



National Audit Office

Consultation document

by the National Audit Office

Local audit in England
Code of Audit Practice

Draft Code Consultation

AUGUST 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.

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Introduction

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.

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. The National Audit Office (NAO) received 41 responses to the *Issues paper* and published its [response to Stage 1](#) of the consultation in July 2019.

This document forms Stage 2 of the consultation and it provides a summary of the key changes included in the draft Code.

How to respond

Please respond by 22 November 2019.

We have set out in this paper a summary of the proposed changes. The proposed text of the draft Code can be found on the NAO's [website](#).

When responding to the consultation, please refer as far as possible to the relevant chapter of the draft Code and paragraph(s). It would be very helpful if you could also provide additional explanation and detail where appropriate, to help us understand the basis for your comments.

Please do not feel that you need to comment on the entirety of the draft Code; we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Please email your response to lacg@nao.org.uk.

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.

If you need paper copies of this consultation document 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.

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.

Next steps

Following this consultation, we plan to finalise the text of the new Code by the end of 2019, in order for it to be laid in Parliament early in 2020. This is necessary so that the Code can come into force from 1 April 2020. We intend to publish our response to Stage 2 of the consultation in early 2020.

During the consultation period, we will also consult stakeholders and other interested parties to develop the detailed supporting guidance that will underpin the changes set out in the Code. The guidance will be published by the autumn of 2020 to enable auditors to complete their work under the new Code and report in summer 2021.

Background and context

Scope of the consultation

1 The Code of Audit Practice is a key document setting out how local auditors in England meet their responsibilities. 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 In Stage 1 of the consultation, we set out the scope of the Code and the areas it is able to influence. This consultation focuses on the proposed text of the new Code.

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 drawn on the information gathered from Stage 1 to inform the development of the new draft Code. We believe the new Code will put a sharper focus on value for money and a greater emphasis on effective reporting. We are grateful to those who responded to the consultation for their contribution.

Summary of proposed changes to the draft Code

1 This section summarises the changes proposed within the text of the draft Code.

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

2 When the 2015 Code was adopted, the C&AG decided that the Code should be principles-based, taking 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 We received clear feedback that a principles-based approach remains appropriate for the draft Code. We have therefore retained this approach but have made clearer how the principles set out in the Code link to the wider principles of public audit, grouping them into the areas set out above.

4 We have clarified expectations under the 'wider scope' principle that this also means auditors need to ensure that teams have the necessary skills and knowledge of the relevant financial reporting and regulatory frameworks to enable them to deliver their audit work.

5 Public accountability also acknowledges that local auditors have interactions with members of the public, including local electors. These interactions are important, and so auditors need to ensure that they have open and transparent arrangements in place for engaging with the public effectively.

6 Under public reporting, we have clarified our expectations through introducing a reference to what we consider to be the key principles of effective reporting. This will emphasise the need for auditors to ensure that when reporting their findings, making recommendations, or exercising any of their wider functions, they ensure their reporting to local bodies – and to the wider public – is as effective and transparent as possible and promotes local improvement.

7 The 2015 Code covers both NHS and local government sectors (including police and fire bodies). We saw general agreement from responses to the Stage 1 consultation that a single Code supported by sector-specific guidance is effective. We have therefore maintained a single Code and will continue to support it with sector-specific statutory guidance.

Chapter Two: Audit of the financial statements

8 The 2014 Act, and the NHS Act 2006 for NHS foundation trusts, 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.

9 The draft Code remains aligned with generally accepted auditing standards and has not introduced any adaptations or set any further requirements on how these standards should be applied. This approach will also allow the draft Code to adapt to any changes arising as a result of the wider debate within the audit profession (such as the Brydon review and the Redmond Review).^{1,2}

10 We have, however, considered the level of detail with which auditors report. There are circumstances when auditing standards require auditors to report their findings in more detail. This is known as enhanced auditor reporting and means that in addition to giving their opinion on the financial statements, the auditor also includes other information, including the scope of their work, the audit risks they have identified and how they have responded to them. Enhanced auditor reporting is becoming more widespread across other sectors and we have therefore included in the draft Code the option to introduce enhanced auditor reporting under auditing standards on the financial statements at some, or all, local public bodies.

