



Auditor Guidance Note 3 (AGN 03)

Auditors' Work on Value for Money (VFM) Arrangements

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About Auditor Guidance Notes

Auditor Guidance Notes (AGNs) are prepared and published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG) who has power to issue guidance to auditors under Schedule 6 paragraph 9 of the Local Audit and Accountability Act 2014 (the Act).

AGNs set out guidance to which local auditors must have regard under Section 20(6) of the Act. The guidance in AGNs supports auditors in meeting their requirements under the Act and the *Code of Audit Practice* published by the NAO on behalf of the C&AG.

The NAO also prepares and publishes Supplementary Guidance Notes (SGNs) under Schedule 6 paragraph 9 of the Act. SGNs are prepared and published when the C&AG wishes to address a particular issue. SGNs are part of the full suite of AGNs which as such constitute guidance to which local auditors must have regard under Section 20(6) of the Act.

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The firms that are local auditors under the Act may use these communications to update their own internal communications and reference tools.

AGNs are numbered sequentially and published on the NAO's website. Any new or revised AGNs are brought to the attention of local auditors through the WACs.

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Local auditors should not assume that AGNs are comprehensive or that they will provide a definitive answer in every case.



AGN 03 is relevant to all local auditors of bodies covered by the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

AGN 03 is not relevant to assurance engagements at smaller authorities for which the specified procedures are set out in AGN 02.

Introduction

This AGN sets out guidance for auditors to support their work on value for money (VFM) arrangements. It covers all sectors, and is structured as follows:

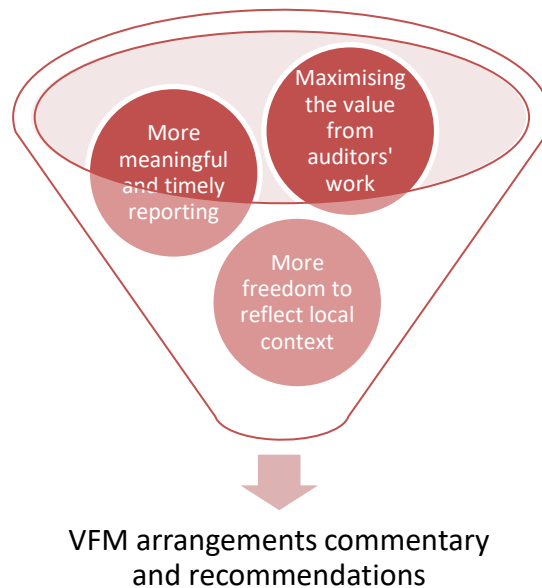
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Purpose of this AGN

1. On 1 April 2020, a new Code of Audit Practice (the 2020 Code) came into force. This AGN sets out how local auditors are expected to approach and report their work on VFM arrangements under the new Code.
2. Following extensive public consultation in 2019 on the development of a new Code, it was clear that it was an appropriate time to re-visit the work of local auditors in this area. Taxpayers, stakeholders and local service users rightly expect that the bodies responsible for their local public services will have arrangements in place to allow them to manage their finances and services and deliver their objectives. Therefore, it is important for local auditors to understand and comment on those arrangements, including drawing attention to areas of significant weakness or other concerns where they arise.
3. The approach set out in this AGN re-focuses the work of local auditors to:
 - promote more timely reporting of significant issues to local bodies;
 - provide more meaningful and more accessible annual reporting on VFM arrangements issues in key areas;
 - provide a sharper focus on reporting in the key areas of financial sustainability, governance, and improving economy, efficiency and effectiveness; and
 - provide clearer recommendations to help local bodies improve their arrangements.



4. A flexible and responsive approach is needed to discharge the auditor's duty to be satisfied whether bodies have proper arrangements in place to secure value for money¹. The 2020 Code sets out a new approach to auditors' work in this area, which has been designed to enable auditors to meet these expectations.
5. From 2020-21 audits onwards, a major output from local audit work on arrangements to secure VFM is an annual commentary on arrangements, published as part of the Auditor's Annual Report². The commentary will enable auditors to explain the work they have undertaken during the year, and to highlight any significant weaknesses that they have identified and brought to the body's attention, along with their recommendations for improvement. The commentary will, however, also allow auditors to better reflect local context and draw attention to emerging or developing issues which may not represent significant weaknesses, but which may nevertheless require attention from the body itself. Paragraph 66 confirms that auditors may also include areas for improvement or to keep in view even if they do not identify any underlying significant weaknesses in arrangements. While the auditor is free to determine how they choose to describe such matters, they should ensure that they are clearly distinguished from recommendations relating to significant weaknesses.
6. Where the auditor has been unable to fully complete all of their work, they should still seek to issue their Auditor's Annual Report each year to cover as fully as possible the matters upon which they are able to report. Where the auditor judges this is not possible, they should explain why in an audit letter as required by paragraph 4.6 of the 2020 Code.

¹ The Local Audit and Accountability Act 2014 expresses this as being satisfied "that the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

² The Auditor's Annual Report constitutes an audit letter for the purposes of local bodies complying with the Accounts and Audit Regulations, Department of Health and Social Care Group Accounting Manual and the NHS Improvement NHS Foundation Trust Annual Reporting Manual.

