

PUBLIC SECTOR AUDIT IN THE UNITED KINGDOM

Introduction

In the UK England, Wales, Scotland and Northern Ireland have their own external public audit agencies. Each of these operates within its own statutory framework.

In England the audit of local government and health authority accounts is the responsibility of the Audit Commission, which also examines aspects of value for money across these bodies.

In Scotland a public body named Accounts Commission is responsible for auditing local authorities. Within the framework of the centrally guided decentralisation process in the United Kingdom and the transfer of devolved powers to new legislative bodies in different parts of the union¹, the post of Auditor General for Scotland was created to audit the accounts and conduct value for money studies of almost all public bodies in Scotland other than local authorities. The Auditor General took on his audit responsibilities in April 2000. The role of a new body, known as Audit Scotland, is to provide the Auditor General and the Accounts Commission with the services they need to carry out their duties. The Auditor General is appointed by the crown and reports to the Scottish Parliament. He is furthermore held accountable for Audit Scotland's work. The Accounts Commission appoints auditors to local authorities and the Auditor General to almost all other public bodies in Scotland. Appointments are made from Audit Scotland staff and private accountancy firms.

An Auditor General for Wales appointed by the Queen was created by the 1998 Act which established the National Assembly for Wales. The Auditor General is the head of the Wales Audit Office and responsible for auditing the Welsh Assembly Government, its sponsored and related bodies and National Health Service organisations in Wales. Apart from auditing accounts, he is also empowered to investigate whether value for money has been achieved.

Local government audit arrangements in Northern Ireland are similar to those in place in England and Wales before the establishment of the Audit Commission in 1983. The

¹ Since 1998 the constitutional structure of the United Kingdom has undergone profound changes. Through the process of devolution certain powers formally vested in the U.K. Parliament have been transferred to new legislative bodies located in Scotland, Northern Ireland and Wales. The process of devolution in the United Kingdom is neither new nor necessarily complete and it would be incorrect to assume that the level of devolved powers for each of these regions was identical. Through the provisions outlined in three key pieces of legislation, The Scotland Act 1998, The Government of Wales Act 1998, and The Northern Ireland Act 1998, differing degrees of home-rule were defined for each country. As a result of these acts, and many subsequent pieces of delegated legislation, Scotland and Northern Ireland now experience a traditional form of devolved government consisting of legislative and executive branches, although in Northern Ireland there have been periods when the Assembly was in suspension due to a breakdown in the Northern Ireland peace process. Wales' experience with devolution is more limited. At the present time there is no primary legislation authority granted to Wales.

Department of the Environment appoints local government auditors who are mainly responsible for the audit of Northern Ireland District Councils and report the results of their work to the Department of the Environment. Some of these auditors are staff of the Northern Ireland Audit Office (NIAO). The NIAO supports the Comptroller and Auditor General for Northern Ireland in fulfilling his responsibilities which includes the financial audit of all Northern Ireland departments and agencies, as well as a number of other bodies. He also has the power to conduct value for money investigations. The results of his work are reported to the Northern Ireland Assembly or to the United Kingdom Parliament during the suspension of devolution.

The following sections summarise the key features of the Audit Commission which is responsible for the audit arrangements in England².

Legal framework – the Audit Commission (England)

The Audit Commission for Local Authorities in England and Wales (the Commission) was established on 21 January 1983 by the Local Government Finance Act 1982. The Commission is a public corporation and began operations on 1 April 1983.

On 1 October 1990 the Commission assumed responsibility for the external audit of the National Health Service and its name was changed to the Audit Commission for Local Authorities and the National Health Service in England and Wales. A consolidating Act, the Audit Commission Act 1998, was given Royal Assent in June 1998 bringing the earlier statutory provisions together into one document.

The Public Audit (Wales) Act 2004 created a single audit office in Wales as from 1 April 2005, by transferring the office of the Audit Commission in Wales to that of the Welsh Auditor General. The words ‘and Wales’ were removed from the Commission’s name in 2008 under the Local Government and Public Involvement in Health Act 2007.

