

Public sector

March 2005



# Code of Audit Practice 2005

For local government bodies

The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high quality local services for the public. Our remit covers around 11,000 bodies in England, which between them spend more than £180 billion of public money each year. Our work covers local government, health, housing, community safety 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 ensure that public services are good value for money and that public money is properly spent.

For further information about the Audit Commission, visit our website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

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# Foreword

We are pleased to present the Audit Commission's new *Code of Audit Practice* for local government bodies.

The *Code* determines the nature, level and scope of local audit work and, as such, underpins all of our activities. It has been developed with the benefit of input from a range of key stakeholders who have responded to consultation documents and worked with us to produce a *Code* which will provide a robust framework for the delivery of the Commission's strategic aims and objectives over the next five years.

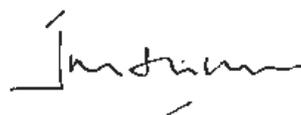
At the core of the Commission's strategy is a commitment to Strategic Regulation and the *Code* embodies the key principles which will contribute to the delivery of Strategic Regulation in practice.

We believe that this *Code* will produce benefits for local government bodies by maximising the impact and minimising the burden of regulation. It will result in:

- a more streamlined audit targeted to those areas where auditors have most to contribute to improvement;
- specific auditor judgements in respect of value for money, with a focus on overall financial and performance management arrangements;
- a reduction in mandatory value for money work on individual services and functions;
- better and clearer reporting of the results of audits; and
- auditors working in partnership with other regulators to provide a coherent and co-ordinated approach.

Our mission is to be a driving force in the improvement of local public services. The *Code* will enable us to provide the assurances on proper stewardship and value for money in the use of resources which underpin the delivery of high quality services to the public.

**James Strachan**



Chairman

**Steve Bundred**



Chief Executive

# 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 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 from the Commission's own staff 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 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>

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<sup>1</sup> This Code covers the audits of local government bodies. These comprise the various bodies that provide public services locally, 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.

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, 31 and 41 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.

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, where relevant, 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
- audited bodies' arrangements for securing economy, efficiency and effectiveness in their use of 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.

# 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 9 March 2005 and replaces the *Code* that has been in effect from 29 March 2000, as amended on 1 April 2002. The 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 the audited body's arrangements for securing economy, efficiency and effectiveness in its 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) whether the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its 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 economically, 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 and other forms of joint working or contracts with other public sector, voluntary or private sector bodies. Auditors should therefore consider whether they need to follow public money into and across such 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 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 maximum 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, thereby supporting and encouraging 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 that 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), (b), (c)
2. To be satisfied that proper practices have been observed in compiling the accounts.	s5(1)(d)
3. To express an opinion on the accounts.	s9(1)(b)

- 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<sup>1</sup>, 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;

<sup>1</sup> Although local probation boards are local government bodies for the purposes of this Code, they are not local authorities. In particular, local probation boards are subject to a different accounting framework from other bodies covered by this Code. Where relevant, requirements that apply specifically to local probation boards are highlighted in the Code.

(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 mis-statement, 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 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.

**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)
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)
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 corporate performance management and financial management arrangements form a key part of the system of internal control and comprise the arrangements for:

- establishing strategic and operational objectives;
- determining policy and making decisions;
- ensuring that services meet the needs of users and taxpayers and for engaging with the wider community;
- ensuring compliance with established policies, procedures, laws and regulations;
- identifying, evaluating and managing operational and financial risks and opportunities, including those arising from involvement in partnerships and joint working;
- ensuring compliance with the general duty of best value, where applicable;

- managing its financial and other resources, including arrangements to safeguard the financial standing of the audited body;
  - monitoring and reviewing performance, including arrangements to ensure data quality; and
  - ensuring that the audited body's affairs are managed in accordance with proper standards of 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 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.
- 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. 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.

## 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. These are the significant operational and financial risks to the achievement of the audited body's statutory functions and objectives, which apply to the audited body, and are relevant to auditors' responsibilities under the *Code*. 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 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. 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.

## Risks identified by the Commission

- 29 The Commission may identify risks relating to the use of resources faced by all local government bodies of a particular type or within a locality. In the light of these risks the Commission may develop 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)
2. To consider whether, in the public interest, to report on any 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
3. To certify the completion of the audit.	s9(1)(a)
4. To express an opinion on the accounts.	s9(1)(b)
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)
6. 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

- 30 The results of audit work will be reported in a range of outputs that, unless specified otherwise, should be addressed to the audited body.
- 31 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 conclusions of the auditor;
  - (d) an audit report including the auditor's opinion on the financial statements<sup>I</sup> and a conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its 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.
- 32** 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 under section 8 of the Act;
  - (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, or to assist bodies such as the Commission for Social Care Inspection and the National Audit Office in carrying out their functions.

## Principles of audit reporting

- 33** Auditors should maintain regular communications with audited bodies and ensure that emerging findings are discussed at the level within the audited body which auditors consider to be most appropriate and on a timely basis.

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<sup>I</sup> For local probation boards the opinion on the financial statements includes the auditor's opinion on the regularity of expenditure and income.

- 34 All outputs from the audit should be:
- clear and succinctly expressed;
  - relevant to the needs of the audited body;
  - explicit when drawing conclusions and making recommendations; and
  - issued promptly at the appropriate point in the audit process.
- 35 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 significant issues arising from auditors' work;
  - the nature and grounds for any concerns they have; and
  - where appropriate, any action that needs to be taken by the audited body to secure improvement.
- 36 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 this.

## Audit planning documents

- 37 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.

- 38 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

- 39 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

- 40 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 that they consider to be most appropriate.

## The audit report

- 41 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 its 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 being satisfied that the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its 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

- 42** 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.
- 43** 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 its 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

- 44 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.
- 45 While the format of the annual audit 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.
- 46 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.
- 47 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 Commission, following the end of the financial year to which the accounts relate.
- 48 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

- 49 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.
- 50 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.
- 51 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

- 52 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

- 53 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
2. To apply to the court for a declaration that an item of account is contrary to law.	s17
3. To consider whether to issue and, if appropriate, to issue an advisory notice or to make an application for judicial review.	s19A, 19B and 19C s24

- 54 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, including when they are carrying out audits of small local government bodies under Schedule 1, auditors should tailor their approach to the particular circumstances of the matters under consideration.
- 55 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.

- 56 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.
- 57 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 that summarises the audit work carried out in the period, auditors' opinions or conclusions (where appropriate) and 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.

## **Audit committee**

A committee established as part of the overall governance arrangements of the audited body. Audit committees are not mandatory for local government bodies, except for police authorities and local probation boards. However, bodies are expected to put in place proper arrangements to allow those charged with governance (see below) to discuss audit matters with both internal and external auditors. In local authorities this is achieved in a variety of ways, for example, through the full council / authority, an audit committee, an overview and scrutiny committee or any other committee.

## **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 APB, 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)**

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

**Ethical standards**

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and 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 are responsible for carrying 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, for the purposes of applying this *Code*, local authorities, local councils (parish and town councils), police authorities, fire authorities, national park authorities and local probation boards. While some of these bodies, such as local probation boards, operate within their own national policy framework, the model of public audit set out in this *Code* applies to them.

**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 mis-statement 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, which 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 the expenditure and income of local probation boards)**

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 whether they 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.

### **Statement on internal control**

Local government bodies are required to publish a statement on internal control (SIC), in accordance with proper practice, with their annual accounts. Local probation boards are required to prepare a SIC in accordance with the requirements specified by HM Treasury in Government Accounting.

**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; and
- 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.

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