

Corporate

Consultation paper

# Consultation on the draft codes of audit practice

**The Audit Commission** is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local and national services for the public. Our remit covers more than 15,000 bodies which between them spend nearly £125 billion of public money every year. Our work covers local government, housing, health, criminal justice and fire and rescue services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we monitor spending to ensure public services are good value for money.

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# Introduction

## Background

The Audit Commission Act 1998 requires the Audit Commission to ‘prepare, and keep under review, a *Code of Audit Practice*, prescribing the way in which auditors are to carry out their functions under this Act’. This must embody ‘what appears to the Commission to be best professional practice with respect to the standards, procedures and techniques to be adopted by auditors’. The Audit Commission Act 1998 also provides for the preparation of a ‘different *Code*... with the respect to the audit of the accounts of health service bodies as compared with the *Code* applicable to the accounts of other bodies’.

In February 2004 the Commission published a consultation paper on the issues likely to influence the development of a new *Code of Audit Practice* (the *Code*). In that consultation document we stressed that the *Code* is central to the Commission’s audit regime. We also referred to the opportunity which the need to update the *Code* now gives us to take forward the Commission’s commitment to Strategic Regulation by proposing important changes to the way in which auditors should carry out their work at local audited bodies.

We also explained in our consultation document that the paper was intended to help us seek views from stakeholders and other interested parties, including specifically, the professional accountancy bodies and representative associations of audited bodies, on the direction in which we see the *Code* developing, before consulting more formally on a revised *Code* later in the year. We mentioned that our eventual aim will be to locate the statutory *Code* within an overarching document, summarising the standards that apply across the Commission’s audit and inspection regimes in local government and health, to help audited bodies and other stakeholders understand how the different elements of our regulatory regime fit together.

## Developing the Codes of Audit Practice

We agree with those stakeholders who told us, in response to our earlier consultation, that it would now seem sensible to prepare separate *Codes* for local government and the NHS. In particular, the development of separate *Codes* has enabled us to reflect better the implications for auditors of the increasingly divergent accounting, corporate governance and performance management frameworks in the two sectors.

Responses to our earlier consultation on the key issues and principles have helped us to prepare the draft *Codes* on which we are now consulting formally. The proposed draft *Codes* for local government and the NHS are in parts 1 and 2. Part 3 summarises the responses to our earlier consultation with key external stakeholders and sets out our responses to the comments made, and how we are reflecting these in the draft *Codes*.

The new *Codes* are designed to deliver the Commission's strategic aims and objectives through its local audit regime, and to implement Strategic Regulation, by achieving the following key outcomes:

- an approach which is proportionate to risk with a more streamlined audit targeted on areas where auditors have most to contribute to improvement;
- a significant reduction in mandatory local value for money work;
- a specific obligation on auditors to have regard to the value for money implications of recommendations; and
- better and clearer reporting of the results of audits.

In particular, we believe that the draft *Codes* will enable us to:

- deliver the Commission's strategic aims and objectives through its local audit regime, and, where appropriate, bring about changes in behaviour and approach within the Commission's audit suppliers;
- give the Commission sufficient flexibility to adapt its audit regime over time. This means that each *Code* needs to be an enabling document which is pitched at a high level and is sufficiently 'future proof' over its five year lifespan; and
- clarify our expectations of auditors, which means that each *Code* is effectively equivalent to an 'auditing standard'.

Because the *Codes* are intended to be high level documents which set out the principles governing the audit, the opportunity has also been taken to strip out more detailed guidance on how auditors carry out their responsibilities so that supporting guidance can be maintained and kept up to date as required. For example, in relation to electors' questions and objections in local government the *Code* now simply sets out the key principles that should govern auditors' approach, with a strong emphasis on timeliness and proportionality.

## The main changes

In summary the significant changes which are reflected in the new *Codes* and which will have an impact across the Commission's audit regime are as follows:

- auditors' three responsibilities under the current *Code*, in relation to the financial aspects of corporate governance, the accounts and performance management, will be replaced by two responsibilities in relation to the accounts and use of resources, thereby mirroring their statutory responsibilities under the ACA 1998. Auditors' work in relation to the financial aspects of corporate governance will in future largely be covered by their work on the accounts – reflecting recent developments in auditing standards – with audit work in relation to financial standing carried out as part of the work in relation to the use of resources;
- a clear focus, in auditors' work on audited bodies' arrangements for the use of resources, on overall financial and performance management arrangements;

- a more explicit focus on improvement (through the risk assessment process) and on the need for auditors to have regard to the risks arising from audited bodies' involvement in partnerships and joint working arrangements and, where appropriate, to 'follow the public pound' into and across such partnerships;
- an approach to audits at local NHS bodies which is also consistent with the audit approach in the NHS Foundation Trusts' Independent Regulator's code;
- an emphasis on clearer, more timely reporting based on explicit conclusions and 'SMART' recommendations;
- a new style narrative audit report to meet statutory and professional requirements; and
- for local government bodies subject to inspection by the Commission, the annual audit letter formerly prepared by the auditor will be subsumed within a combined audit and inspection letter to be prepared and issued by the Commission.

## Agreeing the NHS Code with the Healthcare Commission

Under the Health and Social Care (Community Health and Standards) Act 2003, the Commission must obtain the agreement of the Commission for Healthcare Audit and Inspection (the Healthcare Commission) in respect of those parts of the *Code* which concern auditors' responsibilities in relation to the use of resources at local NHS bodies. We are, therefore, working closely with the Healthcare Commission Executive Team who have supported our work on the consultation draft of the NHS *Code*. The formal agreement of the Healthcare Commission to the NHS *Code* will be sought in December 2004.

## Next steps

The new *Codes* will need to be approved by Parliament by no later than March 2005, and in practice this means that it will need to be in place by January 2005, for application to the audit of 2005/06 accounts. **In order to meet this timetable we are now seeking comments on the consultation drafts by 25 October 2004, and these should be sent to:**

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## Part 1 – Code of Audit Practice – 2005: Consultation Draft (local government)

### Overview of proposed structure of the Code

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Preface – not part of the formal Code

The Code of Audit Practice – Local government bodies

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Schedule 1: The audit of small bodies

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# Foreword

(To be drafted for signature by Chairman and Chief Executive. This will be included in the final published version but not in the version to be laid before Parliament.)

# Preface

## The role of external audit in the public sector

External audit is an essential part of the process of accountability for public money. It makes an important contribution to the stewardship of public resources and the corporate governance of public services. External auditors in the public sector give an independent opinion on public bodies' financial statements and may review, and report on, aspects of the arrangements put in place by public bodies to ensure the proper conduct of their financial affairs and to manage their performance and use of resources. Because of the special accountabilities attached to public money and the conduct of public business, external audit in the public sector is characterised by three distinct features:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements, but also aspects of corporate governance and arrangements to secure the economic, efficient and effective use of resources; and
- auditors may report aspects of their work to the public and other key stakeholders.

These features are consistent with the 'principles of public audit' as defined by the Public Audit Forum, which comprises all the national audit agencies in the UK.

## The role of the Audit Commission

The Audit Commission (the Commission) is an independent body with statutory responsibilities to regulate the audit of local government and NHS bodies in England, and to promote improvements in the economy, efficiency and effectiveness of public services. The Commission also has statutory responsibilities to carry out inspections of best value authorities and to assess the performance of local authorities.

In particular, the Commission is responsible, among other things, for:

- appointing auditors to local government and NHS bodies;
- setting the required standards for its appointed auditors; and
- regulating the quality of audits.

The Commission appoints auditors ('auditors'), from the Commission's own Operations Directorate and from private firms of auditors. It provides advice and support to auditors on technical matters and monitors their performance through a rigorous quality review process. Once appointed, auditors carry out their statutory and other responsibilities, and exercise their professional judgement, independently of the Commission.

## Statutory responsibilities and powers of appointed auditors

The statutory responsibilities and powers of appointed auditors are set out in the Audit Commission Act 1998 and Local Government Act 1999. In discharging these specific statutory responsibilities and powers, auditors are required to carry out their work in accordance with the Commission's *Code of Audit Practice* (the *Code*).

## The Code of Audit Practice

The Audit Commission Act 1998 (the Act) requires the Commission to 'prepare, and keep under review, a *Code of Audit Practice* prescribing the way in which auditors (appointed by the Commission) are to carry out their functions under the Act, and which embodies what appears to the Commission to be the best professional practice with respect to the standards, procedures and techniques to be adopted by auditors'.

The Act also provides for the preparation of a 'different *Code*... with the respect to the audit of the accounts of health service bodies as compared with the *Code* applicable to the accounts of other bodies'.<sup>1</sup>

Under the Local Government Act 1999 the Commission is also required to prepare and keep under review a code of practice prescribing the way that auditors should carry out their functions in relation to the audit of best value performance plans. The Commission has prepared a combined *Code*, to emphasise the integrated nature of the Commission's audit regime and also, for practical purposes, to provide a single point of reference on the Commission's audit requirements, for both auditors and interested parties. Paragraphs 21, 32 and 42 relate specifically to the responsibilities of auditors of local government bodies in relation to best value performance plans.

The *Code* must be read in conjunction with any regulations that are in force under section 27 of the Act.

The Commission is committed to keeping the *Code* up to date to reflect changes both in the operating environment of audited bodies and in auditing standards and practice, and may amend the *Code* where appropriate in the light of practical experience.

<sup>1</sup> This *Code* covers the audits of local government bodies, including local authorities, fire authorities, police authorities, local councils and local probation boards. It also incorporates the code relating to the audit of best value performance plans. A separate *Code* has been prepared for the audits of NHS bodies.

The *Code* must be approved by a resolution of each House of Parliament at intervals of not more than five years. In the intervening period, the *Code* may be amended by laying proposed alterations before Parliament. The *Code* prescribes the way in which auditors are to carry out their functions under the Act and, in local government, section 7 of the Local Government Act 1999.

In addition to the *Code*, the Commission publishes separate documents that are aimed specifically at audited bodies and members of the public:

- **Statement of Responsibilities of Auditors and of Audited Bodies** – which highlights the different responsibilities of the auditor and the audited body, and the limits on what the auditor can reasonably be expected to do;
- **Council Accounts: Your Rights** – which sets out the rights of members of the public to inspect, and of local electors to question and object to, local government bodies' accounts, and explains the powers of the auditor; and
- **Something to Complain About** – which explains how audited bodies or members of the public can complain about the work of the Commission and its auditors.

## The Commission's model of public audit

The *Code* has been developed on the basis of the Commission's model of public audit, which defines auditors' responsibilities in relation to:

- the financial statements of audited bodies; and
- aspects of audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of their resources.

The model reflects the Commission's concept of an 'integrated audit', in which work in relation to one element of the audit informs audit work in relation to other elements. Central to auditors' work in relation to each of these audit responsibilities is a risk-based approach to audit planning, which reflects their overall knowledge of the audited body's business and assessment of the relevant business risks that it faces.

## The contents of the Code

The *Code* comprises five sections:

- general principles;
- auditing the financial statements;
- auditors' responsibilities in relation to the use of resources;
- reporting the results of audit work; and
- principles relating to the exercise of specific powers and duties of local government auditors.

Schedule 1 to the *Code* provides for the audit of small bodies. Appendix 1 contains a glossary of terms. Transitional provisions are set out in Appendix 2.