Since 1998, a number of important amendments to the Commission’s functions have been made by various statutes. Under the Local Government Act 1999 local authorities were given a new duty to make arrangements ‘to secure continuous improvement in the way in which their functions are exercised, having regard to a combination of economy, efficiency

² In August 2010, the Department for Communities and Local Government (DCLG) announced plans to put in place new arrangements for auditing England's local public bodies. DCLG has indicated that it intends to publish a draft Bill on the future arrangements for local public audit for further scrutiny and comment in spring 2012. The Bill will outline how the current audit regime and the Audit Commission will be replaced. The Audit Commission's in-house Audit Practice currently undertakes the majority of audits for local public bodies. In July 2011, DCLG Ministers confirmed their preference for transferring this work to the private sector by outsourcing contracts. The Commission's Board is carrying out a procurement process to give private sector bidders the chance to compete for the Commission's audit work. This will mean all of the Commission's in-house work will be outsourced in time for the audit of 2012/13 accounts. The Audit Commission will remain in place to oversee the contracts and other statutory functions but will be significantly smaller following the outsourcing.

and effectiveness.’ The Commission was also given a power to carry out an inspection of local authority services to assess compliance with this.

The Local Government Act 2003 gave the Commission power to inspect registered social landlords, as well as placing Comprehensive Performance Assessment (CPA) on a statutory footing. This gave the Commission power to undertake overall assessments of the performance of all local authorities and report publicly. The Fire and Rescue Services Act 2004 extended the Commission’s inspection function to the inspection of fire and rescue authorities’ compliance with the Secretary of State’s Fire and Rescue National Framework.

In 2008 the Local Government and Public Involvement in Health Act 2007 altered the Commission’s structure, made various changes and extensions to its powers, including a new power to advise and assist public bodies, and a new power to undertake Comprehensive Area Assessment. New powers were also conferred on the Commission by the Serious Crime Act 2007 on 6 April 2008 allowing data matching by the Commission to identify fraud.

On 1 April 2009 Comprehensive Area Assessment was introduced. This replaced CPA with a new assessment described below.

The Audit Commission Act 1998

The powers of the Commission have been brought together in one statute – the Audit Commission Act 1998. The Commission’s statutory powers and duties in relation to audit are to:

- appoint auditors to local government and NHS bodies;
- prescribe how auditors should carry out their functions through a Code of Audit Practice;
- set scales of fees for audit work; and
- make arrangements for certifying grant claims and returns.

The work of the Audit Commission

The work spans four main areas:

1. **Audit:** the Commission is the primary auditor of local public services. It appoints auditors to provide assurance and promote value for taxpayers’ money across local government, health, housing, community safety, fire and rescue and other public services. Some of these auditors work for private audit firms, but the majority work for the Commission’s own audit practice.
2. **Assessment:** the Commission carries out performance assessments for councils, fire and rescue services, and housing organisations. It also leads a team of six

inspectorates that have developed a new way of assessing public services, Comprehensive Performance assessment (CAA) focuses on how all local services work together to deliver better outcomes for the communities they serve.

3. Research: the Commission carries out research and provides independent, authoritative analysis to give insights into complex social problems and best practice in tackling them. It makes practical recommendations for policymakers and for people delivering public services.
4. Data-matching: the Commission helps public bodies detect fraud and error by comparing sets of data, such as payroll or benefits records. The National Fraud Initiative (NFI) has identified around £450 million of fraud and overpayments since it was established.

Scope of audit and assessment activity

Accounts and Value for Money

In England, the Commission's model of public audit is set out in the Code (or Codes) of Audit Practice which the Commission has a statutory duty to prepare, and keep under review. The Code(s) prescribe the way in which auditors must carry out their functions under the Audit Commission Act 1998 (the Act). The Code must embody 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 allows for separate Codes to be produced for the audit of local government and NHS bodies.

The Code has to be approved by both Houses of Parliament at five yearly intervals and auditors have a statutory duty to comply with it. As such, it constitutes secondary legislation, and Parliament approved the current Codes in March 2005.

The Codes are high level documents, which focus on the Commission's core requirements and aspects of audit specific to its regime. Each Code:

- sets out the general principles to be followed by auditors in delivering their objectives;
- outlines their responsibilities regarding the audit of financial statements and use of resources; and
- sets out the range of outputs through which the results of audit are reported.

As well as the audit of the annual accounts for each local authority, auditors are also required by the Code to report their conclusion on the audited body's arrangements for securing economy, efficiency and effectiveness in its use of resources (VFM conclusion). In order to be consistent, the Commission specifies standard criteria to assist auditors in arriving at their VFM conclusion.

The local government Code also outlines how auditors should fulfil certain specific statutory functions outlined in the Act. These specific functions are:

- to give electors the opportunity to raise questions about the accounts and consider and decide upon objections received in relation to the accounts;
- to apply to the court for a declaration that an item of account is contrary to law; and
- to consider whether to issue and, if appropriate, to issue an advisory notice or to make an application for judicial review.