7. Sections 20 and 21 of the Act require auditors to be satisfied that the body *“has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources”*. The Act also requires local auditors to give their opinion on the statement of accounts, which they do in accordance with International Standards on Auditing (ISAs). The auditor’s work on VFM arrangements – including their commentary – is, however, not undertaken in accordance with ISAs, but rather in accordance with the Code and its supporting statutory guidance. The C&AG has determined through the 2020 Code and guidance that a major output from local audit work in respect of VFM arrangements is the commentary as reported in the Auditor’s Annual Report; it is therefore not a VFM arrangements ‘conclusion’ or an ‘opinion’ in the same sense as the opinion on the financial statements themselves. The statutory duty to report where the auditor is not satisfied with arrangements is discharged through compliance with the exception reporting section of this AGN. This means that there may be matters referred to in the auditor’s commentary, but which do not represent significant weaknesses in arrangements and therefore do not appear by exception in the auditor’s opinion on the financial statements. Auditors are reminded, however, that they should adopt an integrated approach to their work on VFM arrangements and the opinion on the financial statements and plan their work and consider the findings accordingly.
8. The 2020 Code states in paragraph 4.6 that *“the auditor’s annual report should be published at the same time as the opinion on the financial statements for local NHS bodies. For relevant authorities other than local NHS bodies, the auditor’s annual report should be published no later than 30 September. Where the auditor is unable to do this, they should issue an audit letter including a statement explaining the reason for the delay.”* The audit letter should be issued to those charged with governance.³

Special reporting provisions

9. The ongoing delays in local audit continue to impact audited bodies and the financial reporting and auditing process, and may therefore affect the timing of when the work on VFM arrangements set out in this AGN is performed and reported.
10. Paragraph 9 of Schedule 6 of the Act gives the C&AG powers to issue guidance regarding the exercise by local auditors of their functions under the Act. Special provisions are therefore included in the Annex to this AGN, reflecting the C&AG’s view as to how auditors should respond to these circumstances.
11. Where auditors have completed their work on VFM arrangements sufficiently to determine whether or not there are significant weaknesses to report by exception at the time of issuing the opinion on the financial statements, auditors should follow the guidance set out in the main body of this AGN. Where this is not the case, they should

³ An audit letter that includes a statement explaining reasons for a delay also constitutes an audit letter for the purposes of local bodies complying with the Accounts and Audit Regulations, Department of Health and Social Care Group Accounting Manual and the NHS Improvement NHS Foundation Trust Annual Reporting Manual.

refer to the guidance in the Annex to this AGN. It is for the auditor to determine at what point they are satisfied in respect of significant weaknesses.

12. Where possible, auditors should also issue their Auditor's Annual Report in line with the requirements set in the Code and this AGN. Where the auditor is not in a position to issue their Auditor's Annual Report in line with these requirements, they should refer to the guidance in the Annex to this AGN.

The Legal and Professional Framework

13. This AGN is consistent with the relevant requirements of the Local Audit and Accountability Act 2014 (the Act) and the 2020 Code of Audit Practice (the 2020 Code), which sets out how auditors meet their responsibilities under the 2014 Act. In undertaking VFM arrangements work, auditors are required to comply with the Code and to have regard only to the guidance set out in this this AGN.
14. This AGN supersedes the guidance note issued on 14 December 2021 and applies to 2022-23 audits. For 2021-22 audits, auditors should have regard to AGN 03 issued on 14 December 2021. Audits relating to 2019-20 or earlier should be undertaken in accordance with the 2015 Code of Audit Practice and relevant AGN 03. Auditors can access previous versions of our guidance via the Extranet or by contacting the NAO.

Subject Matter – Definitions of Proper Arrangements

15. The subject matter for the purposes of auditors' work under this AGN is a local body's arrangements to secure economy, efficiency and effectiveness in its use of resources. In particular, the Act and the 2020 Code require auditors to consider whether the body has put in place 'proper arrangements'. This AGN sets out the arrangements that fall within the scope of 'proper arrangements'.
16. The 2020 Code states in paragraph 3.7 that the *"auditor's work should be underpinned by consideration of 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."*
17. In both local government and the NHS, organisations are already required to have arrangements in place to ensure proper governance, resource and risk management, and internal controls, and to report on the design and operation of those arrangements through annual governance statements. These arrangements should be appropriate and proportionate to the nature of the public body and the services and functions that it has been created to deliver.
18. This AGN draws on relevant requirements applicable to each sector and aligns the scope of proper arrangements with those that responsible parties are already required to have

in place and to report on through documents such as annual governance statements and annual reports (where applicable).

19. When considering bodies' arrangements, auditors should have regard to the arrangements as set out below under the three specified reporting criteria:

- **Financial sustainability: *how the body plans and manages its resources to ensure it can continue to deliver its services, including:***
 - how the body ensures that it identifies all the significant financial pressures that are relevant to its short and medium-term plans and builds these into them;
 - how the body plans to bridge its funding gaps and identifies achievable savings;
 - how the body plans finances to support the sustainable delivery of services in accordance with strategic and statutory priorities;
 - how the body ensures that its financial plan is consistent with other plans such as workforce, capital, investment, and other operational planning which may include working with other local public bodies as part of a wider system; and
 - how the body identifies and manages risks to financial resilience, e.g. unplanned changes in demand, including challenge of the assumptions underlying its plans.
- **Governance: *how the body ensures that it makes informed decisions and properly manages its risks, including:***
 - how the body monitors and assesses risk and how the body gains assurance over the effective operation of internal controls, including arrangements to prevent and detect fraud;
 - how the body approaches and carries out its annual budget setting process;
 - how the body ensures effective processes and systems are in place to ensure budgetary control; to communicate relevant, accurate and timely management information (including non-financial information where appropriate); supports its statutory financial reporting requirements; and ensures corrective action is taken where needed, including in relation to significant partnerships;
 - how the body ensures it makes properly informed decisions, supported by appropriate evidence and allowing for challenge and transparency. This includes arrangements for effective challenge from those charged with

