



National Audit Office

Code of Audit Practice (Draft) – Consultation document

SEPTEMBER 2014

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This document is available on our website at: www.nao.org.uk/consultation-code-audit-practice

If you have any enquiries regarding this document, email CodeConsultation@nao.gsi.gov.uk or write to us at:

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Foreword by the Comptroller and Auditor General

The work of the external auditors of local public bodies plays an important role in improving public services and helping people hold users of public money to account. To support this, people must be confident that the auditors conduct their work within a framework that promotes high quality audit, carried out consistently across the auditing profession. This confidence has its roots in clear, public communication of what the requirements of auditors are. The draft Code of Audit Practice aims to provide this clarity. It sets out, in one place, the framework that auditors of local public bodies are required to operate within in order to meet their statutory responsibilities. As such, it forms an important part of the government's new model of local public audit, introduced by the Local Audit and Accountability Act 2014.

In taking responsibility for the Code, I am clear that it needs to preserve the auditor's independence to decide on the detailed audit approach locally, based on their understanding of the sector and the particular risks and challenges that the audited body faces. Ultimately, it is the auditor's professional judgement that should determine the precise nature and amount of audit work required to perform a high quality audit that meets their statutory responsibilities.

I am particularly interested in receiving views on the work that auditors of local public bodies should carry out to meet their statutory requirement to consider local bodies' arrangements to secure value for money. This is an important element of the wider scope of public audit providing accountability locally and nationally. The auditor's work should provide challenge and insight to the audited body, holding them accountable to the local electorate and local service-users.

Auditors have discharged this part of their role in different ways over time and across different sectors. Like its predecessors, the element of the draft Code that relates to value-for-money arrangements work is struck at a high level. The precise approach that auditors take once the Code is in operation will be informed by more detailed guidance which the NAO will develop. I'm keen to get the views of all who have an interest in this to help shape the form that that guidance will take, in support of high quality external audit at reasonable cost.

The Code of Audit Practice must address the needs of a wide variety of stakeholders, including audited bodies, audit practitioners, the local electorate and wider community of service users, and Parliament. Your views will play an important part in helping us produce a code that meets this objective. I am pleased to issue the draft Code of Audit Practice for public consultation and look forward to receiving your comments.

Sir Amyas CE Morse
Comptroller and Auditor General

Overview

In August 2010, the Secretary of State for Communities and Local Government announced the government's plans for the introduction of a new framework for the audit of local public bodies. The Local Audit and Accountability Act 2014 (the Act) provides the legislative basis for the new framework.

The Act makes the Comptroller and Auditor General (C&AG) responsible for the preparation and maintenance of the Code of Audit Practice (the Code). The Code prescribes the framework within which local auditors are to carry out their statutory responsibilities. The auditor's application of the contents of the Code will be influenced by their professional judgement of what is reasonable and appropriate, reflecting the circumstances of individual local public bodies.

Subject to Parliament's approval, the Code will take effect from 1 April 2015 for audit work relating to the 2015-16 financial year onwards. This consultation seeks views and comments on the draft Code of Audit Practice. Following the consultation, we will publish a final Code before the end of 2014 to allow time for consideration by Parliament in early 2015.

How to respond

This is a public consultation. It is open to anyone with an interest in the draft Code of Audit Practice. **Please respond by 31 October 2014.**

We set out in this paper a brief summary of each section of the Code along with consultation questions. A complete list of questions is provided at the end of the paper. If there are further observations you would like to make in addition to the questions included in this consultation, please include these in your response.

Please use the response form provided on our website (www.nao.org.uk/consultation-code-audit-practice). This can be completed electronically or printed and completed by hand.

Please email your response to the following address: CodeConsultation@nao.gsi.gov.uk

You can also post responses to us at:

Future of Local Audit Team
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If you need paper copies of this consultation document, the draft code or the response form please let us know (using the email, phone number or correspondence address above to provide us with your contact details). We will be happy to post copies to you.

Consultation questions

When answering the consultation questions it would be very helpful if you could also provide additional explanation and detail. This will help us to understand the basis for your answers and inform finalisation of the Code.

Please do not feel that you need to respond to all of the consultation questions set out in this document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Preface

The preface to the Code aims to provide a clear articulation of the C&AG's and the National Audit Office's responsibilities, together with information about the Code's purpose and characteristics. In particular, it notes that the C&AG has opted to produce a single code for the audit of the different types of local public bodies covered by his responsibilities under the Act. The Code is principles-based, though tailored where necessary to reflect the differing duties and reporting requirements placed upon auditors of different types of local public body. The preface also confirms that the NAO will provide additional guidance to auditors where more detailed or sector specific advice is required. It sets out key components of the guidance package, for example: the auditor's work on value-for-money arrangements; limited assurance engagements at smaller authorities; the auditor's additional duties and powers; and auditor reporting.

