements that some preparers see as being less important, such as valuations of certain types of asset, or the valuation and disclosures of pension liabilities. Some argued that auditors should focus on the figures in the financial statements that have a direct impact on the council tax requirement, as these are the figures that are of most interest to local authorities and local taxpayers.

23 There was, however, a general recognition that while there was an argument for the Code to seek to require auditors to apply auditing standards differently at some local public bodies, this issue went wider than the auditor's remit. This could perhaps be addressed more effectively through engagement with relevant standard setters and regulators in respect of the current accounting requirements, to inform the ongoing debate about 'streamlining' financial statements in the public sector to reduce the size and complexity of financial statements.

24 The NAO acknowledges the comments made as part of the consultation in respect of some respondents' views of the current accounting and auditing requirements for particular sections of the financial statements. We will continue to work with relevant regulators and standard-setters to take forward this debate.

25 Respondents also acknowledged, given the wider ongoing debate about the scope and nature of audit work more generally, that it was important for the Code to remain sufficiently flexible to adapt to any future changes. Aligning the Code to accepted professional practice ensures that public auditors' work on the financial statements remains subject to requirements as these develop across the profession more widely.

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

26 While a number of respondents identified issues with certain aspects of auditing the financial statements, such as property, plant and equipment and pension liability balances in local government, and large estimates such as prescribing in local NHS bodies, there was general acceptance that these issues stem more from the underlying accounting requirements than from the requirements at audit.

27 Most respondents, however, acknowledged that even where accounting or auditing requirements are difficult, this did not, in itself, mean that generally accepted auditing standards should not apply.

NAO response to Section Two

28 In our original *Issues paper*, we stated our view that “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”. Based on the engagement to date and the feedback from respondents to the consultation, we have not seen sufficient evidence to change our view. We therefore propose that the Code remains aligned to generally accepted auditing standards. It is important that local public bodies broadly comply with International Financial Reporting Standards (IFRS) and are audited to International Standards on Auditing (ISAs). This is an important discipline, which supports the credibility and consistency of financial reporting in the public sector as a whole. From a wider perspective, it also supports the “Whole of Government Accounts”² process.

29 We will, however, consider whether there is more that our guidance to auditors can include to assist them in making judgements about how they approach the audits of financial statements in the public sector.

30 We acknowledge the wider points raised in this area about the challenges that the current accounting framework can present to audited bodies and local auditors. We would stress the importance, however, of the points we raised in our *Issues paper* that 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.

31 While we do not consider it to be appropriate to seek to address these issues via the Code itself, we will look to continue this debate with relevant regulators and other relevant bodies, such as the Chartered Institute of Public Finance and Accountancy (CIPFA), the Department of Health & Social Care (DHSC), the Ministry of Housing, Communities & Local Government (MHCLG), and the FRC.

² Whole of Government Accounts (WGA) is a consolidated set of financial statements for the UK public sector.

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

32 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, including consideration of the arrangements local public bodies have in place to manage their business and finances. 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).

33 Currently, the auditor reports against a single overall criterion as to 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."³

34 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, but 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, other assets or alternative delivery models to generate additional streams of income.

35 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.

36 We were therefore interested in views on the current approach, terminology and methods of reporting to inform the development of the Code in this area.

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

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?

37 Respondents set out a range of factors that they felt would be relevant to local audit work in this area over the coming years. This information provided a significant amount of case detail and will be useful to us in developing the associated sector-specific guidance to local auditors supporting the Code.

38 For the Code itself, the common issues identified fall into three main categories:

- Financial sustainability – how the local body plans to ensure adequate resources to allow the continued delivery of service.
- Financial governance – whether the authority takes informed decisions when setting its budget and has adequate budget and risk management arrangements.
- Wider partnership working – how local auditors can cooperate effectively with each other when reporting on partnership working. Partnerships are often non-statutory arrangements in which local auditors can only report on the arrangements in place within the individual bodies they audit.