governance/audit committee; and

- how the body monitors and ensures appropriate standards, such as meeting legislative/regulatory requirements and standards in terms of officer or member behaviour (such as gifts and hospitality or declarations/conflicts of interests), and for example where it procures or commissions services.
- **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, including:**
 - how financial and performance information has been used to assess performance to identify areas for improvement;
 - how the body evaluates the services it provides to assess performance and identify areas for improvement;
 - how the body ensures it delivers its role within significant partnerships and engages with stakeholders it has identified, in order to assess whether it is meeting its objectives; and
 - where the body commissions or procures services, how it assesses whether it is realising the expected benefits.

20. While auditors should consider the arrangements as set out above, the Code requires reporting only to be at the level of the three reporting criteria. It is therefore a matter for auditor judgement to what extent, if any, each of the individual arrangements listed under each criterion feature in their commentary.

21. In understanding the body's arrangements, the auditor should note that the nature and extent of proper arrangements, in particular in respect of financial planning and sustainability, will reflect the significant uncertainty that bodies continue to face as a result of the pandemic.

The Auditor's Approach

22. The auditor will need to gather sufficient evidence and document their evaluation of it in order to enable them to draft their commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations.

23. The evidence required to support the commentary is a matter of auditor judgement but should be sufficient to enable an experienced auditor with no prior knowledge of the body to understand the basis for the auditor's judgements on significant weaknesses, as

well as understand any recommendations made.

24. The work that auditors do on the specified reporting criteria should be based on the understanding that it is the audited body's responsibility to ensure that they have proper arrangements in place.

25. The auditor's work is likely to fall into three broad areas:

- planning;
- additional risk-based procedures and evaluation; and
- reporting.

Planning

Understanding the body's arrangements and risk assessment

26. The auditor should document their understanding of the arrangements the body has in place for each of the specified criteria set out in the Code and this AGN, including the specific arrangements listed under each of the reporting criteria in paragraph 19. While the auditor needs to gather sufficient evidence to support their risk assessment and commentary, they are not required to report on each of the individual arrangements listed under each criterion in the Auditor's Annual Report.

27. Auditors may draw on the relevant principles of understanding the entity and its environment when understanding the body's arrangements in place - specifically:

- **Assertions** – representations by management: understanding the arrangements that the body itself should be reporting on through its annual governance statement and narrative statement (where applicable).
- **Internal controls** – paragraph 3.7 of the 2020 Code states the "*auditor's work should be underpinned by consideration of 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.*" The auditor's work should be to understand the arrangements in place at the entity level and how the body itself ensures compliance with its system of internal control as reported on in its annual governance statement.
- **Risk assessment** – the procedures performed to obtain an understanding of the body's arrangements against the specified reporting criteria to identify where further work may be necessary.

28. In completing and documenting their planning work auditors should consider:

- cumulative knowledge brought forward from previous audits. Given that the auditor's commentary is intended to provide local context, this would include any issues specific to the body that are not common across the sector;
- relevant findings from work undertaken in support of the opinion on the financial statements (for example, understanding the entity and any testing on key systems and controls);
- reports from the audited body including internal audit which may identify potential significant weakness through reporting on arrangements which are not operating effectively, or identify financial difficulty, for example, a section 114 report in local government;
- interviews/discussions with key members and officers;
- information disclosed or available to support the annual governance statement and annual report (where applicable), including any key performance indicators the body is using to measure the quality and effectiveness of its services;
- information available from the audited body's own risk registers, committee or board papers including scrutiny and standards boards;
- recommendations from significant weaknesses identified in previous years and any other findings or recommendations made under paragraph 66 of this AGN; and
- other information available from external sources, such as relevant inspectorates, government departments or national bodies. Where auditors make use of such findings, they are not required to re-perform the work and may refer to the inspectorate's findings as the significant weakness. However, auditors should consider whether the body's response to the inspectorate's findings raises any additional risks, for example, failure to accept the need for action or failure to consider whether the findings represent wider issues.

29. While unlikely to apply at every local body, where the following activities are either planned or in progress, there may be risks of a significant weakness. Examples of activities include, but are not limited to:

- organisational change or transformation, including mergers or local authority reorganisation;
- outsourcing, or transfer to alternative delivery models, e.g. formal partnerships, mutuals, social enterprises, joint ventures, or transferring services and functions back in-house/insourcing etc;

- major capital projects including significant PFI schemes;
 - commercial activities, such as investment or trading, where the organisation has not considered the risks and benefits and is not managing those risks;
 - debt restructuring, especially where this involves entering into unusual or complex forms of new borrowing, or is being used to finance unusual or complex schemes; and
 - legislative/policy changes requiring a body to take on a significant new function(s).
30. Depending on the nature and complexity of the arrangement, this may require the auditor to consider the use of an expert to understand the body's arrangements.
31. Auditors should set out the results of their risk assessment as part of reporting to those charged with governance at an appropriate stage in the audit cycle. This should include any additional work planned in respect of any identified risks of significant weaknesses.
32. The auditor should keep their understanding of arrangements and risks identified during planning under review. Where appropriate, the auditor should update their work to reflect emerging risks or findings that may suggest a significant weakness in arrangements. The auditor should document any resulting changes to their planned work and ensure these are communicated to the audited body.

