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PSAA Ltd welcomes the opportunity to respond to the NAO's consultation on AGN 03 'Auditors' Work on Value for Money (VFM) Arrangements'.

PSAA is specified as an appointing person under the provisions of the Local Audit and Accountability Act 2014, with responsibility for appointing auditors to eligible principal authorities (councils, local police bodies, fire authorities and other local government bodies) that have chosen to opt into the national auditor appointment scheme developed by the company. At 31 March 2020, 478 of the 487 eligible bodies (98%) had opted into PSAA's national auditor appointment arrangements for 2019/20. As such we are keen to comment on issues concerning bodies opted into our scheme.

We are supportive of the move in the 2020 Code of Audit Practice to introduce a VFM arrangements commentary as part of the reporting arrangements recognising that this is a real opportunity to produce an assessment which is of value to audited bodies and the public purse.

For clarity PSAA does not have a role to provide guidance to either auditors or audited bodies, and we are concerned that there is no body that is charged with providing guidance to the audited bodies on how to prepare for the new audit approach to the VFM arrangements. Whilst this AGN will be helpful, it is by design aimed at providing guidance to auditors.

In addition, the supporting guidance has a low profile amongst non-auditor readers, both in terms of its status and relevance to their organisations. Improved visibility and explanation would be of benefit to this group of readers, both enhancing their understanding of the revised approach but also enabling them to prepare for the VFM arrangements audits.

It is important to recognise that there is likely to be an increase in costs for the audited body, both in terms of providing the information and for the auditor's review to enable the commentary. This should be mitigated wherever possible by the auditor making as much use as possible of the body's business as usual documentation of its arrangements (including self-challenge) to inform ongoing audit planning, such as the Annual Governance Statement and supporting material. It would be helpful to reflect throughout the guidance the importance of the quality of the two-way process on the efficiency and effectiveness of the commentary itself.

Whilst not specifically covered by this consultation, it would be helpful if the NAO were to clarify how the success of the guidance will be measured and assessed in order to reflect points learnt during the transition period to the new arrangements, ensuring that the guidance is responsive to any operational matters which might emerge. The credibility of the new arrangements will be undermined if inconsistent interpretations and practices are not addressed in a timely and effective manner.

For example, an annual review may be helpful to identify any practical points arising from its application. Such a review (and refresh if appropriate) is particularly important in relation to the first year of the VFM commentary – perhaps there could be a commitment to at least consider/seek views on the need for a refresh after year one? Although a little way off, our post-2020/21 audit client survey could provide an opportunity to obtain feedback on audited bodies' views of the new commentary.

Consultation questions

Question 1 *– Do you have any comments on the scope of proper arrangements set out under each of three reporting criteria that auditors are required to report? If you think the scope of proper arrangements could be improved, please provide details.*

The explanations with the three reporting criteria are a welcome addition as they provide a high-level guide to the expectations of the auditor when constructing the commentary. A potential issue is that different auditors may default to different levels of challenge at similar authorities. It may be that more detailed guidance/criteria will be useful – this is one of the challenges that a review of year one would consider.

Question 2 *– Do you have any comments in respect of the approach to planning the audit work?*

We consider that a key change from the previous code is the requirement for the auditor to obtain sufficient evidence to be able to comment on all three criteria and judge whether there is a significant weakness in arrangements, rather than assessing whether there is a risk of a weakness in arrangements that could lead to an 'except for' or 'adverse' conclusion. We think the approach set out in the AGN to planning provides a sensible way to understand and document the authority's position. It is helpful that it is clear that where planning work has identified risks it might not be necessary to obtain any additional evidence to determine that there is a significant weakness in arrangements.

Whilst recognising that this is guidance for auditors, we think that it would be helpful to reiterate the desirability of integration and co-ordination of planning for both financial statements and vfm arrangements work.

Potential additional material/clarifications

There are some additional considerations that could support the planning process. For example, the Annual Governance Statements and the work of internal audit could be signposted when referencing internal control arrangements, and the governance arrangements could usefully encompass consideration and assessment of the effectiveness of the challenge from the audit committee/Those Charged with Governance to management's judgements.

Whilst the flexibility provided by para 38 in not having a pre-determined timeframe is understandable, some guidance on the expected timeframe for assessing financial resilience might be helpful - e.g. Is it primarily focused on the annual budget or on the MTFP, or is this for the auditor to decide based on the circumstances?