39 There was, in addition to the themes set out above, support for auditors to continue to be able to report, even if by exception, on areas within the full scope of VFM arrangements.

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

40 We received a mixture of comments in response to this question. Some respondents said that while the terminology was understood by auditors and finance staff, it may be less well understood by others. For example, on some occasions the auditor’s conclusion on arrangements to secure VFM is read as being a conclusion on the achievement of VFM. This creates an ‘expectations gap’ between the assurance the auditor is providing, and that being taken from the conclusion. In addition, there was a view that auditors should not be concluding on arrangements that audited bodies themselves have not provided management assertions against.

41 Some respondents suggested that it may be helpful to consider re-naming the work in this area to both better describe the nature of the work and the assurance provided. Others, however, were content that the current terminology adequately describes the work undertaken and the nature of the conclusion. These responses were, on occasion, supplemented by the argument that a change in terminology could have a negative impact on the extent to which the nature of the auditor’s work in this area is understood.

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

42 We again received a relatively wide range of responses to this question. In summary, responses focused on the following issues:

- Risk-based approach: There was broad agreement that the existing scope of work incorporating a risk-based approach is appropriate in principle and should not be narrowed. However, some respondents also said that within the risk assessment some areas of focus should be specified, most notably in respect of financial sustainability and financial governance.
- Nature of the risk assessment: Some respondents said that the current approach, where the auditor assesses the ‘engagement’ risk (the risk of reaching an incorrect conclusion), should be clarified by focusing more on the risk of weaknesses in the arrangements themselves.
- Nature of the assurance provided: Some respondents suggested that the current format of auditors’ work – a conclusion giving positive assurance on the adequacy of arrangements – should be revisited, and the nature of assurance provided in this area should change, so that the conclusion could either be replaced or accompanied by a narrative style commentary on key areas, such as the body’s arrangements for securing financial sustainability.
- Focus on arrangements: While most respondents understood the requirement is for the auditor to focus on the arrangements bodies have in place to support the delivery of VFM, some argued that this should be extended to assessing the operational effectiveness of arrangements, or even concluding whether the delivery of VFM had been achieved.

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?

43 There was broad agreement that allowing auditors more flexibility when considering areas to focus on as part of their work would be helpful. However, this was balanced with the need to ensure that any work of this type remained compliant with ethical standards, could not be considered as advisory work and did not lead to an unjustified increase in the fee charged.

44 Respondents drew attention to the number of ‘emerging’ issues in public services, such as increasing commercial activity, more partnership working and new approaches to service delivery, which can all have a significant impact on financial sustainability. Respondents argued that the flexibility to consider issues that might have an impact on bodies’ financial sustainability over the medium term, but which did not necessarily constitute a significant risk to the current financial year, would enable bodies to take corrective action earlier, should the auditor raise concerns.

NAO response: Section Three

45 We will consider whether the new Code should introduce a requirement for auditors to consider and report on specified risks each year such as risks to financial sustainability and financial governance. However, auditors should retain the ability to take account of local circumstances when determining the amount of work necessary to respond to these risks. We will also consider whether to give auditors more flexibility to consider emerging risks, which may not constitute a significant risk in the year of audit, but which may have a significant impact on the audited body over the medium term.

46 We are aware of the 'expectations gap' that can arise from the difference between the auditor's focus on arrangements to secure VFM and concluding on whether a body has delivered VFM. Local bodies need to be able to demonstrate how they obtain assurance that the arrangements they have in place to manage their business and finances are working as intended and delivering the expected outcomes. Therefore, while the auditors' focus will remain on the arrangements that bodies have in place, auditors will also be interested in considering how local bodies gather this assurance.

47 We will consider making more explicit the need to consider the body's own internal assurance over its arrangements for ensuring they are operating effectively.

48 We will consider how the auditor should report their findings on the adequacy of arrangements, and whether this should continue to include an annual conclusion or be replaced, or supplemented, by a commentary on the specified risks set out in auditor guidance.