11 Auditors of NHS foundation trusts (FTs) already issue enhanced auditor reports at all FTs irrespective of size. The NAO, on behalf of the Comptroller and Auditor General, will consider the extent to which enhanced auditor reporting may be appropriate at other local public bodies, and will specify any such reporting requirements through its statutory guidance to auditors.

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

12 The 2014 Act, and NHS Act 2006 for NHS foundation trusts, 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).

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.

² The [Redmond review](#) is an independent review, led by Sir Tony Redmond, which will look at the quality and effectiveness of audit in local authorities. This review will meet the Ministry of Housing, Communities & Local Government's commitment to undertake a post implementation review of the audit framework and financial reporting elements of the Local Audit and Accountability Act 2014.

13 Informed by the engagement with stakeholders as part of developing this Code along with the responses to Stage 1 of the consultation, the draft Code sets out a new approach to auditors' work in this area, putting a sharper focus on VfM and an expectation of clearer and more timely reporting.

14 The approach to assessing arrangements to secure VfM under the current Code enables auditors to report their conclusion on overall arrangements, but in reviewing the Code, we think there is more that the Code can do to maximise the impact of local audit work. A significant proportion of the work envisaged under the draft Code is already undertaken by local auditors. The new approach will extract more value from this work and make auditor reporting more useful to the audited body and the wider public. It will not result in any form of scored judgement or rating or require local bodies to compile any form of self-assessment.

15 While the focus on the arrangements the body has in place and the risk-based approach to auditors' work is retained, the draft Code revises the previous reporting criterion to cover the following:

- Financial sustainability: How the body plans and manages its resources to ensure it can continue to deliver its services.
- Governance: How the body ensures that it makes informed decisions and properly manages its risks and finances.
- Improving economy, efficiency and effectiveness: How the body uses information about its costs and performance to improve the way it manages and delivers its services.

16 Under each of these criteria, statutory guidance will set out the procedures that auditors will need to undertake. An initial review of arrangements will consist of mandatory procedures to be undertaken at every local public body, but also allow additional risk-based work where there are emerging issues that are relevant to the auditor's commentary over the medium term.

17 Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances.

18 Stage 1 of the consultation identified that local public bodies are involved in more partnership working, both within and across sectors. Assessing the impact of partnership arrangements can be problematic for the local auditor, because their binary conclusion on arrangements can only cover the arrangements that are in place at the body they are appointed to audit. Replacing the conclusion with a commentary will enable auditors to reflect the local context more effectively, especially with regard to the ways in which local NHS bodies are working together across geographical areas.

19 To ensure clear reporting and that action is taken where needed, the Code requires that where auditors identify significant weaknesses from their work on arrangements, they report this publicly and issue recommendations to help the body understand what it needs to do to improve its arrangements.

20 We also received feedback from Stage 1 of the consultation that the binary conclusion, in some cases, led to the use of ‘standardised’ or ‘boiler plate’ wording to describe the issues giving rise to a qualified conclusion. This was seen as reducing the value of the conclusion to those charged with governance and did not always lead to action being taken in response.

21 We believe that introducing commentary taking account of local context and recommendations that clearly set out the actions the auditor expects the body to take will make auditor reporting more meaningful and impactful. Replacing the binary conclusion with a commentary will also enable auditors to report their findings annually without the need to delay reporting where there are outstanding matters to resolve.

Chapter Four: Reporting the results of the auditor’s work

22 Local auditors undertake an important 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. Through inclusion of principles of effective reporting in Chapter One, the draft Code sets more detailed expectations about what effective reporting should look like and how auditors should approach deciding when – and how – to report.