Additional risk-based procedures and evaluation

33. Determining the amount of evidence necessary to inform their commentary and consider significant weaknesses is a matter of auditor judgement, but appropriate sources of evidence will be similar to those outlined at the planning stage in paragraphs 28 and 29.
34. Where the auditor's planning work has identified risks of significant weakness, the auditor should consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including challenge of management's assumptions (where appropriate).
35. Where the auditor has sufficient evidence from their planning work that corporate processes should identify arrangements which are not operating and enable corrective action to be taken, including being satisfied with internal audit, then the auditor does not need to undertake further work to confirm for themselves that arrangements are operating as expected. However, where planning work has identified a risk that arrangements are not operating in practice, the auditor may wish to carry out additional work such as testing the underlying controls relating to those arrangements, but only insofar as the auditor judges necessary to inform their understanding of the significance of the weakness.

36. Auditors do not need to gather evidence of outcomes in order to inform their commentary on the arrangements in place, but should consider undertaking additional procedures where information coming to their attention, for example evidence of significant service or business continuity failure, suggests there may be a significant weakness in arrangements.

Identification of 'significant weaknesses'

37. In undertaking their work, auditors should consider whether there is evidence to suggest that there are significant weaknesses in arrangements. When considering the significance of weaknesses, auditors are expected to include consideration of the significance of business and operational risks insofar as they relate to the subject matter and the scope of 'proper arrangements' set out in paragraphs 15-21.

38. For the purposes of auditors' work under the 2020 Code and this AGN, being 'not satisfied that the body has proper arrangements to secure economy, efficiency and effectiveness in its use of resources' means having identified a significant weakness in arrangements as part of their work with associated recommendations to the body aligned to the reporting criteria set out in the 2020 Code and this AGN.

39. An auditor's assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement, based on their evaluation of the subject matter in question, including adequacy of the body's responses.

40. Auditors should, however, have regard to the following characteristics. A weakness may be said to be significant if it:

- exposes – or could reasonably be expected to expose – the body to significant financial loss or risk;
- leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on the body's reputation;
- leads to – or could reasonably be expected to lead to – unlawful actions; or
- identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

41. Determining whether an identified weakness is 'significant' is a matter of auditor judgement, but should be informed by their consideration of:

- the magnitude of the issue in relation to the size of the body;
- financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves or surpluses (where applicable), or impact on

budgets or cashflow forecasts, or where the auditor considers that the body has failed to maximise the service provided in relation to the funding accounted for;

- the impact of the weakness on the body's reported performance;
- whether the issue has been identified by the body's own internal arrangements and what corrective action has been taken or planned;
- whether any legal judgements have been made including judicial review;
- whether there has been any intervention by a regulator or Secretary of State;
- whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- the impact on delivery of services to local taxpayers; and
- the length of time the body has had to respond to the issue.

42. Auditors should also consider their findings in relation to their judgement on the arrangements in place *during the year*. In that context, the auditor's judgement should focus on how the body's arrangements in-year are supporting it in addressing the relevant issues. Significant weaknesses that have already been identified and reported by the auditor in previous periods do not need to be repeated, unless the auditor has identified a significant weakness in the body's arrangements for responding. Auditors may, however, elect to draw the reader's attention to representations in the body's annual governance statement in relation to issues that have previously been reported. The auditor's commentary should include details of the body's progress against relevant recommendations made previously by the auditor.

43. Where the audited body is the administering authority for a pension fund, auditors should take account of any information that suggests significant weaknesses in the administering authority's arrangements in respect of the governance and management of the pension fund.

Illustrative significant weaknesses

44. It is a matter of auditor judgement to determine when a weakness in arrangements is significant. Auditors are not expected to document their judgements against each of the illustrative weaknesses set out below; they are intended to be helpful in suggesting the types of issues that could indicate a significant weakness. As a result, the suggestions are not exhaustive. Where the auditor has exercised – or considered exercising – any of their additional statutory reporting powers, auditors may also wish to consider whether this is indicative of a significant weakness in VFM arrangements.

45. Financial sustainability:

- Unidentified savings/funding gaps in financial planning that would substantially threaten the delivery of the plan.
- Seeking to make significant use of capital resources to relieve short-term revenue pressures.
- Significant inconsistencies between budgetary information and the financial position as reflected in the financial statements.
- Financial plans based on key assumptions that are unrealistic, e.g. are over-reliant on uncertain income streams that are significant to the delivery of plan, or not backed by appropriate supporting evidence.
- Unsustainable planned use of reserves to bridge funding gaps.
- Significant unplanned use/reliance on reserves to cover unplanned spending.
- Persistent failure to meet savings plans or financial targets.

46. Governance:

- Decision making that is unlawful or could lead to significant loss or exposure to significant financial risk, or reputational risk such as conflicts of interests.
- Serious and pervasive weaknesses in final accounts processes leading to material errors in draft accounts, failure to meet statutory reporting deadlines and/or a modified opinion on the financial statements.
- Failure to implement or achieve progress on recommendations raised, either as a result of previous external audit recommendations, or those from another regulator or inspectorate. The auditor may also have identified a number of issues that are not significant weaknesses in themselves but which, when taken together, indicate a significant weakness in governance arrangements. It is, however, a matter of auditor judgement whether to consider this a significant weakness.
- Pervasive and significant weaknesses in internal controls, especially where these have had a significant financial/service-delivery impact or exposed the body to fraud.
- A weak or ineffective audit committee that fails to provide appropriate challenge or hold officers and members to account.