Question 1 – Is there any further information that you consider should be included within the preface to the Code?

Question 2 – Do you agree that a single code can work well for all the types of audited body that need to be covered?¹ If not, what would be your preferred alternative?

Question 3 – Do you agree that the Code should be struck at a principles-based level, to be supported as required by more detailed guidance to auditors provided by the National Audit Office on behalf of the C&AG?

Question 4 – Do you agree with the proposed structure and content of the Code?

¹ Currently there are three Codes of Audit Practice. The Audit Commission has separate codes for local government bodies and for NHS bodies. Monitor produces the *Code of Audit Practice for NHS foundation trusts*.

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

Chapter One of the draft Code clarifies its status, provides details on its application and sets out some general principles that the auditor should apply when approaching their work.

The general principles are characteristics and behaviours that we consider it is reasonable to expect from the auditor of a local public body.

The Code of Audit Practice will take effect from 1 April 2015. The first audit engagements to be carried out under its requirements will be for the financial year 2015-16. 2014-15 audits will be carried out under the requirements of the existing codes, ie those prepared by the Audit Commission and Monitor.

Question 5 – Does Chapter One of the draft Code provide a clear description of the status and application of the Code? If you think it could be improved, please provide details.

Question 6 – Does Chapter One of the draft Code identify the correct general principles? Please provide details if you think that additional principles are required or if you consider that any of the principles identified in Chapter One are inappropriate.

Chapter Two – Audit of the annual accounts

Chapter Two of the draft Code addresses the auditor's statutory duties in respect of the audit of the annual accounts. It also sets out the respective responsibilities of the audited body and of the auditor. The chapter is brief, reflecting the fact that professional auditing standards covering the requirements of an audit of annual accounts are already in place, and hence the need for additional material is limited.

Question 7 – Does Chapter Two of the draft Code address clearly the auditor's statutory duties in respect of the audit of annual accounts? If you think it could be improved, please provide details.

Chapter Three – The auditor’s work on value-for-money arrangements

Chapter Three of the draft Code addresses the auditor’s statutory duties in respect of the audited body’s arrangements to secure value for money through the economic, efficient and effective use of its resources. While there are no profession-wide standards setting out how this kind of work should be completed, the approach set out in the draft Code builds on the accumulated knowledge and experience from previous practice.

The legislative requirement placed on the auditor by the Local Audit and Accountability Act 2014 is to be satisfied that the audited body “...has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources”. This is consistent with previous legislation (both the Audit Commission Act 1998 and, in respect of NHS foundation trusts, the NHS Act 2006).

The way in which auditors have been asked to discharge these responsibilities has changed over time, and has differed between sectors. For example, the Audit Commission’s 2005 Codes of Audit Practice introduced the requirement for the auditor to provide a conclusion on value-for-money arrangements and, in 2010-11, the Audit Commission introduced specified reporting criteria to provide a more focused approach to the auditor’s work. Monitor has developed its own requirements for the work that the auditor of an NHS foundation trust is required to complete, based around a review of key documentation and of the work carried out by other relevant regulatory bodies.

The draft Code sets out the respective responsibilities of the audited body and the auditor. It requires the auditor to consider, in carrying out their work:

- the audited body’s disclosures around its own arrangements, in the annual governance statement and in any additional reporting;
- the evidence that arrangements have operated as expected;
- the evidence obtained from the auditor’s other work;
- the work of third parties; and
- any other evidence source the auditor considers appropriate.

The consultation on the draft Code affords an opportunity to take the views of all stakeholders, including local public bodies and their electors, auditors, and government departments, on how best local auditors should go about fulfilling their statutory responsibilities to review value-for-money arrangements. The content of the draft Code is struck at a high level. The precise approach that auditors take will have regard to the auditor's assessment of the risk of reaching an incorrect conclusion on the audited body's value-for-money arrangements, and to more detailed guidance which the NAO will develop. We would like to use this consultation to obtain views on the shape that this guidance might take. There are a number of relevant factors to be considered:

- **the nature of the auditor's responsibilities** – the auditor is required to consider the **arrangements in place** to support the achievement of value for money, but is not required to reach a view on whether value for money **has actually been achieved**. This was also the case under the previous audit framework. We have sought to be clear on this in the draft Code to avoid any expectation gap on the part of those placing assurance on the auditor's work;
- **quality, insight and audit cost** – the auditor's work on value-for-money arrangements should be tailored to the circumstances of the audited body, providing challenge and insight and holding the audited body accountable to the local electorate and local service-users. It should also provide assurance to central government bodies providing funding to local public bodies. There will be a balance to be struck between the value (in terms of insight and of holding to account) yielded by the auditor's work and the related audit cost. We will weigh these factors carefully in developing detailed guidance for auditors in this area, and would be interested in stakeholders' views on this;
- **reporting criteria** – since 2010-11 the Audit Commission has required local auditors to have regard to 2 specific reporting criteria as a basis for issuing a conclusion on the arrangements in place to secure value for money. Those criteria have been: *i) does the audited body have proper arrangements for securing financial resilience?* and *ii) does the audited body have proper arrangements for challenging how it secures economy, efficiency and effectiveness?* The Audit Commission's detailed guidance issued currently to auditors sets out characteristics of proper arrangements in both cases to guide the auditor in their work. We are interested in the views of audited bodies, auditors and other stakeholders on the effectiveness of this approach, and on potential alternative approaches. Should we opt to continue with these specific reporting criteria, are there other matters we should look to cover, eg arrangements to secure value for money from major local projects, or arrangements to underpin the effectiveness of commissioning? Would a themed or cyclical approach, varying the reporting criteria over time, provide more insight into value-for-money arrangements as a whole?; and
- **consistency of approach** – the draft Code proposes a consistent approach to auditors' work across the different types of audited body covered by the Code. We consider this a desirable outcome in principle but recognise that stakeholders need to be content that the proposed approach can work well for each type of audited body.

Question 8 – Does Chapter Three of the draft Code address clearly the auditor's statutory duties in respect of their work on value-for-money arrangements? If you think it could be improved, please provide details.

Question 9 – Do you agree that the approach set out in Chapter Three of the draft Code is appropriate for auditors of the different types of local public body covered by this Code?

Question 10 – Do you agree that the NAO's detailed guidance on how the auditor should approach their work on value-for-money arrangements should focus on key reporting criteria, and, if so, what criteria should these be? If not, what alternative approach would you propose?

Question 11 (for audited bodies) – How valuable do you find the work carried out each year on value-for-money arrangements? How might this be improved? To what extent would you be prepared to pay more in support of a different approach?

Chapter Four – Reporting the results of the auditor's work

Chapter Four of the draft Code addresses the auditor's statutory duties in respect of reporting the results of their work. The draft Code reflects the requirements of auditing standards and the legislative requirements applicable to the auditors of different types of body covered by this Code. The proposed approach is consistent with current practice.

Question 12– Does Chapter Four of the draft Code address clearly the auditor's statutory duties in respect of their reporting requirements for the different types of body covered by this Code?

Question 13 – Are there specific aspects of the auditor's reporting requirements set out in Chapter Four of the draft Code that you consider should be supported by more detailed guidance to auditors? Please provide details of those areas where you consider additional guidance is required.

Chapter Five – The auditor's additional powers and duties

Chapter Five of the draft Code addresses the auditor's use of certain additional powers. This part of the Code does not apply to the audit of health service bodies.

Question 14– Does Chapter Five of the draft Code address clearly the auditor's use of the additional powers set out in this chapter?

Question 15 – Are there specific aspects of the auditor's additional powers and duties set out in Chapter Five that you consider should be supported by more detailed guidance to auditors? Please provide details of those areas where you consider additional guidance is required.

Chapter Six – Smaller authority assurance engagements

Chapter Six of the draft Code addresses the auditor’s statutory duties in respect of the annual accounts of smaller authorities. The draft Code distinguishes between the auditor’s work in respect of smaller authorities and that required for a ‘full audit authority’ as set out in Chapters Two, Three and Four of the draft Code. The auditor of a smaller authority is required to undertake a ‘smaller authority assurance engagement’. The Financial Reporting Council’s auditing standards do not apply to such engagements. The auditor of a smaller authority will meet their statutory duties by conducting work in accordance with this Code and procedures to be specified in guidance to auditors issued by the NAO on behalf of the C&AG. This is consistent with the current approach where auditors are required to undertake procedures specified by the Audit Commission.

The government’s policy objective is to ensure a proportionate approach to the examination of the annual accounts of smaller authorities. It has consulted recently on draft regulations relating to smaller authorities and is considering how it will respond to the comments it has received. The draft Code chapter reflects the government’s proposals as they stand, and will be updated to reflect any changes post-consultation.