23 In its report *Auditing local government*, the Public Accounts Committee said “we drew attention to how difficult it can be for members of the public, or even experienced MPs, to track down information such as audit reports for local public bodies”.³ In recognition of this, our work developing the new Code offers a valuable opportunity to look again at how auditors report and consider whether the Code can do more to support effective and transparent reporting to local bodies and to the wider public.

³ HC Committee of Public Accounts, *Auditing local government*, Eighty-fifth Report of Session 2017–19, HC 1738, March 2019

- 24** The main outputs in terms of local auditor reporting each year will therefore be:
- The auditor's report on the financial statements: The audit report should cover only the results of the auditor's work on the financial statements as required by the Code. This includes any reporting required by auditing standards to those charged with governance, such as the report issued shortly before the completion of the financial statements audit under International Standard on Auditing ISA (UK) 260.
 - The auditor's annual report: The auditor's annual report should bring together all of the auditor's work over the year. A core element of the auditor's annual report will be the commentary on the specified reporting criteria regarding VFM arrangements set out in Chapter Three. The report will be intended to provide a clear, readily understandable commentary on the auditor's findings and highlight any issues that the auditor wishes to draw to the attention of the body or the wider public. The auditor's annual report should include details of any recommendations issued during the course of the year to ensure that all recommendations made by the auditor are accessible and reported publicly. The report should also include details of whether the auditor has exercised any of their additional powers and duties.
- 25** In relation to the opinion on the financial statements, the draft Code maintains the clear expectation that local auditors will complete their work and issue their opinion on the financial statements in time to allow local public bodies to meet their statutory deadlines for publication of audited accounts.
- 26** For work on arrangements to secure VfM, the draft Code introduces the expectation that where work identifies significant weaknesses in arrangements, the auditor will issue a recommendation to the body, setting out the auditor's 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 body should take in response. The draft Code also expects that, when they identify significant weaknesses in arrangements, the auditor considers whether to make their recommendation immediately, rather than wait until the end of the audit.
- 27** The draft Code allows the auditor's annual report to be published alongside their report on the financial statements, or separately, but not later than 30 September. Where the auditor is unable to publish their annual report by 30 September, the draft Code requires them to publish a statement explaining the reason for the delay.

Chapter Five: The auditor's additional powers and duties

28 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.

29 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 draft Code therefore emphasises the need to consider the impact of exercising additional powers, including considering the proportionality of their response.

30 The draft Code also puts additional emphasis on the need for auditors to consider the public interest more widely when deciding whether to issue a Public Interest Report, as a result of receiving an objection. The draft Code sets the expectation that auditors will not only consider the extent to which the issue is already known to the public, but also consider whether it is in the public interest for the auditor to publish their independent view on the matter.

31 Chapter Five also includes a new section setting out expectations on the speed with which auditors should consider any formal objections to a local authority's accounts. The draft Code sets out the time period within which each stage of the objections process should be completed and, where it is not possible for the auditor to meet that timescale, requires them to provide to both the objector and the local authority progress updates on a quarterly basis until such time as the objection has been decided. These additional expectations have been introduced to help to speed up the objections process and to ensure better communication with local electors.

Chapter Six: Smaller authority assurance engagements

32 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.

33 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](#).

34 The draft Code does not make any changes to the overall approach to undertaking work at smaller authorities. It does, however, draw auditors' attention to the changes set out in Chapter One regarding considering proportionality and in Chapter Five covering auditors' approach to exercising their additional powers, including considering objections.

Wider implications of the new Code

35 We are conscious of the possibility that changes made to the Code will alter the amount of work auditors need to do, the resources and skills that firms need to deploy on the audit, and therefore potentially the fee required to fund this work. We are continuing to engage with local auditors and other key stakeholders as part of Stage 2 of this consultation to understand in greater detail the potential impact. We will take account of the feedback from this engagement as part of finalising the draft Code.

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