- Significant or repeated departure from key regulatory and statutory requirements or professional standards, such as the CIPFA Financial Management Code, Prudential Code, Treasury Management Code, departmental statutory guidance issued to local government and local NHS bodies, etc. Note that in assessing arrangements, auditors are not expected to test bodies' compliance, for example with the CIPFA Financial Management Code, but evidence of significant failures to comply could be indicative of a significant weakness in arrangements.

47. *Improving economy, efficiency and effectiveness:*

- Failure to take appropriate action or secure improvement in areas where the body has identified, or a relevant inspectorate or regulatory body has identified, weaknesses in terms of cost/effectiveness or service performance.
- Significant financial loss or failure to deliver efficiency/performance improvements as expected when working through significant partnerships.
- Significant financial loss or failure to deliver efficiency/performance improvements as expected when managing significant outsourced contracts/services.

48. The risk of significant weaknesses may also increase where the body is involved in or planning activities as set out in paragraph 29 above.

49. In considering service and financial sustainability, auditors are not expected to apply a pre-determined timeframe when evaluating subject matter information. Rather, auditors should consider the timeframe that is appropriate to the nature of the subject matter and the subject matter information, taking account of the differing levels of certainty with which bodies in different sectors may be able to plan into the future. In some cases, such as major outsourcing or capital projects, or major transformation such as a structural reorganisation, the appropriate timeframe could extend significantly beyond that which is covered by annual or medium-term financial plans.

50. Where auditors have identified significant issues arising from their work on the financial statements, they should consider whether they highlight a significant weakness that needs to be reported to the body. Also, auditors should be mindful that weaknesses identified under one reporting criterion, for example, improving economy, efficiency and effectiveness, may indicate weaknesses relevant to the other reporting criteria. For example, indicators of higher-than-expected service costs could also be indicative of poor financial planning or budgetary control arrangements.

Major incidents and assessment of significant weakness

51. In any financial year, it is possible that major incidents may occur that have a significant impact on bodies' arrangements for securing VFM, meaning that bodies may need to adapt many – if not all – of their arrangements to adjust to both significant increases in demand for some services, and new ways of working.

52. In considering how major incidents affect the auditor's commentary, the auditor should use their professional judgement in determining whether an identified issue is indicative of significant weaknesses in the body's own arrangements or, for example:

- whether it relates to matters which are within the scope of a relevant inspectorate or regulator; or
- matters relating to national policies or arrangements that are outside the control of an individual body.

Reporting

53. The 2020 Code requires auditors to report in a commentary each year under the specified reporting criteria and expects that where auditors identify significant weaknesses in arrangements as part of their work, they will raise them promptly with those charged with governance at the body⁴.

54. Where the auditor is dealing with issues which extend over a period longer than a financial year, they should exercise their judgement over when it is appropriate to report a significant weakness but should still reflect the current position as far as possible in their Auditor's Annual Report.

Recommendations

55. Paragraph 3.14 of the 2020 Code requires that where the auditor has concluded that there is a significant weakness in a body's arrangements, they should report this to the body and support it with a recommendation for improvement setting out:

- their judgement on the nature of the weakness they have identified;
- the evidence on which their view is based;
- the impact on the local body (or the possible future impact); and
- the action the body needs to take to address the weakness.

56. Where the auditor has raised a recommendation in relation to a significant weakness in arrangements, the recommendation should be clearly labelled as such.

57. Auditors may make recommendations at any time during the year and should include any recommendations in respect of significant weaknesses that have been made, the adequacy of the body's response and progress to date in the Auditor's Annual Report. The auditor should summarise this as part of their commentary on arrangements.

⁴ 2020 Code of Audit Practice – paragraph 1.19

58. When reporting significant weaknesses to those charged with governance, the auditor should decide on the most appropriate format. This could be for example via an ISA (UK) 260 report; a stand-alone interim report, as part of an audit committee update; or possibly under special reporting provisions as part of sharing the draft Auditor's Annual Report where VFM arrangements work was not complete at the time of issuing the opinion on the financial statements.

59. Auditors also have a range of additional reporting powers under the Act, including:

- statutory (written) recommendations under Schedule 7 of the Act;
- reports in the public interest; and
- advisory notices.

60. Auditor Guidance Note (AGN) 07 *Auditor Reporting* sets out guidance that auditors should consider when deciding whether to exercise any of their discretionary powers to report. In particular, auditors should consider the following regarding how and when to exercise additional reporting powers:

- the seriousness of the significant weakness in arrangements which has come to their attention or which they have identified during the audit;
- whether the body itself recognises the need to address a concern and is taking appropriate action in a timely way;
- what information is already in the public domain and whether there is merit in bringing the matter to the attention of the public in the interests of openness, transparency and accountability or to facilitate dissemination of learning to other public bodies;
- which form of reporting is likely to be most effective in helping the audited body to understand the significance of the matter and the need to take action; and
- whether previous reporting has been acted upon and, if not, whether more prominent reporting – such as issuing a statutory recommendation or a report in the public interest – is now necessary.

61. Where an auditor considers it appropriate to exercise one or more of their additional powers in respect of a significant weakness in arrangements to secure VFM that includes recommendations for action, there is no requirement to make a separate recommendation to the one already raised. As stated in paragraph 56 above, the auditor should clearly label recommendations raised in response to a significant weakness in arrangements. Auditors should ensure that the nature of the significant weakness and the associated recommendation are referred to by exception in their report on the financial statements where required, and that they are included in the Auditor's Annual Report.