# 1. General principles

## Status and application of the Code

- 1 *[This Code has been laid before Parliament under section 4 of the Act and section 8 of the Local Government Act 1999 and has been approved by resolution of each House of Parliament. It came into effect on (date) and replaces the Code that has been in effect from 29 March 2000, as amended on 1 April 2002. Transitional provisions set out in Appendix 2 apply to audit work that relates to financial years ending on or before 31 March 2005, completed before 31 December 2005. All other provisions of the Code apply to audit work that relates to financial years ending on or after 31 March 2006.]*

## Scope of the Code

- 2 This *Code of Audit Practice (Code)* prescribes the way in which auditors of local government bodies, as defined in Schedule 2 of the Audit Commission Act 1998 (the Act), appointed by the Audit Commission (the Commission) should carry out their functions under the Act, and the way in which auditors should carry out their functions in relation to the audit of best value performance plans under section 7 of the Local Government Act 1999. As with any code that attempts to cover a wide variety of circumstances, the application of the *Code* in any particular case will depend on the specific circumstances and on auditors' assessment of what is reasonable and appropriate in those circumstances. All the provisions of the *Code* are to be read and applied with that necessary qualification.
- 3 The Commission may wish to appoint different auditors to carry out different elements of the audit at an audited body. In such cases, auditors should apply the *Code* in so far as, in their judgement, it is appropriate, taking into account any relevant guidance issued by the Commission.
- 4 There will be circumstances in which aspects of the *Code* that are potentially applicable may be inappropriate to the audit of certain bodies, for example, because of the nature of their business or the relatively small amounts of public money controlled by the bodies in question. In carrying out the audit of such bodies auditors should apply the *Code* in so far as, in their judgement, it is appropriate, taking into account the nature of the business of the body and any relevant guidance issued by the Commission. In carrying out the audit of bodies with either annual income or annual expenditure below a financial limit determined by the Commission from time to time, auditors should apply Schedule 1 to the *Code* if directed to do so by the Commission.

- 5 From time to time, when necessary, the Commission also issues guidance to auditors. The Commission does so under its powers under section 3(8) of the Act and paragraph 7 of Schedule 1 to the Act, to appoint auditors and to determine their terms of appointment.

## Scope of the audit and auditors' objectives

- 6 Because of the special accountabilities attached to public money and the conduct of public business, the scope of external audit in local government is extended to cover not only the audit of the financial statements but also aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in the use of resources. The audit of the financial statements is covered by professional auditing standards and so this *Code* focuses more on how the wider range of functions of auditors appointed by the Commission should be carried out.
- 7 Auditors' objectives are to review and report on, to the extent required by the relevant legislation and the requirements of this *Code*:
  - (a) the audited body's financial statements and its Statement on Internal Control; and
  - (b) aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in the use of resources.
- 8 Auditors should plan and carry out their audits to meet these audit objectives and comply with the requirements of the *Code*. Overall responsibility for carrying out an audit that meets these objectives is the responsibility of the appointed auditor.
- 9 Auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

## The audit approach

- 10 Auditors should carry out the audit efficiently and effectively, and in as timely a way as possible. In framing an audit approach to meet the objectives of the audit, they should:
  - (a) plan and perform the audit, on the basis of their assessment of audit risks, determining where to direct their work and to allocate resources to ensure that the audit is tailored to the circumstances of the audited body. They should obtain such information and explanations as they consider necessary to provide themselves with sufficient evidence to meet their responsibilities under statute and the *Code*. Auditors are not expected to review or perform detailed tests of all financial or other systems and processes or of all accounting procedures and transactions;

- (b) have regard to the principle that each part of the audit needs to be viewed in the context of the whole, or integrated, audit. No one part stands alone and work in relation to one element of the audit informs work in relation to other elements;
- (c) have regard to the fact that local government bodies operate and deliver their services in a range of partnerships or other forms of joint working arrangements with other public sector, voluntary or private sector bodies. Auditors should therefore consider whether they need to follow public money into and across such partnerships and joint working arrangements;
- (d) discuss with the audited body the need for timely and effective production of working papers and other information required for audit so that the audit process can be carried out as efficiently and effectively as possible;
- (e) establish effective co-ordination arrangements with internal audit. Auditors should seek to place the maximum amount of reliance on the work of internal audit whenever possible;
- (f) co-operate with other external auditors and the Commission, and provide information to the Commission (both locally and nationally), to enable knowledge of good practice to be transferred effectively across local government and from one audited body to another;
- (g) have regard to the wider system of regulation of local government bodies, and establish effective co-ordination arrangements with the Commission and other statutory inspectorates to minimise the burden of regulation on audited bodies, so far as is consistent with the discharge of auditors' responsibilities, and to make best use of overall audit and inspection resources; and
- (h) adopt a constructive and positive approach wherever possible, and thereby support and encourage worthwhile change, while providing independent scrutiny and assurance, and fulfilling their statutory and professional responsibilities.

## Integrity, objectivity and independence

- 11 Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body, which does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired.

## Confidentiality

- 12 Auditors should take all reasonable steps to ensure that they and their staff comply with relevant statutory and other requirements relating to the holding and disclosure of information received or obtained during the audit.

## 2. Auditing the financial statements

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998.

Function	Statute
1 To be satisfied that the accounts comply with statutory requirements.	s5(1)(a),(b),(c) ACA 98
2 To be satisfied that proper practices have been observed in compiling the accounts.	s5(1)(d) ACA 98
3 To express an opinion on the accounts.	s9(1)(b) ACA 98

- 13 The financial statements, which comprise the published accounts of the audited body, are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. It is the responsibility of the audited body to:
- put in place systems of internal control to ensure the regularity and lawfulness of transactions;
  - maintain proper accounting records; and
  - prepare financial statements that present fairly (or, for local probation boards, give a true and fair view of) the financial position of the body and its expenditure and income.
- 14 The audited body is also responsible for preparing and publishing with its financial statements a Statement on Internal Control.
- 15 Auditors are required to audit the financial statements and to give their opinion, including:
- (a) whether they present fairly, or, for local probation boards, give a true and fair view of, the financial position of the audited body and its expenditure and income for the year in question;
  - (b) whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards; and
  - (c) for local probation boards, on the regularity of their expenditure and income.

- 16 In carrying out this responsibility, auditors should provide reasonable assurance that the financial statements:
- (a) are free from material misstatement, whether caused by fraud or other irregularity or error;
  - (b) comply with statutory and other applicable requirements; and
  - (c) comply with all relevant requirements for accounting presentation and disclosure.
- 17 Auditors should review whether the Statement on Internal Control has been presented in accordance with relevant requirements and to report if it does not meet these requirements or if the Statement is misleading or inconsistent with other information of which the auditor is aware. In doing so auditors should take into account the knowledge of the audited body gained through carrying out audit work in relation to the body's arrangements for securing economy, efficiency and effectiveness in the use of its resources.
- 18 In carrying out their audit of the financial statements in accordance with the *Code*, auditors should comply with auditing standards currently in force, and as may be amended from time to time, and have regard to any other relevant guidance and advice, issued by the Auditing Practices Board (APB), including that covering the work of auditors in relation to audited bodies' Statements on Internal Control. Auditors should also comply with the APB's Ethical Standards currently in force, and as may be amended from time to time.

### 3. Auditors’ responsibilities in relation to the use of resources

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998 unless otherwise stated.

Function	Statute
1 To be satisfied that proper arrangements have been made for securing economy, efficiency and effectiveness in the use of resources.	s5(1)(e) ACA 98
2 Where the Commission has issued a direction, under section 44 of the Act, requiring relevant bodies to publish information relating to their activities, to be satisfied that such audited bodies have proper arrangements for collecting, recording and publishing the information.	s5(1)(f) ACA 98
3 To audit the annual performance plan published by a best value authority.	s7(1) Local Government Act 1999

- 19 It is the responsibility of the audited body to put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them. Such arrangements form a key part of the system of internal control and comprise:
- the establishment and monitoring of the achievement of strategic and operational objectives;
  - the body’s policy and decision-making processes;
  - arrangements to ensure that services meet the needs of users and taxpayers and for engaging with the wider community;
  - the arrangements to ensure compliance with established policies, procedures, laws and regulations;
  - the identification, evaluation and management of operational and financial risks and opportunities, including those arising from involvement in partnerships and joint working;
  - where applicable, arrangements to ensure compliance with the general duty of best value;
  - the arrangements for the management of financial and other resources, including systems of internal financial control, and arrangements for the reporting of financial information;
  - the body’s framework for performance management, including arrangements to ensure data quality; and

- the arrangements to ensure that the audited body's affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption.

20 The audited body is responsible for reporting on these arrangements as part of its annual Statement on Internal Control.

## Auditors' responsibilities in relation to the use of resources

- 21 Auditors have a responsibility to satisfy themselves that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In meeting this responsibility auditors should review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements and report on these arrangements. Auditors of best value authorities also have a responsibility to consider, and report on, the audited body's compliance with statutory requirements in respect of the preparation and publication of its best value performance plan.
- 22 Auditors' sources of assurance in discharging their responsibilities in relation to audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources are:
- the audited body's whole system of internal control as reported on in its Statement on Internal Control;
  - the results of the work of statutory inspectorates if the results of the work have an impact on their responsibilities;
  - work specified by the Commission in support of carrying out its functions; and
  - any other work that they feel necessary to discharge their responsibilities.
- 23 Auditors should place reliance on the reported results of the work of statutory inspectorates in relation to corporate or service performance without carrying out procedures to assess the quality of the work performed and without reperforming any of the work.
- 24 In reviewing the audited body's arrangements for its use of resources, it is not part of auditors' functions to question the merits of the policies of the audited body, but auditors may examine the arrangements by which policy decisions are reached and consider the effects of the implementation of policy. It is the responsibility of the audited body to decide whether and how to implement any recommendations made by auditors and, in making any recommendations, auditors should avoid any perception that they have any role in the decision-making arrangements of the audited body.

## Considerations relating to planning audit work in relation to the use of resources

- 25 In planning their audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, auditors should consider and assess the relevant significant business risks, that is those significant operational and financial risks to the achievement of the audited body's statutory functions and objectives, that apply to the audited body and are relevant to auditors' responsibilities under the *Code*, and the arrangements it has put in place to manage these risks. The auditor's assessment of what is significant is a matter of professional judgement and includes consideration of both the quantitative and qualitative aspects of the item or subject matter in question. Auditors should discuss their assessment of risk with the audited body.
- 26 Auditors' assessment of risk should reflect their consideration of the relevance and significance of the potential business risks faced by all bodies of a particular type, and other risks that apply specifically to individual audited bodies. Auditors should also consider the audited body's own assessment of the risks it faces and the arrangements put in place by the body to manage and address its risks. In assessing risks in relation to audited bodies' arrangements to secure economy, efficiency and effectiveness auditors should have regard to:
- evidence gained from previous audit work, including the response of the audited body to previous audit work;
  - the results of assessments of performance carried out by the Commission;
  - the work of other statutory inspectorates; and
  - relevant improvement needs, identified in discussion with the Commission or other statutory inspectorates.
- 27 On the basis of their risk assessment auditors should plan their work and decide whether to:
- highlight the risk to the audited body;
  - defer any further work in the light of current or planned work by the body or other review agencies; or,
  - carry out work in relation to specific risks to form a view on the adequacy of aspects of the body's stewardship and governance and corporate performance management and financial management arrangements.
- 28 In considering whether to carry out work in relation to a particular risk, auditors should have regard to the potential for them to contribute to improvement in the delivery of the functions of the audited body.
- 29 Such work may include working with others in order to assess how well risks arising from the audited body's involvement in partnerships or other joint working arrangements are being addressed.

## Commission national studies

- 30 The Commission may identify risks relating to the use of resources faced by all local government bodies of a particular type or within a sector. In the light of these risks the Commission may design programmes of work or studies that require comprehensive coverage by auditors to enable comparisons to be made. The Commission may specify additional elements of work, to be carried out by auditors, which supplement the local risk-based approach to planning the audit.

## 4. Reporting the results of audit work

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998 unless otherwise stated.

