

National Audit Office, Local Audit in England Code of Audit Practice Consultation response

Date: 31 May 2019

1. About the Local Government Association

1.1 The Local Government Association (LGA) is the national voice of local government. We are a politically-led, cross party membership organisation, representing councils from England and Wales.

1.2 Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.

1.3 We welcome the opportunity to comment on this consultation on the Code of Audit Practice, following on from the last review in 2014 and operation since. We understand that this is the first part of a two stage review and that there will be a further consultation in November on the proposed text of the revised code.

1.4 We have addressed the specific consultation questions in the format requested and these are attached as part of this response.



National Audit Office

Local audit in England

Code of Audit Practice

Issues paper: Consultation response form

Please respond by **31 May 2019**

How to respond

1. Please use this consultation response form to respond to the list of questions below.
2. When answering the consultation questions, it would be very helpful if you could also provide additional explanation and detail where appropriate, to understand the basis for your comments.
3. Please do not feel that you need to respond to all 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. If there are further observations you would like to make in addition to the questions included in this consultation, however, please feel free to include these in your response.
4. Please email your response to lacg@nao.org.uk.
5. You can also post responses to us at Local Audit Code and Guidance Team, National Audit Office, Green 2, 157–197 Buckingham Palace Road, London, SW1W 9SP.
Tel: 020 7798 7842.
6. If you need paper copies of this consultation document or the Code please let us know using the email or correspondence address above, or by calling 020 7798 7842, and provide us with your contact details. We will be happy to post copies to you.
7. **We may draw on your responses when explaining how we have acted on the consultation, or if we need to follow up matters raised with some or all other respondents. Therefore your comments will be regarded as public unless you let us know that they should not be. If so, please let us know when you submit your response whether you consider all or part of your submission to be confidential.**

Name: Local Government Association

Organisation: Local Government Association

Email address: bevis.ingram@local.gov.uk

Telephone number: 020 7664 3258

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?

- Please add any comments to help to explain the basis of your answer

Yes, a principles-based approach is appropriate for the Code. It is helpful for there to be sufficient flexibility in the five year period of the Code, so that specific issues and expectations do not need to be continually included or removed. However this does point to an active and significant emphasis being put on the Guidance to Auditors and it might be worth publicising the availability and content of this guidance more widely.

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

- Please add any comments to help to explain the basis of your answer.

It might be helpful to expand on what is meant and expected in the 'Constructive approach' principle. In our view it should be more than 'politeness' and a willingness to listen and engage, which is one interpretation of its meaning. It should specifically encompass an expectation that the auditor will be mindful of, and communicate, any opportunities for bodies to improve their financial management and governance arrangements that they become aware of through their existing work.

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

- If so, which principles should receive more emphasis?

We have no comment on this.

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

- If separate, what differences between the Codes would you like to see?

We can see that there are significant differences between the sectors in terms of the requirements placed on auditors and the context for the audits. However we can also see that as councils and other bodies, in particular bodies in the NHS, are expected to work more closely together there are benefits from having a combined Code. It is also likely to be more efficient for audit firms and regulators to be able to operate with a single Code and therefore reduce costs.

However it would be helpful for any national reporting by the NAO to distinguish between the sectors, rather than publishing, for example, the results of 'local audit'. The issues arising in local government will be different than in the NHS and other sectors and joint reporting could provide an unfairly negative position for the local government sector when combined with the NHS, where historically a greater proportion of VFM conclusions have been qualified.

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

Local authority trading companies, partnerships and joint arrangements are clearly an increasingly important area and one which is challenging for both the organisations involved and the various auditors. Given the importance surrounding the governance arrangements (including performance) of these arrangements it would be helpful if the Code offered some guidance as to how these could be best addressed.

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?

- If not, please explain.

Yes, but the NAO should encourage auditors to take a risk-based approach to the audit of the application of accounting standards and apply influence on the extent to which they are quality assured, to recognise those cases where their application is less relevant or material in the financial statements of a council.

There is a concern that auditors are too focussed on things that seem less immediately important to councils or to their communities. For example many of our members cite in particular the arcane aspects of fixed asset valuations and reviewing the loan transactions as taking a disproportionate time and focus of the audit. Clearly auditors need to ensure

their work is compliant with relevant Auditing Standards and need to undertake sufficient work to satisfy themselves that councils have complied with relevant Accounting Standards, but a more proportionate level of work based on a risk based approach should be encouraged.

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

- If so, which standards, and why?

We have no comment on this

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?

- Please add comments to help to explain the basis of your answer.

The key accountability for councils is to their residents and local electors. The auditor's role, principally concerned with assurance, needs to be to enhance this essential accountability not replace it or stand in its way.

As the consultation document points out, the value for money judgement is an assessment of the arrangements for securing VFM, not an assessment of VFM itself. The LGA supports this approach. Top-down inspection, which gets in the way of local accountability, has been replaced with greater local transparency and a sector led approach to improvement. The LGA has made all the performance and finance data available to the public and we carry out peer reviews and other support to councils to enable them to improve their accountability to the people they serve.

There are essentially two parts to the regular audit role – the accounts audit and the value for money judgement- and it follows that the balance of resources that can be allocated to one is affected by the other. We therefore welcome the work being done by CIPFA and others to ensure that the accounting code is fit for purpose and in so doing would encourage consideration of how the audit requirements on the accounts can be modified to provide the same level of assurance but without over-emphasising matters that are of less public interest, such as the constant revaluation of assets that are unlikely ever to be transferred or sold.

