The role of the external auditor

Member briefing

June 2013
Agenda

Audit overview

- The framework
- Relationship between KPMG and the Audit Commission
- Audit report
- Integrated approach
- Auditors’ statutory powers & duties
- Auditors’ work on certification of grants
- Audit cycle
- Balance of internal controls and substantive testing

Practical examples

- Fixed Assets and Pension
- VFM

Local Audit Bill

Questions
The framework

The code of audit practice 2010 – local government

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

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 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.

The CIPFA code of practice on local authority accounting

This Code of Practice is based on International Financial Reporting Standards (IFRSs), and has been developed by the CIPFA/LASAAC Code Board under the oversight of the Financial Reporting Advisory Board.
The Department of Communities and Local Government (DCLG) has indicated that it will abolish the Audit Commission and establish a new local public audit regime. However, the government has not yet committed to a firm timetable for laying the required legislation before Parliament.

Until it is abolished by legislation, the Audit Commission will continue to fulfil its statutory functions which include:

- appointing auditors to local government and NHS bodies in England;
- setting a ‘scale fee’ for each audit, and approving any requests for variations to this fee;
- making arrangements for the certification of grant claims and returns submitted by local bodies;
- data matching (the National Fraud Initiative); and
- publishing national studies, although these will be limited to reporting the outputs of auditors’ work – such as the Audit Commission’s annual *Auditing the accounts and Protecting the public purse reports*.

Following the outsourcing of the Commission's in-house Audit Practice, all auditor appointments are of private firms. In assessing the quality of financial statements audits, the Audit Commission uses the work of the Financial Reporting Council’s Audit Quality Review Team (AQRT).
Audit report

Financial Statements

Whether the financial statements:

- Present a true and fair view of the financial position of the Authority and its income and expenditure for the year ended 31 March; and

- Have been prepared in accordance with relevant legislation and applicable accounting standards.

We also consider the Annual Governance Statement.

- 30 September deadline

We also consider the Whole of Government Accounts Pack

- 5 October deadline

Value for money

Whether the Authority has proper arrangements in place for:

- securing financial resilience; and

- challenging how it secures economy, efficiency and effectiveness.

30 September deadline
Integrated approach

Audit of accounts

Value for Money conclusion
Auditors’ statutory powers & duties

Under the Code of Audit Practice external auditors have statutory powers and duties which they can enforce.

Local electors have the right to question the auditor and make objections, and auditors’ responsibilities in dealing with them, are set out in the Audit Commission Act 1998 with further specification in the Accounts & Audit Regulations (revised in 2011).

The auditor’s powers include:

• issuing a public interest report;
• issuing recommendations requiring public response;
• applying to the court for declaration that an item of account is contrary to law; and
• issuing an advisory notice or making an application for judicial review.

The public has significant rights of access to information held by the authority as well as rights that can be exercised during the audit of an authority’s accounts.

As well as being able to contact an auditor informally to raise issues, electors have a statutory opportunity to ask the auditor questions about the accounts of any authority for which they are an elector. The opportunity is time limited and the scope narrowed by the rights of inspection.
Auditors’ work on certification of grants

KPMG’s role

Grants certification is part of the work we perform under our Audit Commission audit work.

We act as agents of the Commission when undertaking certification work:

- not as independent appointed auditors
- grants work is therefore open to scrutiny under the Freedom of Information Act.

This is not an audit – it is a different form of assurance engagement, the precise nature of which will vary according to the amount of the claim or return.

Auditors complete a programme of testing in accordance with Audit Commission guidance.

There is a certification instruction (CI) for each type of grant.

Auditors issue a certificate on each claim or return to grant paying body.

We copy details of any significant adjustments or qualifications to the Audit Commission.

When do we certify them?

Most grants work takes place between July and September of each year.
## Audit cycle

<table>
<thead>
<tr>
<th>Stage</th>
<th>Tasks</th>
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</table>
| **1. Planning** | Update our business understanding and risk assessment.  
Assess the organisational control environment.  
Determine our audit strategy and plan the audit approach.  
Discuss our deliverables with management. |
| **2. Control evaluation** | Evaluate and test selected controls over key financial systems.  
Review the internal audit function.  
Review the accounts production process.  
Review progress on critical accounting matters. |
| **3. Substantive procedures** | Plan and perform substantive audit procedures.  
Conclude on critical accounting matters.  
Identify audit adjustments.  
Review the Annual Governance Statement. |
| **4. Completion** | Declare our independence and objectivity.  
Obtain management representations.  
Report matters of governance interest.  
Form our audit opinion. |

### Timeline

- **Jan**  
- **Feb**  
- **Mar**  
- **Apr**  
- **May**  
- **Jun**  
- **Jul**  
- **Aug**  
- **Sep**
Balance of internal controls and substantive testing