Function	Statute
1 To comply with the <i>Code</i> .	s5(2) ACA 98
2 To consider whether, in the public interest, to report on any relevant matter that comes to the attention of the auditor so that it may be considered by the body concerned or brought to the attention of the public.	s8 ACA 98
3 To certify the completion of the audit.	s9(1)(a) ACA 98
4 To express an opinion on the accounts.	s9(1)(b) ACA 98
5 To consider whether a written recommendation should be made to the audited body requiring it to be considered and responded to publicly.	s11(3) ACA 98
6 To determine whether an audited body should be granted more time to consider a public interest report or other document that contains specified audit recommendations.	s11(6) ACA 98
7 To report on an audited body's best value performance plan, including recommendations whether the Commission should carry out a best value inspection of the body under s10 of the Local Government Act 1999 and whether the Secretary of State should give a direction under s15 of that Act.	s7(4) Local Government Act 1999

### Outputs from the audit

- 31 The results of audit work will be reported in a range of outputs which, unless specified otherwise, should be addressed to the audited body.
- 32 The following outputs should be issued at key points in the audit process:
- (a) audit planning document;
  - (b) oral and/or written reports or memoranda to officers and, where appropriate, members, on the results of, or matters arising from, specific aspects of auditors' work;
  - (c) a report to those charged with governance summarising the work of the auditor;

- (d) an audit report comprising the auditor's opinion on the financial statements and a conclusion whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources. For best value authorities this conclusion incorporates the auditor's report on the audit of the best value performance plan;
  - (e) a certificate that the audit of the accounts has been completed in accordance with statutory requirements; and
  - (f) an annual audit letter or, for those bodies where the Commission carries out inspections, information to be reported to the Commission in a specified format to enable it to prepare an annual audit and inspection letter to the audited body.
- 33 In addition, the following outputs, the need for which may arise at any point during the audit process, should be issued where appropriate:
- (a) a report dealing with any matter that the auditor considers needs to be raised, in the public interest as a matter of urgency;
  - (b) any recommendations under section 11(3) of the Act; and
  - (c) information to be reported to the Commission in a specified format to enable it to carry out any of its other functions, including assessments of performance at relevant bodies.

## Principles of audit reporting

- 34 Auditors should maintain regular communications with audited bodies and ensure that emerging findings are discussed with audited bodies at the level within the audited body which auditors consider to be most appropriate and on a timely basis.
- 35 All outputs from the audit should be issued promptly at the appropriate point in the audit process. Auditors should report to the audited body, in such a way as to enable its members or officers to understand the nature and scope of the audit work, any matters of substance or significant issues arising from auditors' work, auditors' clear conclusions and judgements on these issues, and the nature and grounds for any concerns they have, indicating any action that needs to be taken by the audited body to secure improvement.
- 36 All outputs from the audit should be:
- clear and succinctly expressed;
  - supported by the evidence and analysis carried out by the auditor;
  - relevant to the needs of the audited body; and
  - explicit when drawing conclusions and making recommendations.

- 37 Auditors' recommendations, arising from their work in relation to audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources, should:
- be specific about what action the audited body should consider taking;
  - be useful, practicable and based on an assessment of the benefits to the audited body of implementing them; and
  - take account of the costs of implementation and, where these are likely to be significant, report them.

## Audit planning documents

- 38 Audit planning documents should set out how auditors intend to carry out their responsibilities, in the light of their assessment of risks. Auditors should explain their assessment of risks and discuss audit planning documents with those charged with governance. They should include provision for effective follow up arrangements to review whether the audited body has properly considered any matters that have been identified previously and, where appropriate, has implemented agreed actions. Planning documents should also demonstrate explicitly how planned audit work will relate to those improvement planning priorities, relevant to the responsibilities of auditors, identified following any relevant assessments of performance by the Commission. Planning documents should be kept under review and updated as necessary.
- 39 For those audited bodies where the Commission carries out inspections, information derived from auditors' planning documents may be summarised for inclusion in combined audit and inspection plans prepared by the Commission.

## Reports or memoranda on individual aspects of audit work

- 40 Auditors may report the results of, and matters arising from, specific elements or parts of the audit, in reports, memoranda or properly evidenced presentations. Such reports, memoranda or presentations should be prepared and issued or delivered as soon as possible after completion of the work.

## Report to those charged with governance

- 41 Auditors' reports to those charged with governance should cover the full range of auditors' responsibilities under statute and the *Code*. However, these reports do not need to duplicate significant matters previously communicated to those charged with governance, for example, through reports, memoranda or presentations on specific pieces of audit work during the course of the year. Auditors should satisfy themselves that these reports are considered at the level within the audited body, which they consider to be most appropriate.

## The audit report

42 The audit report covers all the responsibilities of the auditor under section 5 of the Act. Therefore, it comprises the auditor's opinion on the financial statements and, having regard to relevant criteria, the auditor's conclusion whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources. For best value authorities this includes the auditor's conclusion whether the best value performance plan has been prepared and published in accordance with relevant requirements. The audit report should also include, by exception, any report by the auditor on:

- the Statement on Internal Control;
- any matters that prevent the auditor from being satisfied that the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources;
- any matters that prevent the auditor from concluding that the best value performance plan has been prepared and published in accordance with relevant requirements;
- any recommendations relating to the audit of the best value performance plan arising from the auditor's responsibilities under section 7 of the Local Government Act 1999;
- any recommendations whether the Commission should carry out a best value inspection of the body and whether the Secretary of State should give a direction;
- any matters reported in the public interest in the course of, or at the conclusion of, the audit;
- any recommendations made under section 11(3) of the Act; and
- the exercise of any other special powers of the auditor under the Act.

## Auditors' certificates

43 Auditors are required to certify the completion of each audit. The effect of the certificate is to close the audit and this marks the point when the auditor's responsibilities in respect of the audit of the period covered by the certificate have been discharged.

44 There will be occasions when audit work in relation to the financial statements is substantially completed but the audit cannot be concluded – for example, because there are outstanding matters to be resolved arising from action or possible action under the Act. Auditors should consider issuing their audit report, including the opinion and the conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources, as soon as the necessary audit work has been carried out, subject to any exception or other qualification that the auditor may need to consider.

## Annual audit letters

- 45 The purpose of preparing and issuing annual audit letters is to communicate to the audited body and key external stakeholders, including members of the public, the key issues arising from auditors' work, which auditors consider should be brought to the attention of the audited body. The annual audit letter should cover the work carried out by auditors since the previous annual audit letter was issued.
- 46 Whilst the format of the letter is not prescribed it should highlight the key issues drawn from reports to those charged with governance and auditors' conclusions on relevant aspects of the audit. It should be prepared in clear language that is concise and accessible to a wide audience.
- 47 The annual audit letter should be addressed to all the members of the audited body and the auditor should ensure that all members receive a copy. Where the audited body does not arrange for distribution to all members, the auditor should make the necessary arrangements. Although some audited bodies are not subject to a statutory requirement to publish their annual audit letters, auditors should encourage these bodies to publicise the availability of the letters.
- 48 The auditor should issue the annual audit letter to the audited body as soon as possible after completion of the audit and, other than in exceptional circumstances, no later than a date to be specified by the Audit Commission, following the end of the financial year to which the accounts relate.
- 49 For those audited bodies where the Commission carries out inspections, auditors should provide information to the Commission on the key issues arising from their audit work, in a specified format, to enable the Commission to prepare and send to the audited body an annual audit and inspection letter. The letter should cover the work carried out by auditors since the previous annual letter was issued.

## Reports in the public interest (section 8 of the Audit Commission Act 1998)

- 50 Section 8 of the Act requires that auditors should consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit so that it may be considered by the body concerned or brought to the attention of the public.
- 51 Auditors should consider whether the public interest requires any such matter to be made the subject of an immediate report rather than of a report to be made at the conclusion of the audit. A report in the public interest should be made where auditors consider a matter is sufficiently important to be brought to the notice of the audited body or the public as a matter of urgency.

- 52 In preparing and issuing reports in the public interest auditors should tailor their approach to the urgency and significance of their concerns.

## Recommendations under section 11(3) of the Act

- 53 The auditor should consider whether to make any written recommendations to the audited body, under section 11(3) of the Act, which need to be considered and responded to publicly. Where the auditor considers it necessary to make such recommendations these can be included, where relevant, within other written outputs from the audit or they may be the subject of a specific report to the audited body.

## Information to be reported to the Commission

- 54 From time to time auditors may be required to report information to the Commission in a specified format to enable it to carry out its functions.

## 5. Principles relating to the exercise of specific powers and duties of local government auditors

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998.

Function	Statute
1 To give electors the opportunity to raise questions about the accounts, and consider and decide upon objections received in relation to the accounts.	s15 and 16 ACA 98
2 To consider whether to issue and, if appropriate, to issue an advisory notice or an application for judicial review.	s19A, 19B and 19C ACA 98 s24 ACA 98

- 55 In addition to the general functions of auditors set out in previous sections of the *Code*, auditors of local government bodies have specific powers and duties under the Act. In exercising any of these specific powers and duties auditors should tailor their approach to the particular circumstances of the matters under consideration.
- 56 Where any representations are made or information is provided that is relevant to the audit, or matters relevant to the audit otherwise come to their attention, auditors should consider whether the matter needs investigation and action under their specific powers or whether it can be considered more effectively within planned work programmes and audit reporting arrangements under their general audit powers.
- 57 In considering whether to exercise any of their specific powers under the Act, auditors should apply a balanced and proportionate approach in determining the time and resources to be spent on dealing with matters that come to their attention. They should consider:
- the significance of the subject matter;
  - whether there is wider public interest in the issues raised;
  - the costs of dealing with the matter, bearing in mind that these fall directly on the taxpayer; and
  - in the case of objections, the rights of both those subject to objection and the objector.
- 58 Auditors should reject objections that disclose no reasonable cause for action, are frivolous or vexatious, or are otherwise an abuse of the audit process.

# Schedule 1: The audit of small bodies

## Introduction

- S1.1** It is inappropriate to apply the same level of audit scrutiny to certain bodies as to principal authorities, because of the relatively small amounts of public money controlled by the bodies in question. This Schedule sets out the approach to be adopted for the audit of small bodies with either annual income, or annual expenditure, of up to a financial level determined, after consultation with relevant bodies, from time to time by the Commission (referred to in this Schedule as small bodies).

## Governance and accountability

- S1.2** It is the responsibility of small bodies to put in place proper arrangements to ensure the proper conduct of their financial affairs, and to monitor the adequacy and effectiveness of those arrangements in practice. Small bodies are required to prepare their accounts in accordance with their statutory responsibilities, and to maintain an adequate system of internal audit of their accounting records and control systems.
- S1.3** Small bodies meet their responsibilities by preparing and publishing, and providing the auditor with, the accounts prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year.

## The audit approach

- S1.4** Auditors of small bodies should undertake an examination of the annual accounts and additional information and explanation provided by the body.
- S1.5** Auditors should meet their responsibility by:
- reviewing compliance with the requirements for the preparation of the annual accounts;
  - carrying out a high-level analytical review of financial and other information provided to the auditor; and
  - reviewing such additional information and explanation as is necessary to provide sufficient evidence that the body has maintained an adequate system of internal control and internal audit throughout the financial year.

- S1.6** Where, on the basis of the auditor's review, the auditor requires further evidence in relation to any relevant matter, additional testing should be undertaken to address the auditor's concerns.
- S1.7** When the auditor has completed an examination of the annual accounts and additional information and explanation provided, the auditor gives an opinion on the accounts and certifies the completion of the audit. Auditors provide assurance in the form of an opinion whether, on the basis of their review, the accounts and the other information provided are in accordance with the specified requirements and that no matters have come to their attention giving cause for concern that relevant legislative and regulatory requirements have not been met.

# Appendix 1: Glossary

**Act (the)**

The Audit Commission Act 1998.

**Annual audit letter**

Report issued by the auditor to an audited body, which summarises the audit work carried out in the period, auditors' opinions or conclusions (where appropriate) and matters of substance or significant issues arising from auditors' work. For bodies where the Commission carries out inspections, the annual audit letter is included within the annual audit and inspection letter, which also contains a summary of inspection work carried out in the period.

**Audit**

The audit of the accounts of an audited body, which comprises the audit of the financial statements and other work to meet auditors' other statutory responsibilities under the Audit Commission Act 1998 and the Local Government Act 1999.

**Audited body**

Body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also 'members' and 'those charged with governance'.)

**Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

**Auditing standards**

Pronouncements of the Auditing Practices Board, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

**Auditor(s)**

Auditors appointed by the Audit Commission.