Making arrangements for certifying grant claims and returns

The Commission's appointed auditors also certify audited bodies' claims for specific grants from government departments, e.g. Housing Benefit subsidy, which is payable to administering authorities by the Department for Work and Pensions, and other financial returns. Making arrangements for certifying grant claims and returns is a Commission, rather than an auditor, function, so in carrying out this work, auditors are acting as agents of the Commission, rather than in their own right. As such they are required to comply with specific instructions issued by the Commission, which are developed in consultation with the grant-paying bodies.

Comprehensive Area Assessment (CAA)

Comprehensive Area Assessment (CAA) is a new way of assessing local public services in England. Introduced in 2009, it examines how well councils and other public bodies, working together, meet the needs of the people they serve.

CAA is a story about people and places. For the first time, six individual inspectorates have provided a joint assessment of what it is like to live in each area of England and have assessed the prospects for sustainable improvement in the future.

Local public services will be held collectively to account for their impact on improving quality of life for residents. This means that CAA looks across councils, health bodies, police forces, fire and rescue services and others responsible for local public services, which are increasingly expected to work in partnership to tackle the challenges facing their communities.

CAA focuses on what is preventing improvement and identifies success and innovation that others can learn. In this way CAA is:

- a catalyst for improved local services and better value for money
- a source of independent information and assurance for citizens, service users and taxpayers
- an independent evidence base for central government on progress against national priorities
- a means of rationalising and coordinating inspection.

CAA looks most at what matters locally, reflecting the priorities of local communities, political leaders and service chiefs. It covers issues like reducing health inequalities, increasing affordable housing, reducing the fear of crime, improving education, attracting investment or reducing the area's carbon footprint. The issues assessed in each area reflect local priorities for improving quality of life and protecting the most vulnerable.

Other service or organisation specific assessments will continue. For example, health and police services will still be assessed by their respective inspectorates for those services that they are solely responsible for, but these will be delivered alongside CAA to avoid any duplication. Schools, colleges, social housing and residential care homes will also continue to be inspected to check they meet required standards.

Relationship of the Commission with Parliament and the National Audit Office

With regard to the Commission, Parliament has the following interest and responsibilities:

- under the terms of the Local Government Finance Act 1982, as noted above, it approves the Code of Audit Practice prepared by the Commission;
- it receives the Commission's annual accounts; and
- the Commission produces an annual report on the discharge of its functions. Copies are sent to the Secretary of State to be laid before Parliament.

The National Audit Office (NAO) is the public auditor of central government, and the external auditor of the Audit Commission's accounts. The Comptroller and Auditor General (C&AG), who is also the head of the NAO, presents the Commission's annual accounts to the Parliament.

Responsibilities of auditors appointed by the Commission

Auditor responsibilities in relation to the financial statements:

Auditors are required to audit the financial statements and to give their opinion, including:

- whether they present fairly, or, for local probation boards and NHS bodies, give a true and fair view of, the financial position of the audited body and its expenditure and income for the year in question;
- whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards; and
- for local probation boards, on the regularity of their expenditure and income.

In carrying out this responsibility, auditors are required to comply with auditing standards, which are ISAs (UK and Ireland), and should provide reasonable assurance that the financial statements:

- are free from material misstatement, whether caused by fraud or other irregularity or error;
- comply with statutory and other applicable requirements; and
- comply with all relevant requirements for accounting presentation and disclosure.

Auditors should review whether the statement on internal control (SIC) has been presented in accordance with relevant requirements and they should report if the statement:

- does not meet these requirements;
- is misleading; and/or
- is inconsistent with, or incomplete in the light of, other information of which the auditor is aware.

In doing so auditors should take into account the knowledge of the audited body that they gain through carrying out audit work in relation to the body's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Auditor responsibilities in relation to use of resources

Auditors also 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' 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.

Auditors should normally 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 re-performing any of the work, except where particular circumstances or information lead them to conclude that it would not be reasonable to place reliance on such reported results.

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. The audited body is responsible for deciding whether and how to implement any recommendations made by auditors. In making any recommendations, auditors should avoid any perception that they have any role in the decision-making arrangements of the audited body.

Audit procedures

The financial statements

The Audit Commission, along with other UK national auditing agencies has adopted the Audit Practices Board engagement standards and quality control standards as the basis of the approach to the audit of financial statements. Auditors must also undertake work in accordance with the Audit Commission's Code of Audit Practice.

