

22 November 2019

David Aldous,
Director FAPQ
Via Email

Email tony.crawley@psaa.co.uk
Phone 07976 887573
Our reference CoAP Stage 2.

Dear David

PSAA response to the proposed Code of Audit Practice

PSAA welcomes the opportunity to comment on the proposed Code of Audit Practice (the Code), following on from the helpful first stage consultation process.

We are pleased to note that many of the proposed changes to the Code are consistent with suggestions made in our first stage response. The Auditor Guidance Notes (AGNs) to support the Code will set out the substance of the auditor's role, and so will be a key element of the framework. They will be especially important in helping to achieve common understanding and consistent practice as local audit moves to a VFM arrangements commentary from the current binary VFM arrangements conclusion.

We look forward to seeing draft updated AGNs in due course. We understand that they will be subject to a separate consultation process. We are keen to be involved in the discussion on the AGNs, especially as it will help us to understand and consider any implications for audit fees.

We have provided comments below on the Code, using the headings in the explanatory paper issued alongside it. We would be happy to provide further explanation if required, or to discuss any aspect of our response.

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

We welcome the Code continuing to be principles-based, allowing the AGNs to be flexible in dealing with developments that may emerge either from within the local audit environment or the wider professional and regulatory audit framework. The Code also provides helpful clarity on the responsibilities of both the auditor and the audited body.

We support the emphasis given to timely reporting. This is particularly important for the new VFM arrangements work that leads to a commentary in the Annual Audit Report (AAR) up to two months after the audit opinion deadline. It is vital that auditors report promptly on issues in advance of the AAR wherever possible, rather than waiting until they issue the AAR.

The Code's emphasis on teams having the right skills and knowledge is appropriate and timely. It is important that key members of the team have a good understanding of the specialist nature of the sector's financial reporting and auditing frameworks.

However, as you are aware there is a shortage of suitably experienced local auditors in the market at present, which is exacerbated given that in the current regulatory climate Code-compliant audits are more resource intensive to complete. This is a key issue and one which is central to the challenge of maintaining audit quality. Firms are making significant efforts to recruit, including from overseas, but it is likely to take some time to address the skills/knowledge shortage fully.

Our reading of the Code is that it demonstrates a desire for audit to be able to add value to a greater degree than is currently the case. This is in line with our view. We have also stressed the need for proportionality in its application, and we agree with the approach that audits should be geared to local risks relating to individual audited bodies rather than have imposed work programmes. We note the NAO's intention to develop minimum procedures that will be set out in the AGNs, and we are working on the basis that these will be provided as a helpful clarification to all parties of the baseline of the audit work expected, rather than being designed and commissioned in the style of an 'agreed upon procedures' approach.

In the event Chief Finance Officers, Audit Committee Chairs, auditors themselves and other local stakeholders are likely to make subjective assessments as to whether the new Code actually succeeds in adding value to the audit. In our view it will be important to monitor implementation of the new Code closely to enable a more objective, evidence-based view of its impact over time. We would be pleased to discuss how we may be able to contribute to that monitoring.

Chapter 2 – Audit of the financial statements

We welcome the approach not to dilute the application of auditing standards. We are aware of instances of significant tension currently relating to the extent of work carried out on areas of the statements that do not impact directly on resources available to bodies, such as elements of Property, Plant and Equipment (PPE). The debate often centres on the extent to which the needs of the users/public should drive the focus of audit work, alongside the importance of compliance with the requirements of the accounting and auditing frameworks. However, the Code is not the place to resolve these issues.

It may be useful clarification for the reader if the Code were to make specific reference to ISAs(UK) providing the basis for local audit. We understand that both Practice Note 10 and the CIPFA Code of Accounting for Local Government are in the process of being reviewed, and both may contribute to the debate about how the ISA(UK) auditing standards are applied to local audit.

The Code provides the NAO with the option of requiring enhanced auditor reporting (long form audit reports) to any organisations subject to the Code. We have no issue with the option being available to specify the application of enhanced reporting to those audits to which it is considered appropriate. However, we think that when considering the cost/benefit of introducing it to local government the NAO should take into account the sector's uniquely strong commitment to transparency. In particular the routine public availability of audit reports means that the added value of a long form report is more limited than in other sectors. Whilst we acknowledge that elements of ISA 260

reports are technical, they should include clear summaries of the work done and resulting conclusions and messages. At present they are only required by local government bodies that meet the definition of a Public Interest Entity (for example, those with transferable listed debt).