**Best value/best value authorities**

Statutory duty under the Local Government Act 1999 of specified local government bodies (best value authorities) to make arrangements to secure continuous improvement in the way in which their functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

**Best value performance plan**

The plan that specified local government bodies are required to publish annually under section 6 of the Local Government Act 1999, summarising the body's assessments of its performance and position in relation to best value.

**Code (the)**

The *Code of Audit Practice*.

**Commission**

The Audit Commission for Local Authorities and the National Health Service in England and Wales.

**Ethical standards**

Pronouncements of the Auditing Practices Board, which contain basic principles applicable to the conduct of audits with which auditors are required to comply, except where otherwise stated in the standard concerned.

**Financial statements**

The annual financial statements in the prescribed form, or the books of account for those audited bodies that are not required to produce statements.

**Inspectorates**

Those organisations that have responsibilities to carry out inspections including bodies with statutory inspection functions such as OFSTED, the Commission for Social Care Inspection, the Benefits Fraud Inspectorate and Her Majesty's Inspectorate of Constabulary. See also 'review agencies'.

**Internal control**

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

**Local government bodies**

Bodies other than NHS bodies to which the Commission is responsible for appointing auditors, as set out in Schedule 2 of the Act. These include local authorities, local councils (parish and town councils), police authorities, fire authorities, national park authorities and local probation boards.

**Materiality (and significance)**

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects.'

The term ‘materiality’ applies only to the audit of the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, in addition to their responsibility to audit the financial statements, that do not necessarily affect their opinion on the financial statements. The concept of ‘significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the financial statements. Significance has both qualitative and quantitative aspects.

### **Members**

The elected or appointed members of local government bodies who are responsible for the overall direction and control of the audited body. (See also ‘those charged with governance’ and ‘audited body’.)

### **National studies by the Commission**

The Audit Commission has a power under section 33 of the Act to carry out ‘value for money’ studies in local government. Work carried out using these powers is referred to as national studies.

### **Regularity (of expenditure and income)**

Whether, subject to the concept of materiality, the expenditure and income of local probation boards have been applied for the purposes intended by Parliament, and conform with the authorities that govern them.

### **Review agencies**

Review agencies include inspectorates (see ‘inspectorates’) and others that have regulatory responsibilities in relation to local government bodies including government departments, the Government Offices and relevant regulators of local government professions.

### **Those charged with governance**

Those charged with governance are defined in auditing standards as ‘those persons entrusted with the supervision, control and direction of an entity’. In local government bodies, those charged with governance, for the purpose of complying with auditing standards, are:

- for local authorities – the full council, audit committee (where established), any other committee with delegated responsibility for approval of the financial statements;
- for police or fire authorities – the full authority, audit committee (where established), any other committee with delegated responsibility for approval of the financial statements;
- for local probation boards – the board, audit committee; and
- for other local government bodies – the full authority/board/council, audit committee (where established), any other committee with delegated responsibility for approval of the financial statements.

## Appendix 2: Transitional provisions

*[Transitional provisions will be included to apply to all audit work that relates to financial years ending on or before 31 March 2005, completed before 31 December 2005. The Code of Audit Practice that came into effect on 29 March 2000, suitably amended to take account of the changes brought about by the Local Government Act 2000, will be laid as Appendix 2 of this 2005 Code so that the provisions of the old Code can be applied where appropriate on a transitional basis. These provisions will lapse with effect from 1 January 2006.]*

*[Transitional provisions for Wales with the effect that the Commission's existing Code, which applies to both England and Wales, will be re-adopted so that its provisions will continue to apply in Wales up to 31 December 2005, to allow 2004/05 audits to be completed in an orderly manner.]*

# 2

## Part 2 – Code of Audit Practice – 2005: Consultation Draft (NHS)

### Overview of proposed structure of the Code

#### Contents

Foreword – not part of the formal Code

Preface – not part of the formal Code

The Code of Audit Practice – local NHS bodies

1. General principles

2. Auditing the financial statements

3. Auditors' responsibilities in relation to the use of resources

4. Reporting the results of audit work

Schedule 1: The audit of small bodies

Appendix 1: Glossary

Appendix 2: Transitional arrangements

# Foreword

(To be drafted for signature by Chairmen/ Chief Executives of the Commission and the Healthcare Commission. This will be included in the final published version but not in the version to be laid before Parliament.)

# Preface

## The role of external audit in the public sector

External audit is an essential part of the process of accountability for public money. It makes an important contribution to the stewardship of public resources and the corporate governance of public services. External auditors in the public sector give an independent opinion on public bodies' financial statements and may review, and report on, aspects of the arrangements put in place by public bodies to ensure the proper conduct of their financial affairs and to manage their performance and use of resources. Because of the special accountabilities attached to public money and the conduct of public business, external audit in the public sector is characterised by three distinct features:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements, but also aspects of corporate governance and arrangements to secure the economic, efficient and effective use of resources; and
- auditors may report aspects of their work to the public and other key stakeholders.

These features are consistent with the 'principles of public audit' as defined by the Public Audit Forum, which comprises all the national audit agencies in the UK.

## The role of the Audit Commission

The Audit Commission (the Commission) is an independent body with statutory responsibilities to regulate the audit of local government and NHS bodies in England, and to promote improvements in the economy, efficiency and effectiveness of public services.

In particular, the Commission is responsible, among other things, for:

- appointing auditors to local government and NHS bodies;
- setting the required standards for its appointed auditors; and
- regulating the quality of audits.

The Commission appoints auditors ('auditors'), from the Commission's own Operations Directorate and from private firms of auditors. It provides advice and support to auditors on technical matters and monitors their performance through a rigorous quality review process. Once appointed, auditors carry out their statutory and other responsibilities, and exercise their professional judgement, independently of the Commission.

## Statutory responsibilities and powers of appointed auditors

The statutory responsibilities and powers of appointed auditors are set out in the Audit Commission Act 1998. In discharging these specific statutory responsibilities and powers, auditors are required to carry out their work in accordance with the Commission's *Code of Audit Practice* (the *Code*).

### The Code of Audit Practice

The Audit Commission Act 1998 (the Act) requires the Commission to 'prepare, and keep under review, a *Code of Audit Practice* prescribing the way in which auditors (appointed by the Commission) are to carry out their functions under the Act, and which embodies what appears to the Commission to be the best professional practice with respect to the standards, procedures and techniques to be adopted by auditors'.

The Act also provides for the preparation of a 'different *Code*... with the respect to the audit of the accounts of health service bodies as compared with the *Code* applicable to the accounts of other bodies'.<sup>1</sup>

The *Code* must be read in conjunction with any directions made under section 98(2) or 98(2B) of the National Health Service Act 1977.

The Commission is committed to keeping the *Code* up to date to reflect changes both in the operating environment of audited bodies and in auditing standards and practice, and may amend the *Code* where appropriate in the light of practical experience.

Under the Health and Social Care (Community Health and Standards) Act 2003, 'the (Audit) Commission must obtain the agreement of the Commission for Healthcare Audit and Inspection before preparing or altering provisions of the *Code* which:

- a) are applicable to accounts which are or include the accounts of health service bodies;
- b) concern the function under s5(1)(e) (auditors' responsibilities in relation to the use of resources).

The *Code* must be approved by a resolution of each House of Parliament at intervals of not more than five years. In the intervening period, the *Code* may be amended by laying proposed alterations before Parliament. The *Code* prescribes the way in which auditors are to carry out their functions under the Act.

<sup>1</sup> This *Code* covers the audits of all local NHS bodies to which the Commission appoints auditors. It does not, therefore, cover the audits of NHS Foundation Trusts which appoint their own auditors under arrangements overseen by the Independent Regulator for NHS Foundation Trusts. Nor does it apply to the audits of charitable funds held on trust by NHS bodies. A separate *Code* has been prepared for the audits of local government bodies.

In addition to the *Code*, the Commission publishes separate documents that are aimed specifically at audited bodies and members of the public:

- **Statement of Responsibilities of Auditors and of Audited Bodies** – which highlights the different responsibilities of the auditor and the audited body, and the limits on what the auditor can reasonably be expected to do; and
- **Something to Complain About** – which explains how audited bodies or members of the public can complain about the work of the Commission and its auditors.

## The Commission’s model of public audit

The *Code* has been developed on the basis of the Commission’s model of public audit, which defines auditors’ responsibilities in relation to:

- the financial statements of audited bodies; and
- aspects of audited bodies’ arrangements for securing economy, efficiency and effectiveness in the use of their resources.

The model reflects the Commission’s concept of an ‘integrated audit’, in which work in relation to one element of the audit informs audit work in relation to other elements. Central to auditors’ work in relation to each of these audit responsibilities is a risk-based approach to audit planning, which reflects their overall knowledge of the audited body’s business and assessment of the relevant business risks that it faces.

## The contents of the Code

The *Code* comprises four sections:

- general principles;
- auditing the financial statements;
- auditors’ responsibilities in relation to the use of resources; and
- reporting the results of audit work.

Schedule 1 sets out provisions relating to the audits of small bodies. Appendix 1 contains a glossary of terms. Transitional provisions are set out in Appendix 2.

# 1. General principles

## Status and application of the Code

- 1 *[This Code has been laid before Parliament under section 4 of the Act and has been approved by resolution of each House of Parliament. It came into effect on (date) and replaces the Code that has been in effect from 29 March 2000, as amended on 1 April 2002. Transitional provisions set out in Appendix 2 apply to audit work that relates to financial years ending on or before 31 March 2005, completed before 31 December 2005. All other provisions of the Code apply to audit work that relates to financial years ending on or after 31 March 2006.]*
  
- 2 *[The provisions of the Code covering auditors' responsibilities at NHS bodies in relation to arrangements for securing economy, efficiency and effectiveness have been agreed with the Commission for Healthcare Audit and Inspection as required by the Health and Social Care (Community Health and Standards) Act 2003.]*

## Scope of the Code

- 3 This *Code of Audit Practice (Code)* prescribes the way in which auditors of local NHS bodies appointed by the Audit Commission (the Commission) should carry out their functions under the Audit Commission Act 1998 (the Act). As with any code that attempts to cover a wide variety of circumstances, the application of the Code in any particular case will depend on the specific circumstances and on auditors' assessment of what is reasonable and appropriate in those circumstances. All the provisions of the Code are to be read and applied with that necessary qualification.
  
- 4 The Commission may wish to appoint different auditors to carry out different elements of the audit at an audited body. In such cases, auditors should apply the Code in so far as, in their judgement, it is appropriate, taking into account any relevant guidance issued by the Commission.
  
- 5 There will be circumstances in which aspects of the Code that are potentially applicable may be inappropriate to the audit of certain bodies, for example, because of the nature of their business or the relatively small amounts of public money controlled by the bodies in question. In carrying out the audit of such bodies auditors should apply the Code in so far as, in their judgement, it is appropriate, taking into account the nature of the business of the body and any relevant guidance issued by the Commission. In carrying out the audit of bodies with either annual income or annual expenditure below a financial limit determined by the Commission from time to time, auditors should apply Schedule 1 to the Code if directed to do so by the Commission.

- 6 From time to time, when necessary, the Commission also issues guidance to auditors. The Commission does so under its powers under section 3(8) of the Act and paragraph 7 of Schedule 1 to the Act, to appoint auditors and to determine their terms of appointment.

