



National Audit Office

Local audit in England

Code of Audit Practice

Issues paper: Consultation response form

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

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

CIPFA considers that a principles based approach is appropriate. This has advantages for both understandability and maintainability.

It allows the Code to be a concise, high-level document applicable to audits of all relevant bodies, providing a clear framework for auditors to meet their statutory duties. It also helps demonstrate that the requirements for different sub-sectors are aligned insofar as this is appropriate.

A principles based code can focus on outcomes, which fits well with the auditing model in relevant auditing and assurance standards.

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

CIPFA does not believe that any of the principles set out in the Code should be removed, nor can CIPFA think of any additional principles that should be added.

The principles encompass

- Characteristic features of public sector audit encompassing wider scope, independence, and public reporting;

and

- More general principles applicable to the conduct of audit (and indeed many independent assessment activities)

The principles relating to the characteristic features of public sector audit were agreed by the Public Audit Forum. As noted in the issues paper these reflect a well-established understanding of how public sector audit in the UK should be conducted. It is essential that these are retained

The general principles relate to how an independent assessment activity should be carried out having regard to avoiding unnecessary work for the assessed body while achieving the required outcomes. Something similar to these general principles would seem to be essential to the effective conduct of public audit.

The requirement in relation to data security and confidentiality seems to be an implicit legal requirement of any independent assessment activity and in practice it would often be an explicit contractual requirement. As such it may be slightly out of place in the Code.

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

CIPFA does not consider that it would be beneficial to prioritise any of the principles. However, it is essential that the principles are properly understood, and we have some concerns that the current text is not as helpful as it could be. .

We would observe that what we have described as characteristic features and general principles are discussed in separate sections in the code of audit practice for public audit in Scotland. This may provide a clearer explanation that certain principles reflect key deliverables, while others reflect how these need to be delivered.

We also suggest that the content of the principles section is not always focused on the principles themselves, but ranges more widely into more detailed consideration of how the principles should be applied, or what the principles do not mean. We would not suggest that these matters are not important, but they may detract from a clear and concise discussion of the actual principles.

Some CIPFA stakeholders have suggested that it would be helpful to give more emphasis to the wider scope of public sector audit. While we are not minded to elevate one principle over another, it is essential that the importance of this principle is understood. We would note that the wider scope section of the current code contains commentary on what the auditor is not required (or allowed) to do, and notes that the auditor is not acting as a substitute for management. While this material is factually correct, it may result in a loss of clarity, so the NAO may wish to consider if this (important) material could be located somewhere other than the description of principles.

We also note that paragraph 7 of the Issues Paper indicates that NAO are considering whether the principles should contain more emphasis on proportionality, having regard to the cost to the taxpayer of taking further action when exercising additional public reporting powers, or responding to objections to accounts, noting that the cost of additional work may exceed the total expenditure of smaller bodies.

CIPFA acknowledges this point, but suggest that care would be needed to address this, and the Code itself may not be the best place to exercise this. Action by the auditor is both a safeguard and a deterrent and it is important not to send the wrong message.

We would note that Paragraph 1.12 of the extant Code notes that there may be circumstances where aspects of the Code need to be applied in a certain way because of the relatively small amounts of money that a public body controls, and provides that the NAO can issue guidance on this. NAO provides some guidance which is explicitly relates to smaller authority engagements, but as far as we are aware

- None of the smaller authority engagement material reflects on proportionality in, for example the exercise of additional powers.
- The guidance on the exercise of additional powers does not reflect on matters relating to smaller authorities, and that this may affect proportionality considerations.

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

The current approach is to have a single Code, and that auditors apply this using sector-specific guidance which is primarily explaining matters which affect the application of the Code in those sectors.

CIPFA does not have a fixed view on this, but would observe that the current practice of having a single Code serves to clearly differentiate between the mandatory outcomes required by statute, and sector specific considerations which inform the application of that guidance.

CIPFA therefore supports the retention of a single Code.

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

Public sector bodies are increasingly engaging in complex partnerships and commercial ventures, and we agree that additional support would be helpful. Such arrangements are likely to impact both on the auditor's financial statements work and on Value for Money.

Rather than expand the Code, we suggest that additional guidance could be provided in NAO Auditor Guidance Notes.