The Audit Commission’s existing guidance and specified procedures for auditors provide the basis for a proportionate approach that the NAO intends to continue with. This is different from an audit, and accordingly throughout Chapter Six is described as an ‘assurance engagement’. Chapter Six sets out the respective responsibilities of the smaller authority and of the auditor. The auditor’s work will be based around reviewing compliance with the requirements for the preparation of the annual accounts, and performing specified procedures as set out by the NAO.

We would welcome views from auditors and from smaller authorities on our proposed approach.

Question 16 – Does Chapter Six of the draft Code address clearly the auditor’s statutory duties in respect of their work on smaller authorities?

Schedules, Annex and Glossary

Schedule 1 to the draft Code summarises the key responsibilities of auditors for different types of body. Schedule 2 sets out additional matters on which the auditor needs to report by exception in their audit report. Annex A will provide a list of bodies covered by the Code at the time it is published. The Glossary aims to provide ‘plain English’ definitions of key terms used in the Code.

Question 17 – Do you have any comments on the material provided in the Schedules and Annex to the draft Code?

Question 18 – Do you have any observations on the completeness or accuracy of the Glossary?

Next steps

We will analyse all consultation responses received and consider what changes are required to the draft Code of Audit Practice. We plan to publish the Code before the end of 2014 to allow time for Parliament's consideration and approval prior to it taking effect from 1 April 2015. During this period we will continue to work with stakeholders to develop appropriate support arrangements and guidance for auditors covered by the Code.

Publication of responses

We want to ensure a transparent consultation process. We will therefore publish copies of consultation responses on the NAO's website as soon as possible after receipt. If you would prefer us not to do this, for part or all of your response, please let us know when you submit it to us. However, please be aware that we cannot guarantee confidentiality as information people provide in response to our consultation, including personal information, may be disclosed in accordance with the Freedom of Information Act 2000.

If we are asked to release consultation responses under the Freedom of Information Act, we will consult you before releasing the relevant data, and consider your views in relation to applying any appropriate exemptions.

Consultation question list

Question 1 – Is there any further information that you consider should be included within the preface to the Code?

Question 2 – Do you agree that a single code can work well for all the types of audited body that need to be covered?² If not, what would be your preferred alternative?

Question 3 – Do you agree that the Code should be struck at a principles-based level, to be supported as required by more detailed guidance to auditors provided by the National Audit Office on behalf of the C&AG?

Question 4 – Do you agree with the proposed content and structure of the Code?

Question 5 – Does Chapter One of the draft Code provide a clear description of the status and application of the Code? If you think it could be improved, please provide details.

Question 6 – Does Chapter One of the draft Code identify the correct general principles? Please provide details if you think that additional principles are required or if you consider that any of the principles identified in Chapter One are inappropriate.

Question 7 – Does Chapter Two of the draft Code address clearly the auditor's statutory duties in respect of the audit of annual accounts? If you think it could be improved, please provide details.

Question 8 – Does Chapter Three of the draft Code address clearly the auditor's statutory duties in respect of their work on value-for-money arrangements? If you think it could be improved, please provide details.

Question 9 – Do you agree that the approach set out in Chapter Three of the draft Code is appropriate for auditors of the different types of local public body covered by this Code?

Question 10 – Do you agree that the NAO's detailed guidance on how the auditor should approach their work on value-for-money arrangements should focus on key reporting criteria, and, if so, what criteria should these be? If not, what alternative approach would you propose?

Question 11 (for audited bodies) – How valuable do you find the work carried out each year on value-for-money arrangements? How might this be improved? To what extent would you be prepared to pay more in support of a different approach?

Question 12 – Does Chapter Four of the draft Code address clearly the auditor's statutory duties in respect of their reporting requirements for the different types of body covered by this Code?

² Currently there are three Codes of Audit Practice. The Audit Commission has separate codes for local government bodies and for NHS bodies. Monitor produces the *Code of Audit Practice for NHS foundation trusts*.

Question 13 – Are there specific aspects of the auditor’s reporting requirements set out in Chapter Four of the draft Code that you consider should be supported by more detailed guidance to auditors? Please provide details of those areas where you consider additional guidance is required.

Question 14– Does Chapter Five of the draft Code address clearly the auditor’s use of the additional powers set out in this chapter?

Question 15 – Are there specific aspects of the auditor’s additional powers and duties set out in Chapter Five that you consider should be supported by more detailed guidance to auditors? Please provide details of those areas where you consider additional guidance is required.

Question 16 – Does Chapter Six of the draft Code address clearly the auditor’s statutory duties in respect of their work on smaller authorities?

Question 17 – Do you have any comments on the material provided in the Schedules and Annex to the draft Code?

Question 18 – Do you have any observations on the completeness or accuracy of the Glossary?



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