## Scope of the audit and auditors' objectives

- 7 Because of the special accountabilities attached to public money and the conduct of public business, the scope of external audit in NHS bodies is extended to cover not only the audit of the financial statements but also aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in the use of resources. The audit of the financial statements is covered by professional auditing standards and so this *Code* focuses more on how the wider range of functions of auditors appointed by the Commission should be carried out.
- 8 Auditors' objectives are to review and report on, to the extent required by the relevant legislation and the requirements of the *Code*:
- (a) the audited body's financial statements and its Statement on Internal Control; and
  - (b) aspects of the audited body's arrangements for securing economy, efficiency and effectiveness in the use of resources.
- 9 Auditors should plan and carry out their audits to meet these audit objectives and comply with the requirements of the *Code*. Overall responsibility for carrying out an audit that meets these objectives is the responsibility of the appointed auditor.
- 10 Auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

## The audit approach

- 11 Auditors should carry out the audit efficiently and effectively, and in as timely a way as possible. In framing an audit approach to meet the objectives of the audit, they should:
- (a) plan and perform the audit, on the basis of their assessment of audit risks, determining where to direct their work and to allocate resources to ensure that the audit is tailored to the circumstances of the audited body. They should obtain such information and explanations as they consider necessary to provide themselves with sufficient evidence to meet their responsibilities under statute and the *Code*. Auditors are not expected to review or perform detailed tests of all financial or other systems and processes or of all accounting procedures and transactions;

- (b) have regard to the principle that each part of the audit needs to be viewed in the context of the whole, or integrated, audit. No one part stands alone and work in relation to one element of the audit informs work in relation to other elements;
- (c) have regard to the fact that local NHS bodies are part of the wider NHS which means that each audit of a local NHS body needs to be carried out in the context of the local health economy and the wider NHS, and developments to streamline and integrate the regulation of healthcare;
- (d) have regard to the fact that local NHS bodies operate and deliver their services in a range of partnerships or other forms of joint working arrangements with other public sector, voluntary or private sector bodies. Auditors should therefore consider whether they need to follow public money into and across such partnerships and joint working arrangements;
- (e) discuss with the audited body the need for timely and effective production of working papers and other information required for audit so that the audit process can be carried out as efficiently and effectively as possible;
- (f) establish effective co-ordination arrangements with internal audit. Auditors should seek to place the maximum amount of reliance on the work of internal audit whenever possible;
- (g) establish effective co-ordination arrangements with the Commission and other statutory inspectorates to minimise the burden of regulation on audited bodies, so far as is consistent with the discharge of auditors' responsibilities, and to make best use of overall audit and inspection resources;
- (h) co-operate with other external auditors, including the National Audit Office and auditors of NHS Foundation Trusts, and the Commission in order to ensure that audit work is carried out effectively within the context of the needs of the wider NHS;
- (i) co-operate with, and provide information to, the Commission (both locally and nationally) to enable knowledge of good practice to be transferred effectively across the NHS and from one audited body to another; and
- (j) adopt a constructive and positive approach wherever possible, and thereby support and encourage worthwhile change, while providing independent scrutiny and assurance, and fulfilling their statutory and professional responsibilities.

## Integrity, objectivity and independence

- 12 Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body, which does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired.

## Confidentiality

- 13 Auditors should take all reasonable steps to ensure that they and their staff comply with relevant statutory and other requirements relating to the holding and disclosure of information received or obtained during the audit.

## 2. Auditing the financial statements

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998.

Function	Statute
1 To be satisfied that the accounts comply with statutory requirements.	s5(1)(a),(c) ACA 98
2 To be satisfied that proper practices have been observed in compiling the accounts.	s5(1)(d) ACA 98
3 To express an opinion on the accounts.	s9(1)(b) ACA 98

- 14 The financial statements, which comprise the published accounts of the audited body, are an essential means by which it accounts for its stewardship of the resources at its disposal and its financial performance in the use of those resources. It is the responsibility of the audited body to:
- put in place systems of internal control to ensure the regularity and lawfulness of financial transactions;
  - maintain proper accounting records; and
  - prepare financial statements that give a true and fair view of the financial position of the body and its expenditure and income.
- 15 The audited body is also responsible for preparing and publishing with its financial statements a Statement on Internal Control.
- 16 Auditors are required to audit the financial statements and to give their opinion, including:
- (a) whether they give a true and fair view of the financial position of the audited body and its expenditure and income for the year in question;
  - (b) whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards; and
  - (c) for specified NHS bodies, on the regularity of the expenditure and income.
- 17 In carrying out this responsibility, auditors should provide reasonable assurance that the financial statements:
- (a) are free from material misstatement, whether caused by fraud or other irregularity or error;
  - (b) comply with statutory and other applicable requirements; and
  - (c) comply with all relevant requirements for accounting presentation and disclosure.

- 18 Auditors should review whether the Statement on Internal Control has been presented in accordance with relevant requirements and to report if it does not meet these requirements or if the Statement is misleading or inconsistent with other information of which the auditor is aware. In doing so auditors should take into account the knowledge of the audited body gained through carrying out audit work in relation to the body's arrangements for securing economy, efficiency and effectiveness in the use of its resources.
- 19 In carrying out their audit of the financial statements in accordance with the *Code*, auditors should comply with auditing standards currently in force, and as may be amended from time to time, and have regard to any other relevant guidance and advice, issued by the Auditing Practices Board (APB), including that covering the work of auditors in relation to audited bodies' Statements on Internal Control. Auditors should also comply with the APB's Ethical Standards currently in force, and as may be amended from time to time.

## 3. Auditors’ responsibilities in relation to the use of resources

This section sets out how auditors fulfil the following statutory function. References in the table are to the Audit Commission Act 1998.

Function	Statute
1 To be satisfied that proper arrangements have been made for securing economy, efficiency and effectiveness in the use of resources.	s5(1)(e) ACA 98

- 20 It is the responsibility of the audited body to put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them. Such arrangements form a key part of the system of internal control and comprise:
- the establishment and monitoring of the achievement of strategic and operational objectives;
  - the body’s policy and decision-making processes;
  - arrangements to ensure that services meet the needs of patients and taxpayers, and for engaging with the wider community;
  - arrangements to ensure compliance with established policies, procedures, laws and regulations;
  - the identification, evaluation and management of operational and financial risks and opportunities including those arising from involvement in partnerships and joint working;
  - the arrangements for the management of financial and other resources, including systems of internal financial control, and arrangements for reporting financial information;
  - the body’s framework for performance management, including arrangements to ensure data quality; and
  - the arrangements to ensure that the audited body’s affairs are managed in accordance with proper standards of financial conduct, and to prevent and detect fraud and corruption.
- 21 The audited body is responsible for reporting on these arrangements as part of its annual Statement on Internal Control.

## Auditors' responsibilities in relation to the use of resources

- 22 Auditors have a responsibility to satisfy themselves that audited bodies have put in place proper arrangements to secure economy, efficiency and effectiveness in their use of resources. In meeting this responsibility auditors should review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements and report on these arrangements.
- 23 Auditors' sources of assurance in discharging their responsibilities in relation to audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources are:
- the audited body's whole system of internal control as reported on in its Statement on Internal Control;
  - work specified by the Commission, in discussion with the Healthcare Commission, or delegated to the Commission by the Healthcare Commission in respect of its national value for money work programme;
  - the results of the work of statutory inspectorates if the results of the work have an impact on their responsibilities; and
  - any other work that they feel necessary to discharge their responsibilities.
- 24 Auditors should place reliance on the reported results of the work of statutory inspectorates in relation to corporate or service performance without carrying out procedures to assess the quality of the work performed and without reperforming any of the work.
- 25 In reviewing the audited body's arrangements for its use of resources, it is not part of auditors' functions to question the merits of the policies of the audited body, but auditors may examine the arrangements by which policy decisions are reached and consider the effects of the implementation of policy. It is the responsibility of the audited body to decide whether and how to implement any recommendations made by auditors and, in making any recommendations, auditors should avoid any perception that they have any role in the decision-making arrangements of the audited body.

## Considerations relating to planning audit work in relation to the use of resources

- 26 In planning their audit work in relation to the arrangements for securing economy, efficiency and effectiveness in the use of resources, auditors should consider and assess the relevant significant business risks, that is those significant operational and financial risks to the achievement of the audited body's statutory functions and objectives, that apply to the audited body, and are relevant to auditors' responsibilities under the *Code*, and the arrangements it has put in place to manage these risks. The auditor's assessment of what is significant is a matter of professional judgement and includes consideration of both the quantitative and qualitative aspects of the item or subject matter in question. Auditors should discuss their assessment of risk with the audited body.
- 27 Auditors' assessment of risk should reflect their consideration of the relevance and significance of the potential business risks faced by all bodies of a particular type, and other risks that apply specifically to individual audited bodies. Auditors should also consider the audited body's own assessment of the risks it faces and the arrangements put in place by the body to manage and address its risks. In assessing risks in relation to audited bodies' arrangements to secure economy, efficiency and effectiveness auditors should have regard to:
- evidence gained from previous audit work, including the response of the audited body to previous audit work;
  - the results of assessments of performance carried out by the Healthcare Commission; and
  - the work of other statutory inspectorates.
- 28 On the basis of their risk assessment auditors should plan their work and decide whether to:
- highlight the risk to the audited body;
  - defer any further work in the light of current or planned work by the body or other review agencies; or,
  - carry out work in relation to specific risks to form a view on the adequacy of aspects of the body's stewardship and governance and corporate performance management and financial management arrangements.
- 29 In considering whether to carry out work in relation to a particular risk, auditors should have regard to the potential for them to contribute to improvement in the delivery of the functions of the audited body.
- 30 Such work may include working with others in order to assess how well risks arising from the audited body's involvement in partnerships or other joint working arrangements are being addressed.

## Work relevant to the national studies programme of the Healthcare Commission<sup>1</sup>

- 31 The effective conduct of the national programme of studies by the Healthcare Commission, under section 57 (1) of the Health and Social Care (Community Health and Standards) Act 2003, which may be delegated to the Commission, may be enhanced by appropriately co-ordinated local work by auditors. For this reason, the Commission, in discussion with the Healthcare Commission, may specify additional elements of work to be carried out by auditors, which supplement the local risk-based approach to planning the audit.

## Nationally identified risks

- 32 The Commission may identify risks, relating to the use of resources, faced by all bodies of a particular type. In the light of these risks, the Commission may design programmes of work that require comprehensive coverage by auditors. The Commission may specify additional elements of work to be carried out by auditors, which supplement the local risk-based approach to planning the audit.

<sup>1</sup> The Healthcare Commission is the Commission for Healthcare Audit and Inspection.

## 4. Reporting the results of audit work

This section sets out how auditors fulfil the following statutory functions. References in the table are to the Audit Commission Act 1998.

Function	Statute
1 To comply with the <i>Code</i> .	s5(2) ACA 98
2 To consider whether, in the public interest, to report on any relevant matter that comes to the attention of the auditor so that it may be considered by the body concerned or brought to the attention of the public.	s8 ACA 98
3 To certify the completion of the audit.	s9(1)(a) ACA 98
4 To express an opinion on the accounts.	s9(1)(b) ACA 98
5 To refer the matter to the Secretary of State when NHS bodies make, or are about to make, decisions involving potentially unlawful expenditure or if they take, or are about to take, potentially unlawful action likely to cause a loss or deficiency.	s19 ACA 98

### Outputs from the audit

- 33 The results of audit work will be reported in a range of outputs which, unless specified otherwise, should be addressed to the audited body.
- 34 The following outputs should be issued at key points in the audit process:
- (a) audit planning document;
  - (b) oral and/or written reports or memoranda to officers and, where appropriate, directors, on the results of, or matters arising from, specific aspects of auditors' work;
  - (c) a report to those charged with governance summarising the work of the auditor;
  - (d) an audit report comprising the auditor's opinion on the financial statements and a conclusion whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources;
  - (e) a certificate that the audit of the accounts has been completed in accordance with statutory requirements; and
  - (f) an annual audit letter.

- 35 In addition, the following outputs, the need for which may arise at any point during the audit process, should be issued where appropriate:
- (a) a report dealing with any matter that the auditor considers needs to be raised, in the public interest, as a matter of urgency;
  - (b) a referral to the Secretary of State under section 19 of the Act; and
  - (c) information to be reported to the Commission in a specified format to enable it to carry out its functions or to assist the Healthcare Commission in carrying out its functions.