It would be helpful to recognise that improving the arrangements for economy, efficiency and effectiveness could result in stopping the provision of a discretionary service, or that closing or curtailing discretionary services may lead to an overall improvement in areas that the body has identified as its priorities is a subtlety that can be lost when only referring to areas for improvement.

We note that there is no reference to the body's consideration of options for delivery within the criteria. Regardless of the current methodology and model for service provision there should be periodic proportionate consideration of the available options.

Paragraph 18 states that '*the auditor…does not need to test the design and implementation or compliance of the arrangements. The auditor should perform sufficient procedures as is considered necessary to determine whether or not there is a significant weakness*'. We think that it would be useful for non-audit readers to explain some example audit procedures that are envisaged as alternatives to those referred to.

Audit planning evidence

It is clear that getting the planning right will be key to producing a good quality commentary. This is likely to require more time and potentially expert input from both the auditor and audited body than currently.

Based on previous experience we think it would be helpful if the guidance set out for audited bodies that the expectation is that the audit evidence required should mainly be drawn from the body's 'business as usual' documentation of its arrangements, rather than needing to be prepared specifically for the audit.

We note that the guidance does not refer to the body performing any form of self-assessment, but it is likely that the merits of producing one will feature in some local discussions. We think it would be helpful for the guidance to make it clear that a self-assessment is not a requirement, but that an organisation's vfm arrangements would not be complete without some form of self-challenge built in If appropriate arrangements are in place to self-challenge, then this should provide a rich source of information which the auditors could utilise. For example, the Annual Governance Statement should be a key document which could be relied upon. The guidance should emphasise that early discussion between the body and the auditor will help both sides to understand the new process and how assurances can be gained.

We note (para 35) that in assessing arrangements auditors are not expected to test bodies' compliance, for example with the CIPFA Financial Management Code. However, it would be helpful to state that if auditors find evidence of significant failures to comply that this could be indicative of a significant weakness in arrangements.

Question 3 *- Do you agree that the characteristics of a significant weakness in the AGN are helpful? If yes, are there any further characteristics of a significant weaknesses that could usefully be included?*

This will be helpful both for auditors and audited bodies for understanding and promoting consistency. We recognise that the NAO's role is to provide guidance for auditors, but there is also significant potential benefit to auditees. For this to have maximum impact we echo our comment in our response to the Code of Audit Practice, that the AGNs and the supporting information should be publicised to bodies to a greater degree so that they become more widely known. We are happy to include references in our communications to help.

We welcome the comment in paragraph 25 that information on outcomes is not required to determine a weakness, but evidence of outcomes can suggest that a weakness exists. There can be confusion about how outcomes should influence the auditor's assessment, and this provides clarity.

Question 4 *- Do you agree that the examples to help consider whether or not a weakness is 'significant' is helpful? If yes, are there any further considerations to determine when a weakness is 'significant' that could usefully be included?*

We think this will be helpful. We suggest there should be a clear reference to mitigation – i.e. a body could be exposed to big losses on investments but may have mitigated the impact through some form of insurance/bond.

Question 5 *- Do you agree that the illustrative significant weaknesses in the AGN are helpful? If yes, are there any further illustrative examples that could usefully be included?*

We think this will be helpful, particularly for an audience beyond the auditor.

Question 6 *– Do you think that the considerations for deciding how to report a significant weakness in arrangements are clearly communicated?*

We think the clear direction for the structure of recommendations (judgement, evidence, impact and action required) will be helpful for all concerned. We welcome the desire for prompt reporting.

Some further clarification on the links with statutory reporting might be helpful. Our understanding is that a significant VFM arrangements weakness requires a significant weakness recommendation (SWR) which is clearly labled as such. However, the context of the weakness might mean that the auditor decides to use one of the additional reporting powers. Paragraph 49 is confusing in this context in stating that there is no requirement to repeat the recommendation already raised. It maybe that the SWR merits statutory action in the first instance, or that it is required because of a failure of the authority to act. Although the recommendation is not required to be repeated, it would be helpful if it was clearly referenced in the Auditor's Annual Report, indicating where the details can be located.