We note that in Scotland there is a Code of Guidance on Funding External Bodies and Following the Public Pound. While this is formulated for use by local bodies rather than auditors, the good practice set out therein may provide the basis for developing guidance for auditors to assess the governance around such arrangements.

Section Two: Audit of the financial statements

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

CIPFA agrees that the Code should continue to align its requirements with these standards. IAASB ISAs, ISAs (UK) and other FRC standards and guidance are developed through rigorous and transparent process, after due consultation with stakeholders. Public sector stakeholders such as CIPFA contribute to these consultation processes.

The standards currently in use are issued by the Financial Reporting Council, and mainly comprise International Standards on Auditing (UK), the Ethical Standard, and related guidance including practice notes applicable to specific sectors, including Practice Note 10 which relates to the audit of public sector entities.

International Standards on Auditing (UK) encompass International Standards on Auditing (ISAs) developed by the International Auditing and Assurance Standards Board (IAASB), while including UK specific material, mainly relating to specific requirements for UK listed companies.

Concerns have been expressed that the requirements of ISAs may focus on issues which relate primarily to large and complex multi-national companies. We would agree that this has affected the development of standards, and that this is a matter to watch. However, it is our view that at present both the IAASB standards and ISAs(UK) developed by the FRC can be applied effectively to public sector audits.

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

CIPFA is not of the view that there are any areas of the audit of financial statements where the main requirements of ISAs(UK) or other standards are disproportionately difficult to apply. Also, with the exception of some company specific requirements which are dis-applied for most public sector entities, there are no requirements in ISAs(UK) which are inappropriate for these audits. ISAs (UK) and other standards do of course need to be read having regard to the specific nature of the sector. Guidance provided in Practice Note 10 will often be helpful in this regard, as will Auditor Guidance Notes which support the Code.

CIPFA has received some feedback from auditors which relates to the need to apply specific requirements of standards to the audit of Public Interest Entities (PIEs). Particularly in cases where local authorities are determined to be PIEs because they have relatively small amounts of listed debt issued, for example, as War Bonds. This does not seem particularly aligned with the needs of stakeholders, and the benefit of enhanced reporting and engagement requirements may be questionable. The NAO may wish to consider whether this could be addressed through its own guidance, Practice Note 10, or discussion with the FRC on how its standards should be applied.

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

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

CIPFA suggests that the Code and NAO guidance should address the following two key issues:

Financial resilience/ sustainability: Both local government and the health sector are under significant financial strain, and we do not expect this to change in the short or medium term. The key interest of the citizen as taxpayer and user of services is in the ability of bodies to provide essential public services on a sustainable basis.

Governance: In the context of the above, elected members, non-executives and senior management may come under severe pressure. The recent NAO report on local government noted risks to the robustness of key checks and balances, and similar risks probably exist in health. In this environment, decision makers may act with undue haste, engage in high risk projects without proper risk mitigation, and may be pressured to engage in financial misreporting. The auditor's role as watchdog is fundamental.

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

CIPFA is content that 'VFM arrangements conclusion' adequately summarises the nature of the work done from a technical perspective. However, in line with the comments made at paragraph 32 of the issues paper, we know that a number of local bodies and auditors are concerned that reporting on VFM has little impact, and does not add to the knowledge or understanding of preparers.

As the issues paper explains, in planning their risk assessment the auditor does not consider the risk that any particular arrangement is not adequate, but considers 'engagement risk': the risk that the auditor would reach the wrong conclusion about the adequacy of arrangements. We have received suggestions that it would be helpful for the conclusion to give more positive assurance that the key arrangements are in place and were functioning as intended during the year to which the opinion relates.

In order to do this, there would need to be changes both to the focus of the risk based approach to this work (discussed in Question 10), and the reporting on that work.

CIPFA therefore suggests that the Stage 2 consultation should pursue enhanced options for reporting.

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

A risk based approach is appropriate.

However, as the issues paper explains, in planning their risk assessment the auditor does not consider the risk that any particular arrangement is not adequate, but considers ‘engagement risk’: the risk that the auditor would reach the wrong conclusion about the adequacy of arrangements.

While this provides a clear criterion to inform the auditor’s judgment that they have done enough work, we have some concerns that this is not working as well as could be hoped.