## Principles of audit reporting

- 36 Auditors should maintain regular communications with audited bodies and ensure that emerging findings are discussed with audited bodies at the level within the audited body which auditors consider to be most appropriate and on a timely basis.
- 37 All outputs from the audit should be issued promptly at the appropriate point in the audit process. Auditors should report to the audited body in such a way as to enable its directors and management to understand the nature and scope of the audit work, any matters of substance or significant issues arising from auditors' work, auditors' clear conclusions and judgements on these issues, and the nature and grounds for any concerns they have, indicating any action that needs to be taken by the audited body to secure improvement.
- 38 All outputs from the audit should be:
- clear and succinctly expressed;
  - supported by the evidence and analysis carried out by the auditor;
  - relevant to the needs of the audited body; and
  - explicit when drawing conclusions and making recommendations.
- 39 Auditors' recommendations, arising from their work in relation to audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources, should:
- be specific about what action the audited body should consider taking;
  - be useful, practicable and based on an assessment of the benefits to the audited body of implementing them; and
  - take account of the costs of implementation and, where these are likely to be significant, report them.

## Audit planning documents

- 40 Audit planning documents should set out how auditors intend to carry out their responsibilities, in the light of their assessment of risks. Auditors should explain their assessment of risks and discuss audit planning documents with those charged with governance. They should include provision for effective follow up arrangements to review whether the audited body has properly considered any matters that have been identified previously and, where appropriate, has implemented agreed actions. Planning documents should be kept under review and updated as necessary.

## Reports or memoranda on individual aspects of audit work

- 41 Auditors may report the results of, and matters arising from, specific elements or parts of the audit, in reports, memoranda or properly evidenced presentations. Such reports, memoranda or presentations should be prepared and issued or delivered as soon as possible after completion of the work.

## Reports to those charged with governance

- 42 Auditors' reports to those charged with governance should cover the full range of auditors' responsibilities under statute and the *Code*. However, these reports do not need to duplicate significant matters previously communicated to those charged with governance, for example through reports, memoranda or presentations on specific pieces of audit work during the course of the year. Auditors should satisfy themselves that these reports are considered at the level within the audited body, which they consider to be most appropriate.

## The audit report

- 43 The audit report covers all the responsibilities of the auditor under section 5 of the Act. Therefore, it comprises the auditor's opinion on the financial statements and, having regard to relevant criteria, the auditor's conclusion whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources. It should also include, by exception, any report by the auditor on:
- the Statement on Internal Control;
  - any matters that prevent the auditor from being satisfied that the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources;

- any referrals under section 19 of the Act; and
- any matters reported in the public interest in the course of, or at the conclusion of, the audit.

## Auditors' certificates

- 44 Auditors are required to certify the completion of each audit. The effect of the certificate is to close the audit and this marks the point when the auditor's responsibilities in respect of the audit of the period covered by the certificate have been discharged.
- 45 There will be occasions when audit work in relation to the financial statements is substantially completed but the audit cannot be concluded – for example, because there are outstanding matters to be resolved arising from action or possible action under the Act. Auditors should consider issuing their audit report, including the opinion and the conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources, as soon as the necessary audit work has been carried out, subject to any exception or other qualification that the auditor may need to consider.

## Annual audit letters

- 46 The purpose of preparing and issuing annual audit letters is to communicate to the audited body and key external stakeholders, including members of the public, the key issues arising from auditors' work, which auditors consider should be brought to the attention of the audited body. The annual audit letter should cover the work carried out by auditors since the previous annual audit letter was issued. The auditor should encourage the audited body to publicise the availability of the letter.
- 47 Whilst the format of the letter is not prescribed it should highlight the key issues drawn from reports to those charged with governance and auditors' conclusions on relevant aspects of the audit. It should be prepared in clear language that is concise and accessible to a wide audience.
- 48 The annual audit letter should be addressed to all the directors of the audited body and the auditor should ensure that all directors receive a copy. Where the audited body does not arrange for distribution to all directors, the auditor should make the necessary arrangements.
- 49 The auditor should issue the annual audit letter to the audited body as soon as possible after completion of the audit and, other than in exceptional circumstances, no later than a date to be specified by the Audit Commission, following the end of the financial year to which the accounts relate.

## Reports in the public interest (section 8 of the Audit Commission Act 1998)

- 50 Section 8 of the Act requires that auditors should consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit so that it may be considered by the body concerned or brought to the attention of the public.
- 51 Auditors should consider whether the public interest requires any such matter to be made the subject of an immediate report rather than of a report to be made at the conclusion of the audit. A report in the public interest should be made where auditors consider a matter is sufficiently important to be brought to the notice of the audited body or the public as a matter of urgency.
- 52 In preparing and issuing reports in the public interest auditors should tailor their approach to the urgency and significance of their concerns.

## Referrals to the Secretary of State

- 53 Auditors of NHS bodies have a particular responsibility under section 19 of the Act to refer forthwith to the Secretary of State any matter where it is believed that a decision by a body or officer has led to, or would lead to, unlawful expenditure, or that some action by a body or officer has been, or would be, unlawful and likely to cause a loss or deficiency. This responsibility is distinct from that of auditors of specified NHS bodies to give an opinion on the regularity of the body's expenditure and income.
- 54 Referrals to the Secretary of State may be concerned with matters of public interest. Therefore, whenever a referral is made, the auditor should also consider whether to issue a report in the public interest on the matter.

## Information to be reported to the Commission

- 55 From time to time auditors may be required to report information to the Commission in a specified format to enable it to carry out its functions or to assist the Healthcare Commission to carry out its functions.

# Schedule 1: The audit of small bodies

## Introduction

- S1.1** It is inappropriate to apply the same level of audit scrutiny to certain bodies as to principal authorities, because of the relatively small amounts of public money controlled by the bodies in question. This Schedule sets out the approach to be adopted for the audit of small bodies with either annual income, or annual expenditure, of up to a financial level determined, after consultation with relevant bodies, from time to time by the Commission (referred to in this Schedule as small bodies).

## Governance and accountability

- S1.2** It is the responsibility of small bodies to put in place proper arrangements to ensure the proper conduct of their financial affairs, and to monitor the adequacy and effectiveness of those arrangements in practice. Small bodies are required to prepare their accounts in accordance with their statutory responsibilities, and to maintain an adequate system of internal audit of their accounting records and control systems.
- S1.3** Small bodies meet their responsibilities by preparing and publishing, and providing the auditor with, the accounts prepared for the financial year, together with such additional information and explanation as is necessary to provide sufficient evidence that they have maintained adequate systems of internal control and internal audit throughout the financial year.

## The audit approach

- S1.4** Auditors of small bodies should undertake an examination of the annual accounts and additional information and explanation provided by the body.
- S1.5** Auditors should meet their responsibility by:
- reviewing compliance with the requirements for the preparation of the annual accounts;
  - carrying out a high level analytical review of financial and other information provided to the auditor; and
  - reviewing such additional information and explanation as is necessary to provide sufficient evidence that the body has maintained an adequate system of internal control and internal audit throughout the financial year.

- S1.6** Where, on the basis of the auditor's review, the auditor requires further evidence in relation to any relevant matter, additional testing should be undertaken to address the auditor's concerns.
- S1.7** When the auditor has completed an examination of the annual accounts and additional information and explanation provided, the auditor gives an opinion on the accounts and certifies the completion of the audit. Auditors provide assurance in the form of an opinion whether, on the basis of their review, the accounts and the other information provided are in accordance with the specified requirements and that no matters have come to their attention giving cause for concern that relevant legislative and regulatory requirements have not been met.

# Appendix 1: Glossary

**Act (the)**

The Audit Commission Act 1998.

**Annual audit letter**

Report issued by the auditor to an audited body, which summarises the audit work carried out in the period, auditors' opinions or conclusions (where appropriate) and matters of substance or significant issues arising from auditors' work.

**Audit**

The audit of the accounts of an audited body which comprises the audit of the financial statements and other work to meet auditors' other statutory responsibilities under the Audit Commission Act 1998.

**Audited body**

Body to which the Audit Commission is responsible for appointing the external auditor, comprising both the board members of the body (the directors of NHS bodies) and its management (the senior officers of the body). Those charged with governance are the directors of the audited body. (See also 'directors' and 'those charged with governance'.)

**Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

**Auditing standards**

Pronouncements of the Auditing Practices Board, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

**Auditor(s)**

Auditors appointed by the Audit Commission.

**Code (the)**

The *Code of Audit Practice*.

**Commission**

The Audit Commission for Local Authorities and the National Health Service in England and Wales.

**Directors**

Members of the board who are collectively and individually responsible for the overall direction and control of the audited body. (See also ‘those charged with governance’ and ‘audited body’.)

**Ethical standards**

Pronouncements of the Auditing Practices Board, which contain basic principles applicable to the conduct of audits with which auditors are required to comply, except where otherwise stated in the standard concerned.

**Financial statements**

The annual financial statements in the prescribed form, or the books of account for those audited bodies that are not required to produce statements.

**Healthcare Commission**

The Healthcare Commission is the short name for the statutory Commission for Healthcare Audit and Inspection created by the Health and Social Care (Community Health and Standards) Act 2003. The Healthcare Commission inspects health services and reviews and reports on their performance. Its remit includes carrying out national value for money studies across NHS bodies and it may delegate aspects of its national value for money programme to the Audit Commission.

**Inspectorates**

Those organisations that have responsibilities to carry out inspections including the Healthcare Commission. See also ‘review agencies’.

**Internal control**

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

**Materiality (and significance)**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects.’

The term 'materiality' applies only to the audit of the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, in addition to their responsibility to audit the financial statements, that do not necessarily affect their opinion on the financial statements. The concept of 'significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the financial statements. Significance has both qualitative and quantitative aspects.

#### **National studies programme of the Healthcare Commission**

The Healthcare Commission is responsible for promoting or undertaking national value for money studies across English NHS bodies other than Strategic Health Authorities. Work carried out in relation to this responsibility is referred to as the national studies programme of the Healthcare Commission and may be delegated to the Audit Commission.

#### **Regularity (of expenditure and income)**

Whether, subject to the concept of materiality, the expenditure and income of the audited body have been applied for the purposes intended by Parliament, and conform with the authorities that govern them.

#### **Review agencies**

Review agencies include inspectorates (see 'inspectorates') and others that have regulatory responsibilities in relation to local NHS bodies including the Department of Health, internal audit and regulators of the healthcare professions.

#### **Those charged with governance**

Those charged with governance are defined in auditing standards as 'those persons entrusted with the supervision, control and direction of an entity'. In local NHS bodies, those charged with governance, for the purpose of complying with auditing standards, are the board of directors and, in respect of certain responsibilities, the audit committee on behalf of the board.

## Appendix 2: Transitional provisions

*[Transitional provisions will be included to apply to all audit work that relates to financial years ending on or before 31 March 2005, completed before 31 December 2005. The Code of Audit Practice that came into effect on 29 March 2000 will be laid as Appendix 2 of this 2005 Code so that the provisions of the old Code can be applied where appropriate on a transitional basis. These provisions will lapse with effect from 1 January 2006.]*

*[Transitional provisions for Wales with the effect that the Commission's existing Code, which applies to both England and Wales, will be re-adopted so that its provisions will continue to apply in Wales up to 31 December 2005, to allow 2004/05 audits to be completed in an orderly manner.]*

# 3

## Part 3 – Revising the Audit Commission’s Code of Audit Practice: issues for stakeholders

### Contents

Introduction

Analysis of responses

General comments relevant to all sectors

Comments relevant to the health sector

Comments relevant to local government, housing and criminal justice

# 1. Introduction

- 1 In February 2004 the Commission distributed to key stakeholder groups its consultation paper on the issues which we see as influencing the development of new *Codes of Audit Practice* (the *Codes*). The paper was also made available on the Commission's website. Responses were received from a range of stakeholders who are listed in the Appendix.
- 2 This paper summarises the views that we have received and sets out how the Commission is responding in its drafting of the new *Codes* set out in parts 1 and 2.
- 3 In our consultation document we stressed that the *Code* is central to the Commission's audit regime and that our review of the current *Code* provides us with an opportunity to take forward the Commission's commitment to Strategic Regulation by proposing important changes to the way in which auditors will carry out their work at local audited bodies. In particular, we made proposals that we considered would help us to achieve the following goals:
  - clearer and more understandable reporting of the audit work, so that it has more impact where and when it is needed, by making conclusions and judgements more explicit and ensuring that any recommendations to improve performance that have significant resource implications are properly thought through and fully costed;
  - a more streamlined audit that is targeted on the areas where auditors have most to contribute to improvement, leaving other regulators to focus on the areas where they have most impact;
  - a significant reduction in compulsory value for money audit work; and
  - a more efficient audit, by linking the work that auditors do on financial aspects of corporate governance more closely to their work on the accounts.
- 4 We also explained in our consultation document that the paper was intended to help us seek views from stakeholders and other interested parties, including specifically the professional accountancy bodies and representative associations of audited bodies, on possible changes, before consulting more formally later in the year. We mentioned that our eventual aim will be to locate the statutory *Code* (or *Codes*) within an overarching document, summarising the standards that apply across the Commission's audit and inspection regimes in local government and health, to help audited bodies and other stakeholders understand how the different elements of our regulatory regime fit together.