62. Where the auditor issues a public interest report (PIR) related to a significant weakness in arrangements, but does not make a recommendation in the PIR, they should still make an associated recommendation immediately to those charged with governance. This should also be included in the Auditor's Annual Report as set out in paragraph 57 above.
63. Where the auditor of an NHS body has issued a 'referral of matters arising'⁵, the auditor should consider whether the matter reflects a significant weakness in the body's arrangements which therefore requires the auditor to make a recommendation in response to the issues referred.

Commentary on arrangements

64. The commentary should include a summary under each of the specified reporting criteria that sets out the work the auditor has undertaken during the year as determined by the auditor's risk assessment as set out in paragraph 26 above. The commentary should also provide a clear narrative in plain English that explains to the reader the auditor's judgements in relation to their findings and any local context the auditor wishes to include to explain their findings. Describing the arrangements that are in place at an audited body would not meet this responsibility.
65. Where an auditor has identified, as a result of their work, significant weaknesses in arrangements up to 31 March 2023 and has made a recommendation in relation to the weaknesses, they should explain this in their commentary. The commentary should also include any significant weaknesses and recommendations made in relation to the 2023-24 financial year where these have come to the auditor's attention. Equally, where an auditor has not identified a significant weakness in arrangements this should be reflected in their commentary. Where auditors are making use of information from external sources, such as relevant inspectorates, government departments or national bodies, the auditor should clearly identify that they are doing so in their commentary and any associated exception reporting.
66. Auditors should consider whether to include in their commentary any other matters arising from their work that, in their professional judgement, are significant to the auditor's consideration of arrangements to secure VFM, for example, matters reported to those charged with governance in the ISA (UK) 260 report. Auditors may also include areas for improvement or to keep in view even if they do not identify any underlying significant weaknesses in arrangements. While the auditor is free to determine how they choose to describe such matters, they should ensure that they are clearly distinguished from recommendations relating to significant weaknesses.
67. There may be matters relevant to the issues covered by the auditor's commentary that have taken place since 31 March, for example, where the body states that it has taken

⁵ Referral to the Secretary of State under Section 30 and Schedule 13 of the Local Audit and Accountability Act 2014 for bodies other than NHS foundation trusts, or referral to the relevant NHS regulatory body under Schedule 10 of the National Health Service Act 2006 for NHS foundation trusts.

action in respect of a significant weakness. In such cases, if the auditor wishes, they may undertake additional work to inform their commentary. However, the auditor may elect to simply reflect their understanding of the situation and they are not required to undertake additional testing. If this is the case, they should make clear in their commentary that they reserve judgement and will consider those matters as part of their VFM arrangements work in the following year.

68. Where auditors consider it to be appropriate, they may issue a combined Auditor's Annual Report covering more than one body. This could be where local bodies are merging or where there are shared management arrangements during the year under audit, for example, a police and crime commissioner and chief constable. However, where an auditor has identified a significant weakness in arrangements the commentary should identify clearly which entity the weakness relates to.
69. There may be circumstances where it may be appropriate to issue a commentary on VFM arrangements covering more than one financial year. Where auditors consider this to be appropriate, for example delays in completing VFM arrangements work, they should refer to section A of SGN 02 *Audit reporting issues 2021-22*.

Follow-up of previous recommendations

70. Where an auditor has reported significant weaknesses in arrangements in the previous year, the auditor should follow up recommendations issued previously and include their view as to the status of the recommendations and whether they have been implemented satisfactorily within the Auditor's Annual Report. Where the auditor cannot yet determine whether a recommendation has been implemented satisfactorily (for example, where an inspectorate is yet to revisit and reassess), they should reflect the current position. Auditors should continue to follow up previously issued recommendations until they have been fully addressed.

Exception reporting – auditor's report on the financial statements

71. In accordance with the special provisions set out in paragraphs 9 to 12 above, where auditors have not completed their work on VFM arrangements at the time they issue their opinion on the financial statements, they should read the following section in conjunction with the Annex.
72. As set out at the start of this AGN, the 2014 Act requires auditors to be satisfied that bodies have proper arrangements in place to secure economy, efficiency and effectiveness in their use of resources. Under Schedule 6 of the 2014 Act, the C&AG is required to publish a Code of Audit Practice (the 2020 Code) that sets out how auditors discharge their responsibilities under the Act. The C&AG may also issue guidance to which local auditors must have regard when carrying out their work. The 2014 Act also requires auditors of some local bodies, where they are not satisfied with the arrangements bodies have in place, to refer to this by exception in their report on the

financial statements. For consistency, the 2020 Code applies the concept of exception reporting to all bodies covered by this AGN.