49 We will consider whether a change of terminology will help address the issues raised. We will also consider whether the Code can more clearly describe the nature of the work undertaken and the assurance provided.

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

50 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. Auditors need to ensure that where they are identifying risks and issues, 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.

51 The Code can play an important role in setting the expectations for when and how local auditors report issues to the bodies they audit, and so we were interested in views about how auditors currently report the results of their work, and whether these could be improved.

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

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 regularity opinion).</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 AAL 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, is set out below

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.

53 Through engagement with stakeholders while developing the *Issues paper*, there was a view that reporting on local public bodies can, and should, go wider than the minimum 'basic' audit reporting of an opinion and a 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.

54 Timeliness of reporting is also valued, both in terms of reporting promptly (meeting a particular reporting deadline) and ensuring that issues are raised at the appropriate time. Conclusions on VFM arrangements, for example, can be delayed for more than a year in some cases (for example, where an auditor is considering an objection to a local authority's accounts). In such cases, the impact of the conclusion, especially where it is qualified, is significantly reduced.

55 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.

56 We therefore sought views from respondents on how effectively the current reporting arrangements helps local taxpayers understand the key issues and hold local bodies to account and asked how reporting by local auditors could be more effective.

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?

57 While some respondents were content that local auditor reporting was sufficient to enable local bodies to be held to account, more respondents felt that reporting could be more effective. Many respondents drew attention to the language used in reports, which they stated made them less accessible to those with a non-financial background.

58 Some respondents said that the auditor's Annual Audit Letter (AAL), intended to be an accessible summary of the auditor's work during the year, added little to that already reported elsewhere. Suggestions for how to address this issue, however, were varied. Some proposals were that the AAL should be re-focused to comment on future risks, the body's overall financial position and set out any recommendations made by the auditor. Others, proposed that the AAL should be removed from the Code's requirement, with more detailed reporting of the auditor's work included in an 'enhanced' report, issued alongside the opinion on the financial statements, detailing the opinion and VFM risks identified and the auditor's response.

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

59 A significant number of respondents argued that additional commentary on issues such as financial sustainability and emerging risks would add more value to local auditors' reports.

60 Others argued that the auditor’s work on the opinion and wider issues such as VFM arrangements should be split from the opinion work and reported on separately, either at a different time of year, or in a separate report (such as the AAL or equivalent).

61 There was broad agreement that auditor reporting would be more valuable if there was explicit follow-up and reporting of actions taken in response to previous recommendations, to demonstrate whether the body was responding adequately to the auditors’ concerns.

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?

62 We received a range of responses to this question, which broadly fell into two categories:

- those who were satisfied with the current single overall criterion, as it allowed the auditor freedom to report on the issues they considered to be most significant; and
- those who would prefer the auditor to report against more specific criteria. Within these criteria, most respondents highlighted reporting on financial sustainability (and associated areas such as levels of reserves, budget-setting and medium-term financial planning) and reporting on the effectiveness of governance arrangements as being most important.

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

63 Views expressed in responses to this question ranged from; support for the existing approach; to suggestions that the distinction is dropped; and that where auditors qualify a conclusion they include more narrative to explain the conclusion they have reached.

64 Comments from those suggesting further narrative from the auditor in support of their conclusion also included reference to the current language used not always being accessible and, in our wider engagement around the new Code, we also encountered reference to a ‘boiler plate’ approach from local auditors, where standardised wording was applied to particular types of qualification.

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

65 The overall theme from responses to this question was the need for clarity from reporting. Suggestions on how this could be achieved ranged from the introduction of ‘enhanced reports’ (as referenced in paragraph 58), to the requirement for the auditor to provide a clear commentary on key areas, such as financial sustainability and governance.