5 Our overall timetable is as follows:

February 2004	Publication of the 'issues' consultation paper
April 2004	Completion of consultation on principles/issues
July 2004	Issue draft text of new <i>Code</i> (or <i>Codes</i> )
October 2004	Completion of consultation on new <i>Codes</i>
December 2004	Approval of the final draft prior to process for laying the <i>Codes</i> before Parliament
January 2005	Target date for commencement of <i>Codes</i>

## 2. Analysis of responses

### General comments relevant to all sectors

- 6 Generally the refocusing of audit work indicated by our proposals has been welcomed and, in particular, commentators agree that the proposals will fulfil the Commission's commitment to Strategic Regulation. The support for the principles of Strategic Regulation is consistent with the feedback to the Commission on other recent consultations – particularly the consultation carried out as part of developing the Commission's strategic plan. Commentators supported what they saw as measures to minimise or rationalise the burden of regulation, and supported the proposed focus on corporate performance management and financial management arrangements. But the comment was also made that the Commission will need to monitor the impact of proposed changes to ensure that the planned benefits of Strategic Regulation are achieved.

### Value for money audit work and contributing to improvement

- 7 While generally welcoming our proposals for focusing the auditor's value for money work on overall arrangements, there were comments about the way in which the auditor's functions should be carried out reflecting some mixed views and/or perceptions about the roles of auditors in local government and the NHS. One accountancy body commented that, if auditors are to be expected to assess value for money, there should be clear criteria against which to make such assessments. Two commentators expressed concerns about what they perceived as a move away from carrying out local service-based value for money studies which they felt could move the Commission away from areas of work that in the past have contributed to its reputation and credibility in public audit. A further concern reported by one commentator was that our proposals would shift the auditor away from a focus on auditing the accounts to a more strategic focus, which they did not consider to be appropriate. On the other hand, another commentator suggested that the *Code* needs to be more enabling to support improvement in services.
- 8 In general the business risk approach to the audit has been welcomed as the basis for all audit work under the *Code*. However, one commentator suggested that risk based planning of the audit work programme should be conducted in the context of a 'genuine discussion with the audited body' rather than, in their view, reflecting an imposed auditor view of the significant risks and, hence, the audit work to be done.
- 9 Other commentators suggested that the Commission's work on the *Code* should consider the impact on public services and their audit, since the last *Code* was written in 1999, of partnerships, pooled budgets, joint arrangements and so on. A commentator also referred to the audit implications of the preparation and publication of performance information on a multi-agency basis, across traditional organisational boundaries. These developments have implications for the risk assessments of auditors and so for the work that they plan to do across their responsibilities under the *Code*.

**The Commission's response**

***The Codes will be pitched at a high level, setting out principles governing the audits of local government and NHS bodies. Each Code will be an enabling document that will ensure that the audit can be tailored appropriately to local needs in the light of the Commission's commitment to Strategic Regulation. The Codes will say more about the approach to auditors' local value for money work than the audit of the accounts because this is the area that is not covered by professional auditing standards, which apply to the audit of the accounts. Nevertheless the provisions in the Codes relating to value for money work will be principles based. This will allow the Commission to set out in supporting guidance to auditors appropriate criteria for assessing aspects of value for money as required.***

***The Commission remains committed to ensuring that the audit is risk-based. This includes ensuring that auditors' risk assessments consider significant risks to audited bodies arising from their participation in partnerships and other forms of joint working.***

### Costing performance audit recommendations with significant resource implications

- 10 The proposal that generated the largest number of concerns among stakeholders was our proposal to cost those recommendations to improve performance which are likely to have significant resource implications. Views on this were mixed and some commentators put forward alternative proposals for improving the way in which recommendations are thought through before they are made to the audited body. Particular points raised were:
- it is the audited body's role to assess whether and how it should implement recommendations and to assess both the requirement for and the availability of resources;
  - management has a greater knowledge of the effects of implementing recommendations;
  - audited bodies will assess the costs and benefits of recommendations having regard to the organisation's assessment of acceptable risk and priorities;
  - the requirement to cost performance improvement recommendations is a good discipline but could impair audit independence: while recommendations should be well thought through and meaningful they should not prescribe actions that management is obliged to take;
  - a requirement to cost recommendations should not become a constraint on the auditor's freedom to surface important issues;
  - past experience of putting numbers on costs or savings from recommendations has shown that this directs the debate to the numbers rather than the points for improvement;
  - preparing robust costings would add significantly to the time required, and therefore cost of, audit work;

- it would be better to put more emphasis on identifying the benefits of implementing recommendations rather than focusing on costs;
- auditors should bear in mind the cost of recommendations, and one option would be to place the responsibility to assess costs on the audited body, but this would risk the estimates being inflated; and
- costing recommendations with significant resource implications only may be a way forward.

11 While some groups of local government treasurers who responded strongly supported our proposal for making conclusions more explicit and ensuring that recommendations are properly thought through and costed, another group of local authority treasurers qualified their support for the proposal. This second group welcomed the proposal 'if realistically undertaken' and went on to comment that determining spending levels that are acceptable to local people is a political judgement that is not for auditors to make. Another commentator noted that the Commission and its Code must retain an independent and neutral stance. Comments on the value for money of services or local strategic management decisions must respect the right of authorities to determine local issues within the national legislative framework.

***The Commission's response***

***The Commission remains committed to ensuring that auditors' conclusions and recommendations are relevant to the needs of audited bodies and are properly thought through. The credibility of the Audit Commission and its appointed auditors depends in large measure on the quality of reporting to audited bodies. Therefore, auditors should report in such a way as to enable members or officers to understand the nature and scope of the audit work, matters of substance or significant issues arising from auditors' work, auditors' clear conclusions and judgements on these issues, and the nature and grounds for any concerns, indicating any action that may be required to secure improvement. Audit reports should be:***

- ***clear and succinctly expressed;***
- ***supported by the evidence and analysis carried out by the auditor;***
- ***relevant to the needs of the audited body; and***
- ***explicit when drawing conclusions and making constructive recommendations.***

***Auditors' recommendations, arising from their work in relation to audited bodies' arrangements for securing economy, efficiency and effectiveness in the use of resources, should:***

- ***be specific about what action the audited body should consider taking;***
- ***be useful, practicable and based on an assessment of the benefits to the audited body of implementing them; and***
- ***take account of the costs of implementation and, where these are likely to be significant, report them.***

***The Commission also agrees with respondents that, in assessing the potential implications of recommendations, auditors should take care not to assume – or be perceived to assume – the responsibilities of the audited body or its management. Similarly, the Commission believes that it is not feasible or appropriate for auditors to be required to evaluate the costs of all recommendations. For example, where the auditor identifies fundamental weaknesses in the audited body's system of internal control, financial management or corporate governance, which need to be addressed by the audited body, it would be inappropriate to fetter the auditor's ability to raise these concerns, and the need for action, in a timely way, by imposing a requirement to cost recommendations.***

### Auditor's role in relation to performance information systems

- 12 Most stakeholders who commented on the points made in the consultation on 'aggressive performance management', and our proposals relating to the audit of performance information agreed that 'aggressive performance management' is a risk and that auditors should have a role in reviewing the underlying systems for preparing performance information, and reporting where they have concerns. An accountancy body agreed that responding to the risks of 'aggressive performance management' should be dealt with using a risk-based approach but another accountancy body suggested that there may be a need to redesign the current audit. Another commentator suggested that there is a need for more guidance where audit work on performance information is required, and that the focus of this work should be on systems. A local government respondent commented that current arrangements regarding performance indicators generally work well and suggested that the focus should be on management arrangements rather than a detailed review of indicators.
- 13 One commentator suggested that performance-rating systems determined by external bodies can, in their view be 'arbitrary' or 'too complex'. They suggested that it may instead be helpful for auditors to give an opinion on whether the audited body has itself set clear priorities and has management systems to support these.

#### ***The Commission's response***

***The Commission's intention is to focus auditors' responsibilities in relation to their local value for money work on the overall performance management and financial management arrangements of audited bodies. This work will be risk based and will encompass, on the basis of the auditor's assessment of risk, consideration of the work that auditors consider necessary in relation to arrangements for preparing and reporting key performance information.***

### Auditors' role in relation to Statements on Internal Control

- 14 One of the most significant developments in the reporting of governance arrangements by audited bodies themselves in recent years has been the introduction of requirements to prepare and publish Statements on Internal Control (SICs). In both the NHS and local government sectors audited bodies now have this responsibility. SICs became a requirement in local government for the first time in respect of the

financial year 2003/04, and the *Code* is an opportunity to reinforce the role of SICs in good governance reporting. Against this background we proposed that the *Code* should recognise this new requirement more explicitly. Because the requirement (particularly in local government) is still relatively new, commentators suggested that further clarification of our proposals relating to SICs would be helpful including clarification of the extent of any audit work relevant to SICs that may be needed. One group of local authority treasurers expressed concern that the new emphasis in the audit approach on SICs might be an additional burden for authorities.

- 15 Comments on what any further guidance should contain included one that auditors must take all reasonable steps to consult audited bodies in circumstances where their views on matters relevant to the SIC diverge from the audited body's own view. Another commentator suggested that guidance to auditors should emphasise the need to focus on the substance of SICs and not just the process of preparing and reporting them.

***The Commission's response***

***The Commission agrees that the development of SICs in the public sector has been significant and, in local government, is a relatively recent change. The responsibility for preparing the SIC is first and foremost the responsibility of the audited body, and the Commission notes that CIPFA has now prepared proper practice on the form and contents of SICs in local authorities and guidance on how to prepare them.***

***With regard to guidance on the auditor's role in relation to SICs the Commission will expect auditors to follow guidance in bulletins from the Auditing Practices Board (APB).***

## Audit reporting

- 16 Our proposals for seeking to improve audit reporting were generally welcomed but prompted several commentators to give views on what they consider to be weaknesses in the current reporting arrangements. For example, one commentator welcomed our proposal to use accessible language but went on to comment that this is 'rarely done successfully at present'. Similarly, another comment was that timely reporting of the right quality and clarity depends on audit teams having the right experience of audited bodies and the audit, and also depends on reporting timetables being agreed with clients prior to the audit. A local government respondent welcomed the commitment to reports being based on explicit criteria adding that such criteria have not been clear in the past.
- 17 One of the auditing profession's commentators made the point that auditors need to follow reporting guidance under SAS 610, and this sets certain limits on the language that can be used. The comment was also made that audit reports are for the audited bodies and that the onus for making audit reports more physically accessible is on audited bodies. Another commentator said that reports should be produced in a consistent format and then suggested that reporting would be further improved by appropriate follow up by auditors.

- 18 A further theme in our proposals on audit reporting is to improve the timeliness of public interest reports (PIRs). The references in our consultation document to public interest reporting prompted concerns about the higher profile that we are giving to public reporting and the 'drift towards PIRs'. There were also concerns about early issuing of PIRs with a comment that our emphasis in the *Code* should be on auditors raising concerns early with the audited body (and, in the NHS, with the strategic health authority). A comment was made that any changes to arrangements for reporting in the public interest should be consulted upon further.
- 19 Our consultation document made a reference to 'private' reports from auditors to the Commission. This prompted some to question what these are and/or to be concerned about the implications of these for the transparency of audit reporting.