A risk based approach to value for money work is appropriate, and as the risk profile of councils changes, an ongoing dialogue with the sector on where new risks are emerging should be encouraged. It is helpful when the auditor's work adds value within the council,

but it is not necessarily a weakness if audit work does not add to a council's knowledge or understanding of the risks it faces. There would be room for greater concern if audit work frequently raised significant risks of which councils were previously unaware, and the auditor can use the reporting framework, and if necessary additional powers, to encourage an appropriate response from councils.

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

- If no, what would be a more informative description?

No comment

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

- If no, how should the focus of auditors' work change?

See above, response to question 8, and also bear in mind response to question 6. We support a risk based approach but are concerned that the work has been pared back so much that it is less useful.

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?

- If so, on what basis should auditors determine how and where to focus their work, consistent with their responsibilities as auditors?

Yes, see above response to questions 6, 8 and 10. But if so there needs to be clarity over the definition of what a "concern" could be in this case and over how consistency will be maintained.

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?

- If no, what would improve this?

We need the Code and its guidance to ensure auditors act promptly and report on a timely basis when there are concerns, as will be required in line with auditing standards. It is possible that a significant problem could emerge which is already known by the auditor, but the reporting has lagged and so it has not yet been reported. The Code should encourage early reporting of known issues, with a greater emphasis on the need to report emerging concerns to Audit Committees (or elsewhere if defined as 'Those Charged With Governance').

We welcome the idea of reporting in "plain language" so that the reports can be readily understood by the public, but at the same time reports should not be "dumbed down". Audit reports need to still be sufficiently technical to explain issues properly and in sufficient detail to make the issues clear to officers and members as well as to other observers.

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

In line with professional standards, the actual reporting needs to be timely and also relevant. The way to add more value in this area is to ensure that this is always the case. Many of our members have expressed concerns that in some cases the work has been so pared back that it is now less relevant.

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?

- If so, what sort of criteria would be helpful?

As outlined above, the key concern is with the level of work undertaken.

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

- If not, please explain your answer and how auditor reporting could be improved.

We would not argue for a change here.

The discussion document (paragraph 41) is perhaps a little confusing on this point and so could be clarified. It is accepted that both "adverse" and "except for" conclusions are serious; however, an "adverse" conclusion will usually be seen as being more serious than an "except for" conclusion, so if this is not intended, it perhaps needs to be clarified in the

code. That said, any qualification is significant and should be taken seriously by those receiving it.

Another concern raised by our members is that if an authority wanted to challenge an “except for” VFM conclusion or an “adverse” VFM conclusion there is no formal route for them to do so.

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

See above, question 13.

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?

- If so, which areas would this be most useful?

An important role of the Code is to support auditors on when it is appropriate for them to use their additional powers and to encourage councils to respond appropriately.

We would support the continuation of the costs of dealing with a matter being included in the auditor’s consideration of whether to exercised additional powers and in doing to applying the principle of proportionality.

One area we have highlighted in the past has been over “objections” to the accounts and what this means. Some of our members have raised concerns of a lack of understanding by local electors that an “objection” to the accounts should be where there is a case that can be made for the auditor exercising their powers, not where the elector just “doesn’t like something in the accounts”. Guidance to help auditors identify what action should be taken in response to an objection would be helpful, and, while this might be outside of the scope of the code, further detailed guidance for the public as to what constitutes an “objection” would be very helpful.

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?

- If no, how should the approach be adapted?

The LGA does not represent smaller authorities, however, we would support a general principle that auditors apply the principle of proportionality to their work.

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?

- If no, what would you like to change?

As stated above, the LGA does not represent smaller authorities, however, the approach of not issuing a VFM arrangements conclusion and only reporting on this on an exception basis when serious weaknesses are found seems to be appropriate.

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?

- If no, how should auditors' capacity and capability be strengthened?

One of the biggest risks facing the future provision of local audit, as identified in the recent Cardiff Business School review of PSAA's Appointing Person scheme, is the availability of a sustainable market of audit providers. The risks relate to a lack of skilled professionals who know and understand the specific requirements for an effective audit in this sector, the willingness of firms to commit to this market when there is a perception there is a constant drive to reduce costs and internal pressures with the audit firms to stop working in 'low margin' sectors. Councils or PSAA could find it difficult to appoint auditors with the required competence or we could see the number of suppliers shrink with a small number of suppliers able to command higher fees without effective competition. The revision of the Code should recognise this risk and consider ways in which the audit of local bodies can continue to be attractive, but recognising this needs to be balanced with the sector's needs for the overall fee to be kept to the minimum level possible. It may be possible to achieve this through a 're-balancing' of the audit away from technical financial statements work and review towards work to support the VFM conclusion

General Comments

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

One area that our members have raised with us is that the code needs to be flexible enough to cope with new governance structures such as local authority trading companies, partnerships and joint arrangements.

The code also needs to be flexible enough to cope with new bodies that are created or take on new areas of responsibility. One area of change since the last code was published has been the introduction of mayoral combined authorities; these have different powers and responsibilities and have taken on responsibility from a variety of predecessor bodies – including (different in different areas) police, fire waste, transport and others. They still retain varying governance structures. Thought needs to be given to how these varying governance structures within a single organisation affect the audit opinion, particularly regarding the VFM conclusion.