66 Some local government respondents suggested it would be helpful for bodies to have an opportunity to respond to the auditor’s comments in this area, so that they can set out how they plan to address the issues. This was mirrored in some responses to question 12 about the effectiveness of current reporting, where some respondents suggested that concerns about significant weakness in arrangements to secure economy, efficiency and effectiveness could be supported by statutory recommendations for improvement from the auditor. This would allow, and in fact require, the body to consider and respond to the recommendation publicly.

NAO response to Section Four

67 We agree ensuring local auditors report effectively is crucial to ensuring the work of local auditors is valued, has impact and contributes to the improvement of local public services. We are therefore proposing the following in respect of the new Code.

68 We will consider whether the Code should put greater emphasis on the need for ‘timely’ reporting, not only in terms of reporting by required deadlines, but also in terms of raising issues at the appropriate time, and also escalating them appropriately through the exercise of additional powers where necessary.

69 We will set a clear expectation that when auditors report their findings, they should set out their judgements clearly along with a summary of the evidence on which those judgements are based. The auditor should also explain the impact the judgement has on the body itself and set out clearly the actions the auditor is recommending that the body take in response.

70 We acknowledge the differing views between respondents on the usefulness of the AAL. We will consider whether the Code can set out the elements upon which auditors are expected to report in their opinion on the financial statements and what could be more effectively reported in a separate, public-facing annual auditor’s report. This would replace the AAL, be issued at the same time as, or as soon as possible following, publication of the auditor’s opinion on the financial statements and cover the full range of local auditors’ responsibilities.

71 There would be an additional requirement to formally follow-up and report on progress against previous recommendations and set out the auditor’s view of the adequacy of the body’s response. We would also expect auditors to clearly state where they are making recommendations that require a public response from the audited body (such as those made under Schedule 7 of the 2014 Act).

Section Five: The auditor's additional powers and duties

72 Auditors' additional powers and duties are set out in the 2014 Act and reflect the wider scope of public audit. The additional powers and duties 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.

73 The NAO's 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 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).

74 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.

75 For this consultation, therefore, we were interested in views on whether it may be helpful for the Code to set out clearer expectations of auditors in terms of when their powers might be used.

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

76 From the responses received, there was broad agreement that more guidance from the NAO would be helpful in this area, while acknowledging that the exercise of these powers is for the local auditor to determine, based on their professional judgement.

77 Areas where additional guidance was considered to be particularly helpful were in relation to:

- application of the principle of proportionality to the exercise of additional powers;
- auditors' approach to considering objections to accounts; and
- scenarios where auditors should consider exercising powers, such as statutory recommendations in response to significant weaknesses identified in arrangements to secure economy, efficiency and effectiveness.

78 Some responses also noted the importance of effective communication about the consideration and exercise of powers, as well as the exercise of the powers themselves, highlighting the need for auditors to actively engage with audited bodies and local electors on these issues.

NAO response to Section Five

79 We acknowledge the desire for further support and guidance in this area, both to assist auditors in exercising their powers appropriately, and to assist the wider public in understanding the nature and extent of these powers.

80 We agree that more can be set out in the supporting statutory guidance than in the Code itself. We will therefore consider updating our guidance on additional powers and duties to take account of the issues raised in the consultation.

81 There are, however, some important principles highlighted here that we may consider reflecting more strongly in the Code:

- an expectation that auditors will report on whether they have exercised any of their additional powers and the considerations relevant to their decision; and
- an expectation for auditors to determine promptly whether they will accept an objection for consideration and that they will actively communicate with the elector and the audited body on progress.

Section Six: Smaller authority assurance engagements

82 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 set out in [Auditor Guidance Note 02](#).

83 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.

84 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.

85 We were therefore interested in views on the effectiveness of the current approach.

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?

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?

86 Responses to these questions were broadly supportive of the overall limited assurance approach under specified procedures. However, respondents noted developments in the sector that they thought should be considered, including:

- the need to be clear about the status of the auditor’s work, in that it is not a full audit, as this can lead to an expectations gap about the amount of work undertaken and the level of assurance applied; and
- the need to recognise that smaller authorities are becoming more complex as, in some cases, they take on functions previously carried out by upper or second-tier councils. With some smaller authorities spending well in excess of £1 million annually, it may be appropriate to consider specifying additional procedures for some of the larger bodies.