***The Commission's response***

***The Commission remains committed to improving the quality and timeliness of audit reporting, in all its forms. The Commission also remains committed to the Public Audit Forum's principles of public audit, which include the expectation that auditors report in public where appropriate. The Codes will set out key principles relating to reporting (including principles relevant to issuing public interest reports). We also intend to take out some of the more detailed guidance on the process of preparing and issuing public interest reports.***

***The reference to 'private' reports to the Commission in our consultation document was a reference to the information that auditors need to provide to the Commission from time to time to enable the Commission to fulfil its functions. As such they are not subject to the reporting requirements that apply to the discharge of the auditor's own functions.***

### Other developments likely to impact on the audit

- 20 The Commission has, for several years, promoted effective co-ordination of work by authorities, internal auditors and external auditors under principles referred to as the 'Managed Audit'. Our consultation document made no explicit reference to the Managed Audit, and so some commentators (particularly groups of local authority treasurers) suggested that there would be benefits in making a specific reference to reinforce the principles of Managed Audit and, in particular, the contribution that internal audit can make to minimising duplication of effort.
- 21 The comment was made that the impact of accounting developments on the auditor's risk assessment needs to be considered more explicitly. Examples of relevant developments given were the introduction of Whole of Government Accounts and the international harmonisation of accounting and auditing standards. Another commentator suggested that we should make a more explicit reference to the impact on the audit approach of e-government.

- 22 A local government respondent made the general comment that the Commission should review the application to the public sector of auditing standards issued by the Auditing Practice Board. They should not necessarily be applied automatically without question.

***The Commission's response***

***The consultation document did not refer to the Managed Audit. This was not because the principles of the Managed Audit are no longer relevant. The Commission remains committed to ensuring that the new Codes promote these principles as far as possible since they are consistent with our commitment to Strategic Regulation.***

***The Commission does not intend to refer to specific areas of potential risk to authorities (such as the impact of new accounting standards or the consequences of implementing e-government) but will wish to ensure that, as high-level documents, the Codes requires auditors to make appropriate risk assessments that take account of such developments. This will help to ensure that the Codes will continue to be relevant over their expected five-year lifespan.***

***The Commission remains committed to applying relevant auditing standards to the audits of financial statements. In the UK the standard setting body is the APB which also issues Practice Note 10 on the application of auditing standards to the public sector. The Commission is an active participant in the APB's public sector committee, which will be updating Practice Note 10 in the light of recent changes to auditing standards.***

## Comments relevant to the health sector

- 23 The comments in the preceding section were generally applicable to audits across all the sectors falling within the Commission's audit regime. However, a number of comments were more specifically relevant to particular sectors or types of audited body. This section highlights the comments made that are particularly relevant to the audit of bodies in the NHS.

### A separate Code for the audits of NHS bodies?

- 24 Our consultation document suggested that we would continue to prepare a single Code covering audits in the NHS and local government but we indicated that we would have sector specific modules within this document, based on common principles. This reflected, in part, the differences in the audit regime around a basic core audit to be carried out in all sectors and, in part, the need for us to agree with the Healthcare Commission those parts of the Code that relate specifically to the local value for money work that auditors still need to do at NHS bodies. There is a suggestion that we should now go further than a modular structure to the Code and consider issuing a separate Code for health bodies. However, this suggestion needs to be considered alongside another comment that we should refer where relevant to social care as well as healthcare, recognising the cross-cutting nature of services in these areas.

**The Commission's response**

***Although we are pitching the document at a high-level that, as far as possible, will set out requirements that are generic to all audits, we agree that for ease of reference and to improve presentation it will now be helpful to have a separate Code for NHS audits. This separate Code will still contain a common core of requirements that will be based on the Commission's public audit model in both local government and health. We do not believe that a separate Code for audits of NHS bodies will facilitate or prevent cross-cutting work any more than would a Code covering both local government and the NHS.***

## The relationship with the new Healthcare Commission

- 25 A number of comments were made about the impact of the creation of the new Healthcare Commission (the Commission for Healthcare Audit and Inspection). In particular, commentators reinforced our own comments about the need to ensure that there is appropriate co-ordination between the Commission's audit regime and the role and remit of the Healthcare Commission. Stakeholders have asked for further clarification of the relationship of auditors appointed by the Audit Commission with the Healthcare Commission, and, in particular, the implications for local value for money work. Some have questioned whether our proposals go far enough to avoid duplication with the role and work of the Healthcare Commission.

**The Commission's response**

***The Commission continues to work closely with the Healthcare Commission. The parts of the Code that relate to local value for money audit at NHS bodies must be agreed with the Healthcare Commission. We believe that our proposals will minimise duplication and ensure that local value for money work dovetails with the responsibilities of the Healthcare Commission.***

## The impact of NHS foundation trusts

- 26 One of the most significant developments affecting the health sector specifically is the introduction of NHS Foundation Trusts which will not be subject to the Audit Commission's audit regime but will fall under arrangements determined by the new Independent Regulator for NHS Foundation Trusts. With this in mind a suggestion was made that we should consider what impact the increasing number of NHS Foundation Trusts might have on the provisions of the Code that relate to health bodies since, over time, our Code is likely to relate more to the audits of strategic health authorities and primary care trusts.
- 27 With regard to the question of whether the overall audit approach for NHS bodies generally should differ from that for NHS Foundation Trusts, there were slightly differing views. One view is that one of the reasons for introducing NHS Foundation Trusts is to give greater financial freedoms and so there would be an expectation of some differences between the audit regimes. On the other hand, another view is that both the Audit Commission's Code and the code of the Independent Regulator for NHS Foundation Trusts adopt the principles of public audit and while the statutory

arrangements are different this need not mean differences in the audit approach. Another commentator went further and suggested that the audit requirements for those local NHS bodies that remain within the Audit Commission's regime should be subject to the same audit approach as that applicable to NHS Foundation Trusts.

***The Commission's response***

***The Code will be a high-level document setting out the principles governing the audits of NHS bodies within the Commission's audit regime. As far as possible the requirements will be pitched at a level that will make them generic to the audits of all NHS bodies within the Commission's regime.***

***The Commission has also worked closely with the Independent Regulator and provided comments on the draft code for NHS Foundation Trusts. As far as possible the Independent Regulator and the Commission are preparing Codes that are consistent with each other while recognising the particular circumstances of NHS Foundation Trusts which are expected to have demonstrated high standards of performance.***

## Other comments

- 28 The structure of the NHS, and, in particular, the roles of strategic health authorities and other local bodies in local health economies, prompted an audit supplier to comment that there would be benefits in auditors being able to consider financial standing across health economies.
- 29 The commitment to shorter, more user-friendly audit reporting (particularly in the annual audit letter) was welcomed, with one comment that there should be a version aimed at the general lay reader.

***The Commission's response***

***The Commission agrees that there will be benefits in being able to look across health economies, particularly in relation to auditors' consideration of financial standing as part of their assessment of overall financial management arrangements. The Commission also considers it important that auditors of NHS Foundation Trusts and auditors of other NHS bodies are able to liaise appropriately and we are pleased that the Independent Regulator's code for audits of NHS Foundation Trusts acknowledges and provides for this.***

***The Commission remains committed to improving the clarity and accessibility of annual audit letters prepared for local NHS bodies.***

## Comments relevant to local government, housing and criminal justice

- 30 This section highlights the comments we received that are particularly relevant to the audits under the Audit Commission regime within the local government, housing and criminal justice sectors.

## Local government and housing

- 31 While our proposals under Strategic Regulation for streamlining the audit and being clearer about how auditors carry out their responsibilities within a more complex regulatory environment were welcomed, comments were made reinforcing the need to achieve, with other parties, a more co-ordinated approach to audit and inspection. There were comments that areas of activity outside the control of the Commission are relevant here and so steps will need to be taken to achieve effective co-ordination in practice. Another commentator added that while the role of Relationship Managers was good in principle the effectiveness of this role was weakened by those external bodies who do not fully participate in co-ordinated working.
- 32 Our proposals on reducing the burden of the audit of best value performance plans were welcomed. This is consistent with support that the Commission has previously received within the local government sector for the eventual removal of the separate audit of the best value performance plan.
- 33 There was a suggestion that we should make more explicit reference to the impact on the audit approach of the prudential framework in local government. This new approach to capital finance will have a significant impact on local authorities and will, in turn, be relevant to the work of auditors.
- 34 One commentator referred to the development, since the publication of the current *Code*, of the scrutiny function in local government. The potential impact of this on the auditor's role should be considered.
- 35 Some concerns were expressed about the perceived 'loss' of an annual audit letter for local government bodies. In particular, some commentators were unsure about its replacement by a brief summary document prepared by the Commission rather than by auditors.
- 36 A local government respondent welcomed the commitment to review how auditors consider and report on questions and objections from electors.

### ***The Commission's response***

***The Commission is committed to ensuring that audit and inspection work within its regime is co-ordinated effectively both within its regime and externally with the work of other inspectors and review agencies. This is consistent with our commitment to Strategic Regulation. The Commission is an active participant in the Local Services Inspectorate Forum and is working closely with other bodies, through that forum, to improve the co-ordination and proportionality of audit and inspection. For its part the Commission is taking steps, through the proposed changes to the Code, to ensure that audit work is based on an assessment of risks and is properly positioned within the overall regulatory environment.***

*We are also continuing to press for the removal of the statutory audit of the best value performance plan. While this remains a statutory requirement we will integrate the work required within the general audit in order to streamline it as far as possible.*

*The Commission recognises the impact on local government of the prudential framework. With this in mind we see the work that auditors will need to carry out on financial standing as forming a key part of the work that they will need to do in relation to overall financial management arrangements under the Code. This work will need to consider any significant risks to the audited body associated with meeting the requirements of the new prudential framework.*

*We believe that the general requirements in the Code relating to risk assessments by auditors should be sufficiently flexible for auditors to consider the possible impact on the audit of scrutiny arrangements on a case-by-case basis.*

*The Commission does not agree that the proposal for a combined annual audit and inspection letter for local authorities, prepared by the Commission, means that the annual audit letter by the auditor has been 'lost'. Auditors will continue to be required to report to those charged with governance under auditing standards and, if they consider it appropriate, will continue to be able to report in the public interest. Summarised findings from the audit will also feed into the combined audit and inspection letter. We believe that members of the public will find a short summary of the results of both audit and inspection work, written in plain English, helpful in informing their views on the performance of their local authority.*

*The Commission is continuing to review how auditors' work in relation to electors' questions and objections can be made more proportionate and timely.*

## Police authorities

- 37 One commentator suggested that there should be an explicit section dealing with police authorities recognising the differences in the performance management framework applicable to them.

### **The Commission's response**

*The Code will be a high-level document setting out the principles that auditors should adhere to when carrying out their statutory functions. As far as possible the requirements will be pitched at a level that will make them generic. The Commission does not consider that there is a case for a separate Code covering the audits of police authorities and that the differences in the performance management framework can be adequately reflected in more specific guidance to auditors in support of the Code.*

# Appendix 1: Respondents

## Local government, housing and criminal justice

Association of Police Authorities  
Society of London Treasurers  
Association of Local Authority Treasurers  
Society of County Treasurers  
Society of District Council Treasurers  
Birmingham City Council

## NHS

NHS Confederation  
Healthcare Financial Management Association

## Central government

Office of the Deputy Prime Minister  
Department of Health  
Home Office Accounting and Finance Unit

## Audit Commission audit suppliers

Audit Commission Operations  
Baker Tilly  
Deloitte  
PKF

## Other public audit agencies

National Audit Office  
Audit Scotland

## Accountancy profession

Chartered Institute of Public Finance and Accountancy  
Institute of Chartered Accountants in England and Wales

In addition the consultation paper was considered by the Commission's external Technical Advisory Group (TAG) whose membership includes representatives from HM Treasury, the Auditing Practices Board, public audit bodies, the accountancy profession and academic research into accountancy and audit. All the Commission's audit suppliers have also made comments through the Code Technical Working Group which comprises representatives from the Commission's Auditors' Group.



Copies of this report are available at: [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

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