

Future of Local Audit Team
National Audit Office
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By email only to: CodeConsultation@nao.gsi.gov.uk

31 October 2014

Dear Sirs

Code of Audit Practice (Draft)

Deloitte LLP is pleased to respond to your consultation on the Code of Audit Practice (Draft). Our response to certain of the detailed questions set out in the Consultation Paper are set out in the Appendix to this letter.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Richard Gillin on 020 7007 0202 or rgilllin@deloitte.co.uk.

Yours faithfully



Deloitte LLP

Appendix - Answers to the detailed consultation questions

Preface

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

No.

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

Yes. We believe that almost all of the Code is equally applicable to all types of entity and that using one Code reduces the need for additional training for local auditors and therefore those costs being passed on to public bodies.

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?

Yes. Given the need for Parliamentary approval, which is a time-consuming process, we agree that the Code should be struck at a principles-based level. For example, including detailed requirements in the Code could require revision as the FRC's standards on auditing, ethics and quality control change.

This will, however, mean that guidance supporting the Code will be more important and view of this we recommend that the NAO should consult formally or informally on any guidance to the Code, as well as discussing this with existing local auditors. In particular, we believe that whilst the Local Audit and Accountability Act 2014 ("the Act") provides that the Code will apply to the audit of Foundation Trusts, all guidance issued by the NAO may not apply. It will be important for the NAO's guidance to NHS auditors to be as consistent as possible with that issued by Monitor for auditors of NHS Foundation Trusts and we suggest that the NAO and Monitor consult jointly on such guidance wherever possible.

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

Yes.

Chapter One Status of the Code, application and general principles

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.

Yes.

We are aware that the Department of Health is making a technical amendment to clarify that audit under the Act will only apply to non-charitable funds of Special Trustees and NHS Trust Trustees, with charitable funds audited under the Charities Act 2011. Ideally this change will be made prior to finalisation of the Code; if not, a footnote may be necessary to clarify that it will only apply to such trustees if the Act applies.

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.

Yes, we believe that the correct general principles are applied.

We recommend that more clarity is added to paragraph 1.8, in order to make it clear that there may be situations where it could be appropriate for an auditor to carry out other non-audit work for an audited body provided that appropriate safeguards were in place.

We suggest that the section on professionalism and proportionality make an explicit reference to audit quality; arguably ISQC (UK and Ireland) 1 is included within the reference to professional standards in paragraph 1.11, but it would be helpful to remind auditors of the importance of audit quality.

We also recommend that paragraph 1.13 be expanded to include a general duty on co-operation with other auditors. It would be helpful if it were made clear that local auditors and Foundation Trust auditors should co-operate with the NAO and should also co-operate with each other where appropriate.

Finally, it may be helpful for paragraph 1.15 to make clear that it is work carried out by the auditor “for an audited entity” that should be taken into account. It may, for example, be inappropriate for two engagement teams acting for two different audited bodies to breach confidentiality and discuss the affairs of two bodies with each other.

Chapter Two – Audit of the annual accounts

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.

Yes.

Chapter Two (and other parts of the Code) uses the term “local public body” in various places. We suggest this is replaced with “audited body” or “body” (as in Chapter One) so that it is clear that NHS Foundation Trusts are included in the scope.

In paragraph 2.5 we suggest that “their audit report” is replaced with “their reports to the audited body, the National Audit Office and any other statutory reports”. This makes clear that the auditor must do the work necessary to report to those charged with governance under International Standards on Auditing (ISA) (UK and Ireland) 260 (and other ISAs) and the NAO on consolidation returns together with any other required reports.

Paragraph 2.6 refers to the auditors’ duty to read any document containing the audited annual accounts. It is worth noting that by 2016 it is possible that the scope of ISA (UK and Ireland) 720 will have been broadened to include other documents published in connection with the financial statements.

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

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.

Historically, the codes and requirements applicable to NHS Foundation Trusts and entities audited by the Audit Commission have provided very different guidance on what was required. Aligning these scopes would be likely to change the extent of work required for one of these two populations, and so have cost implications. If the intention is to fully align requirements for all entities, we suggest that further supporting guidance should be subject to formal, detailed consultation.

