

Local audit in England
Code of Audit Practice

Draft Code Consultation

**Response from the Chartered Institute of
Public Finance and Accountancy (CIPFA)**

22 November 2019

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org/

Any questions arising from this submission should be directed to:

Don Peebles

Head of CIPFA Policy & Technical UK
CIPFA
Level 3 Suite D
160 Dundee Street
Edinburgh
EH11 1DQ
Tel: +44 (0)131 221 8653
Email: don.peebles@cipfa.org

Steven Cain

Technical Manager
CIPFA
77 Mansell Street
London
E1 8AN
Tel: +44 (0)20 543 5794
Email: steven.cain@cipfa.org

Our ref: Responses/ 191122 NAO Code Stage 2 consultation

Local Audit Code and Guidance Team
National Audit Office
157-197 Buckingham Palace Road
London SW1W 9SP

By email to lacg@nao.org.uk

Local audit in England Code of Audit Practice Draft Code Consultation

CIPFA is very pleased to have the opportunity to comment on the Stage 2 Consultation on the NAO Code of Audit Practice.

Together with other stakeholders in local public audit in England, CIPFA provided a response to the Stage 1 consultation on issues relevant to the development of a new Code. We are glad to say that the proposals in this Stage 2 consultation address the majority of points made in the CIPFA response, and do so in a helpful and constructive way. Inasmuch as the proposals do not address points raised by CIPFA, it is mainly because some issues are not amenable to resolution through guidance to auditors in the form of a Code of Audit Practice.

Against this background, it is relevant to mention the independent review of the overall arrangements around local public audit in England, led by Sir Tony Redmond. The Redmond Review is considering wider issues around how local authority auditing and financial reporting are implemented and regulated. The call for evidence is open until December and CIPFA will be submitting a comprehensive response on the points raised in the review.

Key points in the draft Code

CIPFA strongly supports the main proposals in this consultation and draft Code, including:

- Changes relating to the auditor's responsibility for value for money arrangements. Refocusing auditor reporting away from the binary opinion and moving to commentary in the annual report should help auditors and audited bodies to communicate better through richer reporting than is achievable under the current approach.
- Focusing on financial sustainability and on governance. Issues around these will always be relevant, but are particularly pertinent in the context of continuing financial pressures due to reduced funding, often in the face of increased demand for locally delivered services.
- More and clearer emphasis on the wider scope of public audit, and the need for sector specific knowledge and skills.

The Stage 1 consultation also raised a number of matters, particularly in relation to the audit of financial statements, where no significant change was proposed because current arrangements are working well. CIPFA supported all of these, while proposing clarifications and refinements in some cases.

Next steps

Moving forward, when the NAO has reflected on this consultation it will develop supporting guidance to auditors that will underpin the changes to the Code. Inasmuch as CIPFA has reservations in responding to this consultation, it is because the full meaning and implications of the main recommendations may only become clear at this stage. This is probably unavoidable because the shift away from an overall opinion is a significant one. But it is crucial that this part of the changed arrangements is handled correctly, in order that auditor reporting provides the planned improvement.

It is also critical to set out clear requirements that will allow auditors to determine that they have done enough work to support their commentary. This will also be important to those doing quality assurance or regulatory inspection activities, and to client local authorities, whose audit committees will be keen to see that auditors are providing appropriate value.

The latter point is particularly relevant given some of the changes to auditor requirements may result in additional auditor costs, which need to be recouped through the audit fee. CIPFA acknowledges suggestions by some stakeholders that audit fees may have been reduced to a level that makes it harder to provide a high quality audit. However, in the current financial situation few local authorities will be comfortable with significant fee increases, and it is vital that any additional costs arising from the new audit approach can be seen to reflect real improvements to the audit.

CIPFA will of course be very happy to contribute to the development of auditor guidance.

As a final observation we would return to our comment that some of the questions asked by the NAO in its Stage 1 consultation raised issues that are not amenable to resolution through the Code of Audit Practice. Some of these will be addressed by the Redmond Review, but this will not deliver changes in the immediate future. We suggest that it is crucial for the NAO and other stakeholders to engage in dialogue, and do as much as possible to resolve such issues within the current framework.

Additionally, we suggest that the changes in the revised Code of Audit Practice are unlikely to fully achieve improvements without contributions from other parts of the regulatory environment. The Code (taken together with related guidance) sets out statutory requirements which auditors must follow, but ideally these would be followed through in all parts of the regulatory and governance framework for audit, including

- procurement of auditors
- audit firm quality management
- external quality assurance and regulator inspection.

Unless these functions operate in accordance with a shared understanding of the wider scope and specific nature of local public audit, as reflected in the revised Code of Audit Practice, there is a risk either that audits will not be subject to appropriate rigorous scrutiny, or that they may need to manage competing views of the requirements for a quality audit.

Detailed comments

Detailed comments on the changes to each chapter of the draft Code are attached as an Annex.

We hope this is a helpful contribution to the development of the Code of Audit Practice.

Chapter 1: Status of the Code, application and general principles

In our response to the Stage 1 consultation, CIPFA strongly supported maintaining the principles based approach and a single Code. We are also pleased that the draft Code provides better signposting of the wider scope of public audit, and the need for audit teams to have relevant knowledge and skills of the local government and health sectors.

The rearrangement of this chapter around the long-established principles of public sector audit (wider scope, independence and public reporting) is helpful.

CIPFA welcomes the new emphasis on timely reporting.