73. Chapter Three of the 2020 Code covers auditors' work on VFM arrangements and specifies the following reporting requirement in paragraph 3.14: *"Where the auditor identifies significant weaknesses in arrangements as part of their work on arrangements to secure value for money, they should make recommendations."* The 2020 Code further expects that auditors will raise such matters promptly during the course of the audit when identified.
74. Chapter Four of the 2020 Code, in relation to the auditor's report of the financial statements, requires in paragraph 4.5 that: *"Where the auditor is not satisfied in respect of arrangements to secure value for money, they should refer to this by exception."*
75. Accordingly, under the 2020 Code and this AGN, auditors will have discharged their responsibilities by including reference in their auditor's report on the financial statements to matters where they have reported, to the audited body, a significant weakness in arrangements to secure VFM up to 31 March 2023. Any significant weaknesses identified in relation to arrangements in place in 2023-24 would not therefore be included until the following year.
76. When reporting by exception, auditors should therefore confirm that they have identified a significant weakness and state to which of the reporting criteria the weakness relates. Since the detail of the significant weakness and the associated recommendation will have already been reported to those charged with governance (and are required to be included in the commentary), a summary of the auditor's recommendations will suffice.
77. There may be occasions when the auditor has yet to conclude whether a significant weakness exists in relation to a particular issue, or for local government bodies has yet to decide an objection at the time the opinion on the financial statements is due. In these circumstances, auditors should not delay issuing their opinion on the financial statements unless the issue is likely to have a material impact on the accounts. Auditors should however reflect the current status of any such issues in their commentary.
78. Auditors are not required to issue repeat recommendations but there may be occasions where a significant weakness remains in place, for example, an issue reported in previous years and which has not yet been addressed but should have been included in the annual governance statement. In such cases, auditors should draw attention to these issues as part of their exception reporting and continue to refer to them as part of their commentary for as long as they remain relevant.

Subsequent events

79. Information relevant to the auditor's view about a body's performance or arrangements comes to the auditor's attention throughout the year. Therefore, it is possible that new information will come to the auditor's attention after they have issued their report on

the financial statements.

80. Where the auditor has already completed their work on VFM arrangements required under this AGN and issued their certificate but has not yet issued their 2022-23 Auditor's Annual Report, they are not required to undertake further procedures to identify any additional reporting issues. (If the auditor has not yet completed their work on VFM arrangements, they should refer to the guidance in the Annex to this AGN).

81. Where new information relating to a 2022-23 significant weakness comes to the auditor's attention after they have issued their report on the financial statements, auditors are not required to revisit their report on the financial statements but should:

- where the certificate has not been issued, refer to the matter in their 2022-23 Auditor's Annual Report and report by exception in the certificate as required by AGN 07; or
- where the certificate has already been issued, refer to the matter in their 2022-23 Auditor's Annual Report but report by exception in their opinion on the 2023-24 financial statements.

82. For significant weakness relating to 2023-24, auditors should:

- report the weakness to the body promptly and make an appropriate recommendation in accordance with the requirements of this AGN (this could be achieved by including the issue in a report to those charged with governance);
- refer to the matter in their 2022-23 Auditor's Annual Report; and
- include reference to the matter in respect of a significant weakness in their report on the 2023-24 financial statements and their 2023-24 Auditor's Annual Report, including progress against the recommendations made.

83. Once the 2022-23 Auditor's Annual Report has been issued auditors should include any new significant weaknesses identified in their 2023-24 Auditor's Annual Report irrespective of the year to which they relate.

Approach to VFM arrangements work at bodies demising during the year

84. It is possible that some audited bodies may demise part-way through or at the end of a financial year (for example, due to a reorganisation in the NHS).

85. For bodies that demise part way through a financial year, auditors are not required to perform the full programme of work set out in this AGN. The auditor is not required to undertake a full risk assessment specifically aimed at planning a programme of VFM arrangements work to support a full commentary on arrangements against the reporting criteria. However, should any significant weaknesses come to the auditor's attention

they should still be reported by exception. Auditors will, therefore, need to assess if there are any risks of significant weakness arising from:

- the auditor's wider work on the audit of the financial statements. Under the Code, and as set out in paragraph 7 in this AGN, there is an expectation of an 'integrated audit'. Therefore, for example, this could include identifying VFM arrangements risks that may be present in minutes covered by the minute review undertaken for audit work on the financial statements;
- the auditor's understanding of the body and interactions with management and those charged with governance;
- the status of significant weaknesses or, where previously reported, improvement recommendations; and
- any other information brought to your attention, for example through correspondence with the public or reports in the media

86. If information from any of the areas listed above suggests there is a risk of a significant weakness in arrangements, the auditor may need to undertake further work to determine whether there is a significant weakness.

87. Paragraph 4.5 of the Code states *"a core element of the auditor's annual report will be the commentary in accordance with the specified reporting criteria set out in Chapter Three (and as supplemented in statutory guidance issued by the NAO)."* For bodies that demise part way through a financial year, the auditor's commentary can be limited to setting out the approach as outlined above and confirming whether any significant weaknesses have come to the auditor's attention, including making any associated recommendations. Auditors may also choose to include improvement recommendations where they consider this to be appropriate.

88. Further guidance relating to the consideration of reporting at CCGs that demised on 30 June 2022 is contained within section C of SGN 02 *Audit reporting issues 2021-22*.

89. For bodies that demise at the end of a financial year, the Code requires auditors to include a commentary on arrangements in their Auditor's Annual Report in accordance with paragraph 26. The commentary should focus on whether or not any significant weaknesses were identified at the demised body but may also highlight any other findings that the auditor considers appropriate. Auditors therefore still need to undertake the work under this AGN to satisfy themselves as to whether or not any significant weaknesses existed. These should still be reported by exception and included in the Auditor's Annual Report which will be addressed to the successor body.

90. Where several bodies are demising and being merged into a single successor body, either part-way through or at the end of a financial year, each auditor may issue a combined



Auditor's Annual Report⁶ covering all of the demised bodies that they audit.

91. Where the auditor identifies significant weaknesses at a demised body, the auditor should include them in their Auditor's Annual Report and note that it will be for the incoming auditor to consider whether the successor body has adequately considered the weaknesses reported and acted appropriately.