NAO response to Section Six

87 Following this consultation, we propose to continue the existing approach of a limited assurance engagement under specified procedures. We will, however, review the wording in the existing Code to determine whether the Code can make clearer the nature of the engagement and the assurance provided.

88 We will also review our supporting statutory guidance and consider whether additional procedures need to be added for bodies with higher levels of income, expenditure or complexity.

Section Seven: Potential implications of changes to the Code

89 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 were 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.

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?

90 Responses to this question focused on two main areas:

- The need for auditors to ensure that they are sufficiently familiar with the legislative and regulatory frameworks in which they operate, much of which is sector-specific.
- The need to ensure that the local public audit market is sustainable, which includes the need to recognise and give prominence to what is different about public audit; namely the focus on the wider areas of economy, efficiency and effectiveness, and reporting in the public interest to promote improvement.

NAO response to Section Seven

91 We agree with the importance of maintaining an effective local public audit market, and the need to attract auditors committed to supporting the principles of public audit discussed in Section One.

92 While the NAO has no remit in respect of audit fees or the auditor appointment process, we will be mindful of the potential implications that changes to the Code can have for the resources needed to complete the audits and the potential for that to require an increase in fees. We do not, however, consider that this should prevent us from making changes to the Code where they are appropriate and will lead to improvements in the value of local public audit.

93 It was clear from the consultation that respondents rightly expect that local auditors must have the necessary skills and knowledge to discharge their functions effectively. We will consider whether we should introduce an expectation that firms undertaking local audit work have arrangements in place to ensure that audit teams have sufficient knowledge of the relevant public sector financial reporting and regulatory frameworks.

94 We will also consider the comments in respect of the level of focus on the wider elements of public audit when finalising our proposals for the text of the new draft Code.

General comments

95 Finally, we were interested in any additional comments that respondents wished to make. The majority of comments added to, or emphasised, points referred to elsewhere in the consultation. However, one theme that could be identified was the need for the Code to be clear about the nature of public audit, and for whom the audit is undertaken.

96 These are important principles that underly the public audit process. We will therefore consider, when revising the Code, whether there is more that the Code itself can say to put into better context both the nature – and the importance – of public audit and the assurance it provides.

Appendix One

Respondents to the consultation

Respondents to the consultation were as follows:

- National Association of Local Councils (NALC)
- Sheffield City Council
- Ichabod's Industries Ltd (LA Accounting & Capital Finance)
- Illogan Parish Council
- PKF Littlejohn LLP
- Basildon Borough Council
- Grant Thornton LLP
- Financial Reporting Council (FRC)
- London Borough of Haringey
- Society of County Treasurers
- Northern Ireland Audit Office
- North Yorkshire County Council
- Healthcare Financial Management Association (HFMA)
- Lancashire Care NHS Foundation Trust
- Commissioners to Northamptonshire County Council
- Devon County Council
- NHSE and NHSI (combined)
- Association of County Chief Executives
- Local Government Association
- Southend-on-Sea Borough Council
- Suffolk County Council
- Mazars LLP

- EY LLP
- Smaller Authority Audit Appointments Ltd
- Society of District Council Treasurers
- Deloitte LLP
- District Councils Network
- Hertfordshire County Council
- Chartered Institute of Public Finance and Accountancy (CIPFA)
- Public Sector Audit Appointments Ltd
- Research for Action
- Data Diligence
- Stoke on Trent City Council
- KPMG LLP
- BDO LLP
- Department of Health & Social Care
- PwC LLP
- Audit Scotland
- Ministry of Housing, Communities & Local Government
- Responses from 2 private individuals

© National Audit Office 2019

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.org.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.



National Audit Office