The proposed requirements introduce a number of changes compared to the requirements for NHS Foundation Trusts at present, as summarised in the table below. As drafted, we believe that the draft code extends the requirements for NHS Foundation Trusts, and so increases the scope of work and cost for audited bodies:

Paragraph 4.8 of the Monitor Audit Code for NHS Foundation Trusts	Equivalent section from paragraph 3.9 of the Code of Audit Practice (Draft)	Comments
Value for Money requirements		
...review the statement made by the chief executive of the NHS foundation trust, as part of the AGS, which includes details of the arrangements put into place to secure economy, efficiency and effectiveness in the use of resources; and...	...the audited body's annual governance statement and any additional reporting by the body on the arrangements it has in place to manage risks to the achievement of value for money through the economic, efficient and effective use of its resources;...	These requirements are broadly consistent. Whilst the Monitor Audit Code does not mention "any additional reporting by the body", auditors would be likely to have considered this already.
...review the results of the work of relevant regulatory bodies, for example the Care Quality Commission, to determine if the results of the work have an impact on their responsibilities.	...the work of third parties (for example, regulators) – where the scope and results are relevant to the auditor's value-for-money responsibilities. The auditor is not required to quality assure or re-perform the work of others and should rely on such work to the extent that, in their judgement, it is appropriate to do so; and...	There is a difference between "the work of relevant regulatory bodies" and "the work of third parties". It would be helpful for the detailed guidance to specify for each sector which bodies are expected to be relevant as a matter of course. Depending on which bodies are intended to be covered, this may affect the scope of requirements.
	...evidence that the audited body's arrangements have operated as expected during the reporting period...	This is not currently a requirement of the Monitor Audit Code and would potentially be a significant increase in the scope of work for NHS Foundation Trusts. A requirement to assess the operating effectiveness of controls might also represent an increase in work on former Audit Commission bodies.

		<p>The impact that this requirement would have upon audit scope would depend upon the evidence available from audited bodies.</p> <p>Our experience is that it is relatively uncommon for organisations to have an explicit formal assurance process behind the statements made in the Annual Governance Statement. If requirements or guidance for audited bodies required them to document the assurances that they would have in place over the operating effectiveness of their value-for-money arrangements, auditors would be able to refer to this in performing this work. Without access to such support, in some cases extensive additional work would be necessary to evidence operating effectiveness of the relevant controls.</p>
	...evidence obtained from the auditor's other work – including previous work on value-for-money arrangements, work completed as part of the audit of the annual accounts or any other relevant engagement, and the audited body's response to this work; and...	Although not explicit in the Monitor Audit Code, this is unlikely to represent an additional requirement.
	...any other evidence source that the auditor regards as necessary to facilitate the performance of their statutory duties. It will ultimately be a matter for the auditor's judgement on the extent of work necessary to support their conclusion on value-for-money arrangements.	This requirement was not explicitly stated in the Monitor Audit Code, but is a reasonable statement of the auditor's responsibilities.

Paragraph 4.15 of the Monitor Audit Code for NHS Foundation Trusts	Equivalent section from paragraph 3.9 of the Code of Audit Practice (Draft)	Comments
Annual Governance Statement requirements		
<p>Appropriate evidence regarding the disclosures will usually be obtained by:</p> <ul style="list-style-type: none"> • considering whether the disclosures are consistent with the auditors' review of minutes of relevant committees; • reviewing supporting documents prepared for the board, the accounting officer (the chief executive of the NHS foundation trust) and audit committee that are relevant to disclosures made in the SIC/AGS; • gaining an understanding of the processes defined in the SIC/AGS through enquiry of appropriate members and officers, and comparing their understanding to the statements made in the SIC/AGS; • attending audit committee meetings at which corporate governance, internal control, risk management and value for money matters are considered; • reviewing work undertaken by internal audit in relation to internal control; and • relating the disclosures made in the SIC to the auditors' knowledge of the NHS foundation trust obtained during the audit of the financial statements in accordance with this code. 	N/A	<p>The draft Code provides less explicit guidance than the Monitor Audit Code on the work required with respect to the Annual Governance Statement.</p> <p>Given the overlap between these documents, the guidance in the Monitor Audit Code has also guided the response to Value for Money requirements. It would be helpful to set out, in either the Code or in supporting detailed guidance, the equivalent expectations for auditors of all health bodies and to clarify the interaction of these requirements with the procedures required in respect of value-for-money.</p> <p>As noted above, it is relatively uncommon for organisations to have an explicit formal assurance process behind the Annual Governance Statement, affecting the auditor's ability to perform the procedure in the second bullet. If this requirement is retained, it would be helpful for there to be guidance for organisations on the process expected to underpin the AGS, to provide a basis for this procedure.</p>

We also note that:

- The current Audit Commission requirements are specifically structured around two reporting criteria. The guidance in the Monitor Audit Code does not explicitly identify criteria for the assessment, and this may represent a difference in practice for some auditors.
- The reporting requirements are also different as for entities other than NHS Foundation Trusts, auditors have always reported on their value-for-money conclusion, whereas for NHS Foundation Trusts this was covered in the matters to report by exception.