The Audit Commission has developed a methodology for the conduct of audit assignments, bringing together the elements of the audit in such a way as to meet all the relevant requirements. Emphasis is placed on:

- planning the work on financial statements;
- understanding how figures get into financial statements;
- assessing the risks of material misstatement;
- obtaining sufficient appropriate assurance;
- undertaking the work as early as possible, and
- understanding the inter-relationships between different parts of audit work.

Auditors are required to give an audit opinion using the concept of materiality. To do so they should:

- plan an audit strategy;
- identify the material figures;
- ascertain what systems gave rise to them;
- identify opinion audit risk at the audited body level;
- identify opinion audit risk at the information system level;
- design and undertake tests that give adequate assurance that the figures are not materially misstated by using either control testing or substantive testing or a combination, as efficiently as possible;
- undertake procedures when the financial statements are available to gain sufficient assurance not already obtained earlier in the audit; and
- give an opinion, qualified or otherwise as is appropriate.

To be able to do these things it is important that auditors understand the audited body, how it works and the wider environment in which it operates, as well as understanding the regulatory infrastructure that surrounds audit work.

Value for money

The Code of Audit Practice requires auditors to include a conclusion in the statutory audit report as to whether they are satisfied that the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources (Conclusion).

The requirement under the Code for a conclusion flows from the statutory requirement on auditors to be satisfied that audited bodies have proper arrangements for securing economy, efficiency and effectiveness in the use of resources. Section 5(1)(e) of the Audit Commission Act 1998 (the Act) places the following duty on Audit Commission appointed auditors of those public sector bodies covered by the Act:

”In auditing accounts required to be audited in accordance with this Act, an auditor shall by examination of the accounts and otherwise ... satisfy himself that the body whose accounts are being audited has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.”

The scope of these arrangements is defined in the Codes as comprising:

- governance;
- corporate performance management; and
- financial management arrangements.

The conclusion is informed and limited by reference to 'relevant criteria' covering specific aspects of audited bodies' arrangements, specified by the Audit Commission in accordance with the Codes.

Auditors must also carry out risk based work to support their Conclusion if a specific risk has been identified.

Addressees of audit reports

In England, the Commission and the auditors have separate and distinct reporting responsibilities.

The Commission is required to publish an annual report on the discharge of its functions. Copies are sent to the Secretary of State, who lays copies before each House of Parliament. As noted earlier, the Commission undertakes studies designed to make recommendations for improving value for money in local government. Copies of these reports are sent to each local authority, to interested Members of Parliament and others, and are publicly available. Where studies are undertaken into the way in which central government actions impact on value for money in local government, the Commission also prepares a report, a copy of which is sent to the Comptroller and Auditor General.

The results of the work of auditors are communicated in a range of reports:

- the audit planning document – which sets out how auditors intend to carry out their responsibilities, in the light of their assessment of risks, and which will be kept under review and updated as necessary;
- 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 – which should be prepared and issued or delivered as soon as possible after completion of the work;
- a report to those charged with governance summarising the conclusions of the auditor – which should cover the full range of auditors' responsibilities under statute and the Code. In accordance with professional standards, this report has to be issued before the auditor finalises, and issues, his or her opinion on the financial statements;
- an audit report, including the auditor's opinion on the financial statements and a conclusion about whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources;
- a certificate that the audit of the accounts has been completed in accordance with statutory requirements; and
- an annual audit letter – which should communicate to the audited body and key external stakeholders, including members of the public, the key issues arising from auditors' work that they consider should be brought to the attention of the audited body. It should highlight the key issues drawn from the report 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.

Financial resources

The Commission receives very little funding from central government. Fees from audits are the Commission's principal source of income and account for 80 per cent of their turnover.

Setting scales of fees for audit work

The Act requires the Commission to prescribe scales of fees in respect of the audit of accounts which are required to be audited in accordance with the Act. Before prescribing any scale of fees it has a statutory duty to consult with audited bodies in local government and the NHS and their representative associations, and the accountancy profession.

Once the Commission has prescribed a fee it becomes payable by the body. The Commission sets scales on a 'fee for audit' approach, i.e. one that is outcome-focused

rather than based on input costs. The scales allow auditors to agree an audit fee with each audited body on the basis of delivering an agreed range of audit outputs to an agreed timetable.

If the auditor and the audited body cannot agree a fee within the range specified in the fee scale, the Commission has the power to determine the fee, which then becomes payable.