CIPFA also supports the inclusion of public reporting principles. However, we would suggest that some of the new material in Chapter 1 provides quite detailed specification rather than setting out principles. In the interests of clarity, the more detailed material might sit better in Chapter 4 on auditor reporting.

Chapter 2: Audit of the financial statements

CIPFA strongly supports the continuing alignment of the Code of Audit Practice with the main body of auditing standards applicable in the UK, which are currently International Standards on Auditing (UK) (or ISAs (UK)), issued by the Financial Reporting Council (FRC), together with related guidance including Practice Note 10, and the guidance issued by the NAO on behalf of the C&AG.

We note that the drafting of the Code has been reframed in quite general terms to refer to *auditing standards currently in force, as may be amended from time to time, having regard to [other guidance]*. We can see that this has an advantage over the current drafting that refers to the FRC, which is soon to be replaced by the Audit Reporting and Governance Authority (ARGA), because it avoids the inclusion of a reference that may become out of date. It also allows for the use of other (essentially equivalent) standards, such as INTOSAI's International Standards of Supreme Audit Institutions (ISSAIs), which are based on the same underlying international standards as the UK standards. In practice we expect that applicable standards will continue to be the ISAs (UK). For the sake of clarity, it might be helpful to indicate that, at the time of issuance and parliamentary approval of the revised Code, the relevant applicable standards are the ISAs (UK).

Chapter 3: The auditor's work on economy, efficiency and effectiveness of corporate arrangements (value-for-money arrangements)

In line with CIPFA's response to the Stage 1 consultation we support the changes proposed in this chapter to move the focus away from the provision of an overall 'binary' conclusion, and to provide commentary on financial sustainability, governance, and improving economy, efficiency and effectiveness.

As set out in the draft Code there will no longer be an overall opinion. The consultation overview explains at paragraph 16 that an initial review of arrangements will consist of mandatory procedures to be undertaken at every local public body, but also allow additional risk-based work where there are emerging issues that are relevant to the auditor's commentary over the medium term.

In line with the above, CIPFA notes that the proposals address the points made by CIPFA and other respondents, but it is not fully clear how this will be realised. In particular, it is not clear to us how the auditor will exercise their judgement to determine they have done enough work to allow them to report on the criteria outlined at paragraph 3.10, and what in general terms will be expected to be included in commentary.

This consultation explains that the next steps include consulting on detailed supporting guidance that will underpin the changes. It is possible that the full nature of the requirements will not become clear until consultation on that material. This is perhaps to be expected, but in the light of the comments above, the follow-up consultation will be particularly important. The move to commentary provides scope for auditors to add greater value, and to provide more nuanced and useful reporting without the constraints associated with providing an opinion. In some cases the auditor may be able to provide this greater value more quickly and with less effort. While we expect the form of reporting may need to be quite flexible, we would note that the code of audit practice used by Audit Scotland sets out requirements for judgements and conclusions, and this may be a useful way to frame this.

CIPFA would of course be very happy to contribute to stakeholder discussions on the guidance.

Chapter 4: Reporting the results of the auditor's work

CIPFA supports the proposals for more streamlined auditor reporting, and with greater emphasis on timely reporting.

Additionally, the reporting timeline described in paragraph 4.5 focuses the first phase of public reporting on the financial statements audit, and thus partially decouples the auditor's work on the financial statements audit and the auditor's value for money work. This is in line with one of CIPFA's suggestions in the Stage 1 consultation, and may provide auditors with additional flexibility and reduce staffing pressures at key points in the audit cycle.

Some CIPFA stakeholders have expressed concern that this has the effect of moving back the formal deadline for value for money reporting to 30 September, and that this may reduce the benefit of the reporting. On balance CIPFA considers that this risk should be minimised if auditors follow the other Chapter 4 requirements to consider reporting at any time, including regular communication to ensure that emerging findings are raised

on a timely basis. Ideally any particularly significant matters noted by the external auditors will be communicated in good time, and can be reflected in the authority's Annual Governance Statement.

We were pleased to see that the presentations made by the NAO in outreach to stakeholders reinforced the message that the Code sets a clear expectation that, where auditors find weaknesses in arrangements, they must report these in a timely manner and make clear recommendations for improvement. However, we suggest that NAO should consider reinforcing this message in auditor guidance, to be clear that it applies to value for money reporting, rather than simply echoing the requirements in ISAs (UK), which emphasise the need for reporting of emerging findings in relation to the financial statements audit.

Chapter 5: The auditor's additional powers and duties

CIPFA supports the material in the draft code which includes additional material in relation to proportionality, on consideration of the public interest, and on objections.

Chapter 6: Smaller authority assurance engagements

CIPFA is content that the draft Code does not make any changes to the overall approach to undertaking work at smaller authorities. CIPFA supports the draft text which draws auditors' attention to the material in Chapter 1 on proportionality and in Chapter 5 in relation to exercising additional powers, including considering objections.

This does not address all of the issues raised in CIPFA's response to questions 18 and 19 of the Stage 1 consultation, where we noted that there is 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. As explained in the response, the Wales Audit Office has identified concerns in this area, but it is not possible to make a comparison with English smaller authorities if the data is not collated centrally, and we see this as a significant gap in public reporting. CIPFA also suggested 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.

Having said this, we recognise that it might be difficult to address these matters through the Code of Audit Practice. CIPFA will be commenting on related matters in our response to the Redmond Review. In the meantime we suggest it would be helpful if the NAO and other stakeholders considered how these issues might be addressed under current arrangements.