In addition to our comments above, we also have some further suggestions to improve the clarity of the wording in the code:

- Paragraph 3.3. refers to the Annual Governance Statement including commentary on “performance during the year”. We would suggest this should refer to “the operation of internal controls during the year” as the AGS is not a general performance statement.
- Paragraph 3.7 implies that the governance codes for each type of organisation will set out the arrangements which would be expected, together with “any other relevant guidance or requirements”. The governance codes typically have only very high level requirements, and so it would be helpful if the code or detailed guidance were to list the other sources of relevant guidance for each type of entity. It would also be helpful for the detailed guidance to explicitly identify how these requirements are expected to impact the auditor’s work.

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?

Yes.

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?

Yes, we agree that the guidance should focus on key reporting criteria. The current criteria remain appropriate for former Audit Commission audited entities.

For Foundation Trusts, we note that the introduction of these criteria might be interpreted as changing the scope of value-for-money work, with an impact on the extent of audit work and cost. The extent of this will depend upon the specific procedures required by guidance and the reporting criteria set for work. The current reporting criteria used for Audit Commission audited entities are relevant for Foundation Trusts, though might be interpreted as being a narrower lens than current considerations, as quality issues have been common causes of Value for Money exceptions for Foundation Trusts.

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?

This question is not addressed to auditors.

Chapter Four Reporting the results of the auditor’s work

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?

Yes.

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.

We note that the draft Code makes no mention of auditors of NHS Foundation Trusts reporting on risks, materiality and scoping in accordance with ISA (UK and Ireland) 700 as if they applied the main UK Corporate Governance Code. We understand that the revised audit code for NHS Foundation Trusts for 2013-14 will contain such a requirement. It is unclear whether this has been deliberately excluded from the Code as the inclusion of this requirement would not align with the Code being struck at a principles-based level and instead it is intended that it will be dealt with in some guidance to support the Code. Were this requirement to be included in the NAO Code, Schedules 1 and 2 would need to be amended to include the additional requirements set out in paragraphs 19A, 19B, 22A and 22B of the ISA (UK and Ireland) 700. We are also unclear as to whether paragraph 22C would apply to NHS Foundation Trusts for periods commencing on or after 1 October 2014 as this will presumably depend on whether the NHS Foundation Trust Code of Governance is amended to reflect the changes to the main code in respect of the liquidity statement.

In view of the differing reporting requirements for auditors as described in Schedules 1 and 2 of the draft Code, we recommend that template reports for each entity type are produced so that the form of reporting is clear and a consistent approach is adopted.

The section "Audit report" refers to the duty to report certain matters by exception. The effect of paragraph 22 of ISA (UK and Ireland) 700 requires that the auditor reports that, if they have nothing to report, they report that fact. This can lead to somewhat confusing language and we suggest that the NAO work with the FRC and practitioners to see if the language can be made more positive and less confusing to both members of the public and those charged with governance.

The section "Referral of matters arising" under paragraph 4.3 should be expanded to include reference to the requirement in paragraph 4.18 of the Audit code for NHS Foundation Trusts to report to Monitor where if, through the review of the SIC/AGS, the auditors identify concerns that indicate that board statements required under the Compliance Framework made in the year by the foundation trust to Monitor were materially inaccurate.

Chapter Five The auditor's additional powers and duties

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

Yes.

It may be helpful for section 5.4 to include a reference to whether a matter has already been considered by another regulator. For example, we have seen situations where auditor queries and objections have been raised on matters that have already been the subject of extensive investigation by the Local

Government Ombudsman; whilst there may be a question of value for money arising, this may be secondary to the underlying concern. Equally, where the legality of a policy has already been considered, action by the auditor in connection with related expenditure is unlikely to result in a different course of action being taken by the audited body.

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.

We believe additional guidance including practical examples, on (a) the question of what is the public interest, (b) the interaction with other regulators and (c) materiality would be helpful.

Chapter Six Smaller authority assurance engagements

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

Yes.

We suggest that the starting point for any supplementary guidance be International Standard on Review Engagements 2400 issued by the IAASB.

Schedules, Annex and Glossary

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

Yes.

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

Yes:

- Judicial review – the courts may issue orders other than a quashing order. Whilst a quashing order is the most likely form of order to be issued as a result of an auditor's application, s31 of the Act makes clear that an auditor may make an application if a public body has failed to act, which could result in a mandatory order. We suggest that the glossary either be expanded, or the words "For example..." are added at the start of the second sentence
- Professional standards – this definition should be extended to include quality control standards. We suggest that this reference be left generic as, whilst there is currently only one standard, ISQC (UK and Ireland) 1, there may be more in future.
- Those charged with governance – it may be helpful here, or in supplementary guidance, to summarise who this might be and also clarify the interaction between the Accounting Officer, the board, the audit committee and in the case of NHS Foundation Trusts, the governors.