The fee scales comprise:

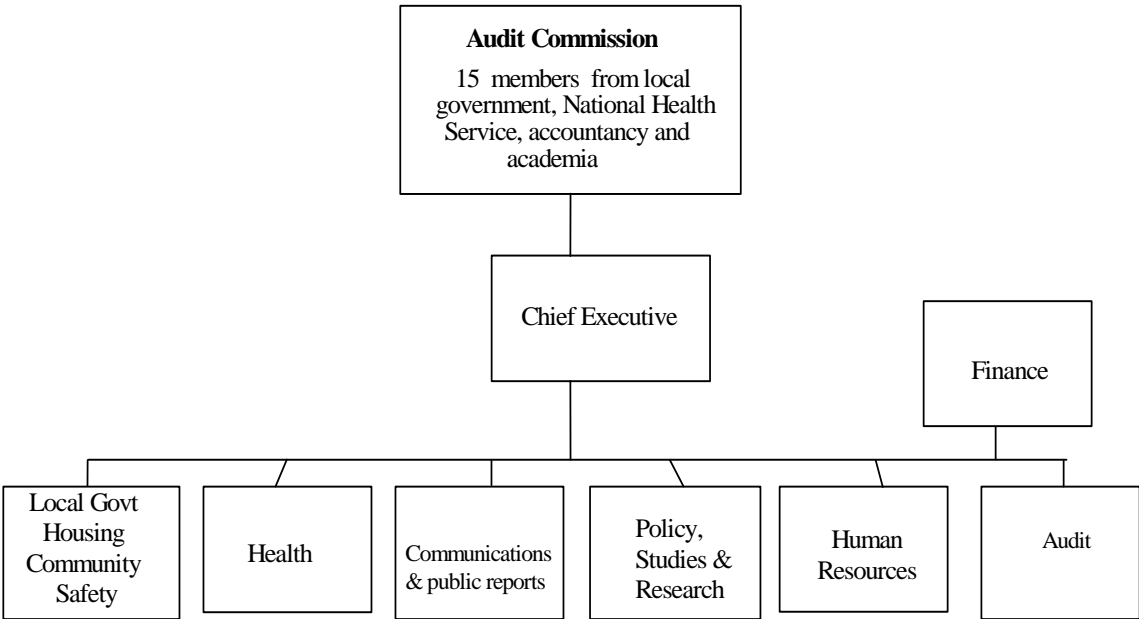
- a fixed element, which is calculated using a formula relating to the gross annual expenditure of the audited body, and any regional premium; and
- an element to reflect the auditor’s assessment of risk and complexity at the audited body. This variable element of the fee should not normally represent more than 30% of the scale fee.

The Commission also sets a schedule of hourly rates for different levels of staff, which are used for specific pieces of work that require the use of staff with specialist skills, in particular work relating to local government electors’ questions and objections.

The fee scales do not cover the costs of certifying grant claims and returns, because the mix and volume of claims and returns varies widely from authority to authority. So, this work is charged out at using the schedule of hourly rates, although in practice auditors often agree a lump sum for this work as part of the audit planning process.

Organisation

The Commission is organised as follows:



Commissioners

The governing board is made up of several commissioners and includes a Chairman. Commissioners are appointed by Communities and Local Government (CLG), following consultation with key stakeholders.

The commissioners meet six weekly and are responsible for:

- setting values, standards, strategy, and objectives
- determining the budget and for the way to carry out functions
- monitoring the Commission's performance
- accountability for the Commission's work
- ensuring that the Commission acts within our statutory remits

Managing directors

The day-to-day operations of the organisation are managed by a team of managing directors led by the Chief Executive. The Managing Directors cover the following 7 areas of the Commission work:

- Local Government and Housing
- Health
- Audit
- Human Resources
- Corporate Services
- Communication and Reporting
- Policy, Research and studies

Our people

The Commission employs over 2,000 people based in offices across England. Support services, like communications, human resources, IT and payroll are based at the main offices in London and Bristol.

In exercising its statutory powers in relation to audit the Commission aims are to secure high quality, value for money audits through a mixed economy of suppliers and to promote a consistent approach both between different auditors and across the country.

The Commission appoints an auditor for each local authority (including police and probation) and other bodies covered by the Act after consultation with the body (except for health authorities). Auditors may be either District Auditors (who are employees of the Commission) or private accountancy firms. The Act does not give audited bodies the choice of auditor as auditors must be independent.