The aspects that currently underpin the overall criterion set out in AGN3:

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

are all relevant. As noted in our response to Question 9, some stakeholders suggest that it would be helpful for the conclusion to give more positive assurance that key arrangements are in place and were functioning as intended. To achieve this it would probably be necessary to move away from overall engagement risk and focus on risks as they relate to the audited body, particularly in respect of financial sustainability, and the effectiveness of governance around key decision-making.

We would note that the Code of Audit Practice developed by the Auditor General for Scotland and the Accounts requires auditors to provide conclusions on ‘four dimensions’ of wider-scope public audit: financial sustainability, financial management, governance and transparency, and value for money. We understand that this is carried through into the risk assessment process.

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?

CIPFA agrees with this suggestion.

As discussed in responses to previous questions, we are concerned that the current approach to risk is not working as well as could be hoped. In particular, CIPFA’s stakeholders consider that there is a high threshold to reach before arrangements which are not satisfactory might be identified as a risk.

They also note that a small number of authorities failed to adopt the 2016 framework Delivering Good Governance in Local Government, as the basis for their governance arrangements and Annual Governance Statement but this was not judged to be a significant failure to have proper arrangements in place. We can see that such non-compliance may not reflect a failure of governance, but we suggest that it might be considered an indicator or risk.

We would note that the recent NAO report on Local Authority Governance identified key checks and balances that, working together, help to ensure that governance is effective. It might be expected that auditors would comment as part of their value for money conclusions if one or more of the checks and balances were not operating effectively. However the NAO survey identified that auditors had concern with one aspect in 19% percent of cases and with two or more in a further 30% of cases. Given that only 8.1% of local government bodies received a qualified conclusion in 2017/18 this raises further concerns that an unqualified value for money conclusion may not adequately provide assurance that proper arrangements are in place. Again this reflects the high threshold to trigger a qualification.

In the light of the above, CIPFA is inclined to agree with the views described at paragraphs 31 and 32 of the issues paper, and we suggest that the proposals should be explored further in Stage 2 of consultation. While we support the suggestion in paragraph 30 that it could be helpful to use alternative terminology to make it clearer that the auditor’s focus is on arrangements the body has in place, it would also be helpful to have assurance on how these are operating in practice. We agree that this could also stimulate bodies to act sooner and strengthen their arrangements.

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

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?

In CIPFA's view the information currently reported publicly by auditors does not help local taxpayers understand the key issues.

The information that is currently reported by auditors seems primarily to provide information which explains how the auditors have discharged their responsibilities for the audit. Inasmuch as it does hold local bodies to account, this is generally where there are adverse findings. The Annual Letter in its current form is backward looking and contains no significant new information. And as discussed in responses to earlier questions, value for money conclusions are not making an impact with either audited bodies or the public.

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

The consultation document suggests that the new code could introduce explicit principles of effective reporting to help improve the quality of the auditors' reports. CIPFA agrees that this would be helpful. It would help citizens, local members and audit committees to understand the basis for the work carried out and generally improve engagement with the work of local auditors.

CIPFA also agrees with the suggestion in paragraph 38 that reporting should go beyond minimum reporting. In line with our response to question 8 it would be helpful for this to provide specific reporting on financial sustainability and governance. The key interest of the citizen as taxpayer and user of services is in the ability of bodies to provide essential public services on a sustainable basis.

In the context of the report to those charged with governance, and the annual audit letter, it would be helpful for recommendations and opinions to be accompanied by guidance on what might be expected of the body to address adverse findings or other matters raised, and the possible consequences if appropriate steps are not taken.

CIPFA also agrees with the observation in paragraph 39 that timeliness of reporting is extremely important, and perhaps additional emphasis should be placed on this in the Code.

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?

In line our response to questions 8-10, CIPFA suggests that it would be appropriate to develop specific criteria and require separate reports on each. Criteria might reflect whether, for example:

- the delivery of services to local citizens is financially sustainable
- the governance arrangements which support decision making are effective

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

The classification of qualifications as ‘adverse’ and ‘except for’ is a requirement of international auditing standards, which help provide a comparable basis for audits of financial statements. However, it is not clear to us that they are effective in communicating issues around value for money.

We agree with the observation in the issues paper that care needs to be taken by auditors that any qualification is a serious matter, and in particular, that the reporting of ‘except for’ qualifications is not downplayed.

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

See our answer to Question 13.