Question 7 *– Do you think that the expectations set out in the auditor's commentary section ~~on~~ will help audited bodies to get more value out of the work auditors undertake on value for money arrangements?*

Yes – the move to extend the auditor's commentary period outside of the historical financial year is welcome. Particularly helpful is that '*auditors may also include areas for improvement or to keep in view even if they do not identify any underlying significant weaknesses in arrangements*'. This could include items such as an audited body needing to put in place suitable governance arrangements for the subsidiaries that it is planning to create.

We strongly agree with the statement that description is not sufficient to meet the Code's requirements, but are aware that the move to a commentary is a significant change in style that may take time to embed. We would encourage a review of first year commentaries to check compliance resulting in positive measures to guide improvement if descriptive elements of commentaries are identified.

If auditors avoid description and there are no significant weaknesses identified in one or more of the three areas, then there is likely to be an element of positive feedback in the commentary. However, the consultation draft does not refer to auditors highlighting notable elements in the body's arrangements (accepting that solutions are not necessarily transferable). In our response to the Code we stated the following, and we are not clear on the way forward on this matter.

'*Consideration of how to highlight practices and arrangements that work well would be helpful. The current pressures on audited bodies heighten the need to learn from elsewhere. Will there be any mechanism for audit teams to highlight practices and 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.'*

(PSAA response to NAO Consultation on the Code of Audit Practice, 2019)

Question 8 *– Do you think that the section setting out the approach to subsequent events is clearly communicated?*

It may be helpful to incorporate para 63 within an extended para 64 to provide the narrative flow to the events. We have provided a suggestion below:

Where new information comes to the auditor's attention which identifies a significant weakness after they have issued their report on the financial statements, auditors are not required to revisit their report on the financial statements, even if that weakness may have impacted on their opinion had they known about it at the time. The auditor should report the weakness to the body and make an appropriate recommendation in accordance with the requirements of this AGN (the 2020 Code further expects that auditors will raise such matters promptly during the course of the audit). Where the auditor has not yet issued their Auditor's Annual Report, they may include reference to the new issue *in their commentary on arrangements. The auditor should include reference to the recommendation in respect of this significant weakness in their report on the financial statements for the following year.*

Question 9 *– Do you agree with the proposal to maintain the supporting information separately from the statutory guidance set out in the draft AGN?*

Yes – continuation of this methodology enables the NAO to routinely provide updated information to auditors whilst the key 'instruction' guidance document will remain unchanged.

However, we think that it would be useful for the benefit of non-auditor readers to spell out in the AGN the extent of, and linkages to, the underpinning documentation such as the supplementary information, and where to find it. It would also be helpful to explain how consistency across sectors will be maintained.

Question 10 *- Are there any other ways in which you think that the guidance could be further strengthened or improved?*

See Question 11

General Comments

Question 11 - *Are there any other ways in which you think that the guidance could be further strengthened or improved?*

Our understanding is that under the current Code the auditor is expected to gather evidence to be satisfied that there are proper arrangements in place at an adequate level to deliver value for money, and that level of evidence required has not increased beyond that adequate level (instead it is the breadth of the arrangements that require public comments and the form of reporting are the areas that have the potential to increase the auditor's work). It may be helpful if the AGN were to clarify that the auditor is not expected to seek evidence to a higher level, for example to be satisfied that there is notable practice (this links to our response to question 7).

It would be helpful to clarify how the AGN is to be kept up to date in practice – for example an annual review to draw on the practical application of its contents. Such a review (and refresh if appropriate) is particularly important in relation to the first year of the VFM commentary – perhaps there could be a commitment to at least consider the need for a refresh after year one? Potentially this could be done through the sector specific supplementary information which we note is to be updated 'as and when required', but the AGN itself by definition carries more weight.

The move to a VFM commentary has the potential to be a very positive addition to the information available to help understand how audited bodies are dealing with the many challenges that they currently face. Arguably the pressures that audited bodies are expected to face mean that the auditor's assessment is more valuable than ever. However, the flipside is that it will cost more public money in respect of demands on both the auditors' and audited bodies' resources at a time when the demands on resources are more than ever.

It would be useful if the NAO set out how it will assess whether the new commentary is being implemented as intended and if it is providing value for money. We would be happy to explore ways that we could contribute to this assessment, for example via questions in our annual client survey that is carried out independently.