We acknowledge that audit reports and the financial statements themselves can sometimes be difficult for interested parties to find on audited bodies' websites, but enhanced audit reports would be similarly affected. The accessibility issue is not a matter for the Code to resolve.

Chapter 3 – VFM arrangements

We are supportive of the proposed changes in relation to VFM arrangements, many of which address the issues we raised in our response to the first stage of this consultation. The move away from a binary conclusion driven by the auditor's assessment of engagement risk to a commentary allows greater flexibility and enables the auditor's focus to be on the risks facing the audited body that are relevant to the auditor's responsibilities.

The emphasis on timeliness is important, with matters to be reported as soon as possible rather than waiting until the AAR. We recognise that the details of the framework need to be worked through and captured in the AGNs. Issues that need to be addressed include

- Enabling consistency of approach by auditors;
- Training/clarification for both auditors and audited bodies on the extent of the areas to be covered (eg there is a risk that the commentary is viewed as being expected to cover all that the body does), and what is expected in terms of reporting;
- Ensuring that it is clear to all parties that the auditors will continue to assess against a standard of "adequate arrangements";
- Ensuring that the commentaries are not simply descriptive and that the reader is clear on the auditor's view (this is particularly important as it is key to the new approach adding value);
- Ensuring that quality oversight will be applied consistently and that the assessors' expectations are clear to all parties before audit work is planned; and
- Consideration of how to highlight practices/arrangements that work well. The current pressures on audited bodies heighten the need to learn from elsewhere. Will there be any mechanism for audit teams to highlight practices/arrangements that they consider may be of interest? If so, how and by whom will they be followed up and disseminated for the greater good? Auditors will be working in line with their new Code responsibilities, and will not be assessing beyond the adequate level. This means that they are unlikely to be in a position to verify what may appear to be potentially good or excellent

arrangements, and so the risk is that opportunities to promulgate helpful examples may be missed.

A significant consequence of moving to a commentary is that there is a potential impact on audit fees. The Code is clear in stating that it is for the auditor to determine the appropriate level of work required to meet their responsibilities in response to the local risks. This further highlights the need for clarity in the AGNs on those responsibilities to enable all parties to understand what is needed.

Chapter 4 – Reporting the results of auditor’s work

We have already commented positively on the Code’s emphasis on timely reporting of any matters that the auditor considers appropriate for comment. This should ensure that decision-makers within audited bodies have an up-to-date understanding of their auditor’s concerns, and so can take them into account as they steward public money.

Our response to the first stage of this consultation highlighted our concern that the Annual Audit Letter (AAL) has become of very limited value. We welcome the evolution of the AAL to an AAR, which should provide a more informed presentation of the work of the auditor. We recognise that the process of constructing and discussing the new report may increase audit resource requirements, and that this is likely to mean more senior input and, potentially additional audit cost. In our view an outcome of greater engagement with the auditor’s work, comments and recommendations would be very positive. However, the challenge is to ensure that in overall terms the investment required to achieve the change is justified by the value that local audit adds for stakeholders.

Whilst we understand the reasons for separating the audit opinion on the financial statements and the AAR, we consider that there should be clear signposting between the two. This would help interested parties understand how to gain a full understanding of the auditor’s Code work on the audited body. This signposting is particularly needed when the audit opinion is issued in advance of the AAR.

The requirement to publicly track audit recommendations is also welcomed and will be helpful in demonstrating that bodies have taken appropriate action.

Chapter 5 – Additional powers

We agree with the Code’s increased emphasis on proportionality in relation to the auditor’s work. The Code usefully highlights s27 (4) of the LAAA 2014, which relates to the auditor needing to decide whether to consider objections (having first established validity). This is an important contribution to ensuring that objections are dealt with in a proportionate way, as it allows auditors to assess the objection at the initial stage beyond simply checking that it has met the administrative requirements.

It may be helpful to non-audit readers in particular if the Code were to make it clear that the auditor is able to give the audit opinion if there is an outstanding objection provided that the auditor is satisfied that the objection does not have an impact on that opinion.

We welcome the specifications re timeliness of objection responses, and we would look to build them into PSAA contract monitoring arrangements. However, we are unclear as to who would monitor performance at opted out bodies, given that challenge work is currently proposed to be outside of the remit of AQR.

Yours sincerely

A handwritten signature in black ink that reads "Tony Crawley". The signature is written in a cursive style with a large, sweeping initial 'T'.

Tony Crawley
Chief Executive