CIPFA has also received one suggestion that may not be something which the NAO is in a position to progress through its Stage 2 consultation: it might be possible for both timeliness and quality to be improved by decoupling value for money work and reporting from the statutory timetable for the financial statements audit. This would allow the relatively small pool of local public audit expertise to be utilised more effectively by avoiding a single peak workload.

Section Five: The auditor's additional powers and duties

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

As noted in paragraph 40, NAO's recent report on Local auditor reporting in England 2018 identified that while auditors exercise their additional reporting powers, they do so infrequently.

CIPFA agrees that this it is appropriate to support auditors further in this area, by setting 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).

Section Six: Smaller authority assurance engagements

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?

CIPFA recognises that smaller authorities have been subject to an alternative regime to 'full audit' for many years, and we have no problem with the current approach in principle. However, this needs to have regard both to the amounts of money involved, and the risks attached to these.

Our principal suggestion is that the NAO should consider how it might monitor the position, so that it can be confident that the specified procedures in the Code remain sufficient, and if appropriate, provide additional guidance for these engagements.

In considering smaller authority engagements, CIPFA suggests that the NAO needs to be mindful of the changes taking place as a result of sustained financial pressures at principal authorities. For example principal authorities seeking to reduce costs may seek to transfer assets or services to smaller authorities as a way of maintaining a local service. This may change the risk profile of affected smaller bodies and place greater demands on governance and financial management, particularly in regards to value for money.

There is currently no overarching review of the adequacy of financial management and governance at smaller authorities. Auditor reporting takes place at the local level but as far as we are aware, common risks and trends are not identified.

We would note that the Wales Audit Office (WAO) published a report on this topic in January 2019: <http://www.audit.wales/publication/financial-management-and-governance-town-and-community-councils-2017-18> and concluded that 'A significant number of councils fail to comply with their statutory responsibilities for preparing accounts and ensuring that proper arrangements are made for the statutory audit'. It does not appear to be possible to make a comparison with English smaller authorities as the data is not collated centrally. This appears to be a significant gap in public reporting.

In a separate report the WAO identified that internal audit arrangements at town and community councils were often not satisfactory.
<http://www.audit.wales/publication/internal-audit-arrangements-town-and-community->

councils-wales. Again, we are concerned that the current arrangements for examining governance arrangements at English smaller authorities would seem to be unlikely to pick up concerns such as this.

The recent report from the Committee on Standards in Public Life also raised concerns about misconduct at parish councils, suggesting that in a minority of cases the misconduct undermines the effectiveness of the council itself. Given that other aspects of the oversight and regulation of smaller authorities are also 'light touch' it is worth considering whether the reporting of auditors should be improved to at least collate any concerns being raised at the national level.

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?

In line with our comments on Question 18, we consider that it would be helpful for the application of the Code to be informed by information on how changes arising from factors such as sustained financial pressures impact upon the risk profiles of smaller authorities.

Section Seven: Potential implications of changes to the Code

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?

NAO will already be aware that there are concerns in relation to the significant reductions in audit fees in recent years, and this may have reduced the capacity of auditors to carry out an audit which meets the expectations of councils and other stakeholders.

For this reason, it is particularly important that the new Code should align with those (reasonable) expectations. Providing greater clarity on what auditors are expected to do may help both auditors and procurers of audit to reach the right balance between audit quality and cost.

There are also concerns that the staffing of some audit teams is overly dependent on key individuals, and that this means that the completion process may be less resilient than it should be.

CIPFA is also aware of concerns from local authorities, police and health bodies that not all members of the local audit teams are familiar with their accounting, governance arrangements and service areas. This has a negative impact on confidence at the local level in the auditor's ability to understand the risks, context and regulatory requirements of the body being audited. Potentially this could undermine both the auditor's assessment of risk and the value placed on any auditor recommendations. Whilst this is primarily a matter for the local auditors themselves to address, CIPFA recommends that the NAO should bear this in mind for the guidance and advice they provide to the auditors.

General Comments

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

CIPFA's key comments are noted above.

We would note in passing that audit more generally, is suffering from a loss of trust. While this may be justified in some cases, it affects the whole of the profession. Public sector auditors and private sector auditors specialising in public sector audit may be less affected, but they are not unaffected.

The Code has an important role to play in helping to maintain trust, both in local public audit and in local government. It is essential that it promotes high quality work which focuses on the right issues, so that auditors can add value, and be seen to be adding value.