Supporting Information

92. In addition to this AGN, auditors have access to sector-specific supporting information, prepared by the NAO.
93. The supporting information does not form part of the statutory guidance to which auditors must have regard, but it helps auditors to understand the key developments and risks that are relevant to VFM arrangements in each sector.
94. The supporting information is updated as and when required, to reflect any significant developments during the year. Auditors are notified of any updates to the supporting information via the WAC.
95. If, in exceptional circumstances, the NAO identifies the need for further statutory guidance to be issued in respect of the current audit year, this may be issued by the C&AG through an updated AGN.

⁶ As a minimum the Auditor's Annual Report is issued on behalf of the audit firm.



Raising Technical Issues or Queries on this AGN

96. Auditors in firms should raise queries within the firm, in the first instance, so that the relevant technical support service can consider whether to refer queries to the NAO's Local Audit Code and Guidance (LACG) team by e-mailing LACG.queries@nao.org.uk.
97. The NAO also engages with the firms through its Local Auditors' Advisory Group (LAAG) and supporting technical networks to consider any emerging regime-wide technical issues on a timely basis. Auditors should follow their in-house arrangements for bringing significant emerging issues to the attention of their supplier's representative on LAAG or the relevant technical network.



Annex: Special provisions for reporting

1. The ongoing delays in local audit continue to significantly impact audited bodies and the financial reporting and auditing process, and may therefore affect the timing of when the work on VFM arrangements set out in this AGN is performed and reported.
2. Paragraph 9 of Schedule 6 of the Act gives the C&AG powers to issue guidance regarding the exercise by local auditors of their functions under the Act. Special provisions are therefore included in this Annex to the AGN, reflecting the C&AG's view as to how auditors should respond.
3. Where auditors have completed their work on VFM arrangements at the time of issuing the opinion on the financial statements, auditors should follow the guidance set out in the main body of this AGN. Where auditors have not completed all of their work on VFM arrangements at the time of issuing the opinion on the financial statements, they should refer to the guidance in this Annex to this AGN.
4. Where possible, auditors should also issue their Auditor's Annual Report in line with the requirements set in the Code and AGN 03. Where the auditor is not in a position to issue their Auditor's Annual Report in line with these requirements, they should refer to the guidance in this Annex to the AGN.

Opinion on the financial statements

5. If the auditor has not completed their planned work on VFM arrangements sufficiently to determine whether or not there are significant weaknesses to report by exception at the time they issue their opinion on the financial statements, they should satisfy themselves as to whether the remaining work is likely to have a material impact on their opinion. Where there is likely to be a material impact, the auditor should not issue their opinion.
6. If there is no material impact on the opinion, the auditor should include a statement in the opinion explaining that they have not yet completed their work on VFM arrangements sufficiently to determine whether or not there are significant weaknesses to report by exception, and that they will report the outcome of their work in their commentary on VFM arrangements and include any additional exception reporting in respect of significant weaknesses in their audit completion certificate.
7. Any significant weaknesses the auditor has identified and reported up to the point of issuing their opinion should still be reported by exception as required by this AGN. However, significant weaknesses identified as a result of completing remaining VFM arrangements work should be reported by exception in the audit completion certificate.

Certificate

8. If at the time of issuing the opinion on the financial statements, the auditor is satisfied as to whether or not there are significant weaknesses in the body's arrangements, they may issue the certificate in advance of completing their commentary and issuing the Auditor's Annual Report. Where the auditor still needs to carry out work to determine whether or not there are significant weaknesses in VFM arrangements, they should not certify completion.
9. Once the remaining work is completed, auditors should comply with the requirements of AGN 07 and "*consider when issuing the certificate if anything has come to their attention that might have a material effect on their opinion including any exception reporting on VFM arrangements from the date of the earlier auditor's report up to the date when the audit is concluded.*

Where such issues are identified, auditors need to consider whether, if that information had been available when the earlier auditor's report was issued, a different opinion on the financial statements would have been given or additional exception reporting on VFM arrangements would have occurred. If so, reference to that fact is required in the certificate. If no matters have come to the attention of the auditor that would have resulted in a different opinion or additional exception reporting on significant weaknesses in VFM arrangements, a statement to that effect should be included in the audit certificate."

Auditor's Annual Report

10. The auditor should issue an audit letter, following any supplementary guidance issued as to its form and content, stating that the timetable for the completion of and reporting on the auditors' work on VFM arrangements has been extended for 2022-23, and that the Auditor's Annual Report and VFM commentary has therefore not been issued.
11. The auditor should perform the remaining procedures required as part of their work on VFM arrangements under this AGN and issue their Auditor's Annual Report when their work is complete. The Auditor's Annual Report should be issued:
 - a. For NHS trusts and commissioners, in accordance with the publication timetable set by DHSC and NHSE&I (which the NAO will continue to communicate via the WAC);
 - b. For NHS foundation trusts (FTs), through discussion and agreement with the body to recognise the need to consider parliamentary laying requirements. Auditors should note that the NHS FT Annual Reporting Manual requires FTs to include the auditor's report and certificate within the annual report and accounts. Auditors therefore need to provide the FT with the certificate before the FT can lay before parliament;



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- c. For bodies other than local NHS bodies, no more than three months after the date of the opinion on the financial statements.

12. Where the auditor is unable to meet the requirements in paragraph 11 above, they should issue a further audit letter explaining the reason for the delay.