<table>
<thead>
<tr>
<th>What we do</th>
<th>Accounts/transactions suited to this testing</th>
<th>For example KPMG’s approach to:</th>
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<tbody>
<tr>
<td>Extensive controls testing</td>
<td>Reduced substantive testing</td>
<td>Low value transactions</td>
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<tr>
<td>Low value transactions</td>
<td>High volume</td>
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<tr>
<td>Homogenous transactions</td>
<td>Little judgement</td>
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<tr>
<td>Low/medium value</td>
<td>Moderate controls testing</td>
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<tr>
<td>Moderate substantive testing</td>
<td>Moderate substantive testing</td>
<td>Low/medium value</td>
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<tr>
<td>High/medium volume</td>
<td>Some areas requiring judgement</td>
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<tr>
<td>Limited controls testing</td>
<td>Extensive substantive testing</td>
<td>High value/ low volume</td>
</tr>
<tr>
<td>Extensive substantive testing</td>
<td>Unusual non-recurring</td>
<td></td>
</tr>
<tr>
<td>Accounting estimates</td>
<td>Significant judgements</td>
<td></td>
</tr>
<tr>
<td>Income and debtors</td>
<td>Purchases and payables</td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td>Valuation of fixed assets</td>
<td></td>
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<tr>
<td>Valuation of fixed assets</td>
<td>Investments and borrowings</td>
<td></td>
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<tr>
<td>Provisions</td>
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## Practical examples
### Fixed assets and pension

<table>
<thead>
<tr>
<th></th>
<th>Fixed Assets</th>
<th>Pension</th>
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<tbody>
<tr>
<td><strong>Controls testing</strong></td>
<td>- Impairment Reviews.</td>
<td>- Joiners/ leavers to scheme.</td>
</tr>
<tr>
<td>(selecting controls to</td>
<td></td>
<td>- Change in rates applied appropriately.</td>
</tr>
<tr>
<td>test)</td>
<td></td>
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<tr>
<td><strong>Analytical review</strong></td>
<td>- Review depreciation charge.</td>
<td>N/a</td>
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<tr>
<td></td>
<td>- Using capital programme ensure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>completeness of disposals is</td>
<td></td>
</tr>
<tr>
<td></td>
<td>reasonable.</td>
<td></td>
</tr>
<tr>
<td><strong>Test underlying detail</strong></td>
<td>- Agree sample of additions to</td>
<td>- Agree assumptions to</td>
</tr>
<tr>
<td></td>
<td>invoice.</td>
<td>benchmark data.</td>
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<tr>
<td></td>
<td>- Agree sample of capital receipts to</td>
<td>- Agree data provided to HR.</td>
</tr>
<tr>
<td></td>
<td>invoice.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Reperform impairment review.</td>
<td></td>
</tr>
<tr>
<td><strong>Disclosures</strong></td>
<td>- Agree to audit work.</td>
<td>- Agree back to actuarial reports and audit work.</td>
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Practical examples
Note on approach to VFM

Background to approach to VFM work

In meeting their statutory responsibilities relating to economy, efficiency and effectiveness, the Commission’s Code of Audit Practice requires auditors to:

- plan their work based on consideration of the significant risks of giving a wrong conclusion (audit risk); and
- carry out only as much work as is appropriate to enable them to give a safe VFM conclusion.

To provide stability for auditors and audited bodies, the Audit Commission has kept the VFM audit methodology unchanged from last year. There are only relatively minor amendments to reflect the key issues facing the local government sector.

The approach is structured under two themes, as summarised below.

<table>
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<tr>
<th>Specified criteria for VFM conclusion</th>
<th>Focus of the criteria</th>
<th>Sub-sections</th>
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</table>
| The organisation has proper arrangements in place for securing financial resilience. | The organisation has robust systems and processes to:
- manage effectively financial risks and opportunities; and
- secure a stable financial position that enables it to continue to operate for the foreseeable future. | Financial governance, Financial planning, Financial control |
| The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness. | The organisation is prioritising its resources within tighter budgets, for example by:
- achieving cost reductions; and
- improving efficiency and productivity. | Prioritising resources, Improving efficiency and productivity |
Overview of the VFM audit approach

The key elements of the VFM audit approach are summarised below.
Future changes to the external audit regime
Local Audit Bill – the story so far...

Consultation document: ‘Future of local public audit’
- March 2011

Consultation responses to CLG
- June 2011

DCLG response to consultation feedback
- January 2012

Draft Local Audit Bill published
- July 2012

Ad hoc committee commences pre-legislative scrutiny
- September 2012

CLG publishes summary of consultation responses
- October 2012

Ad hoc committee publishes its report
- January 2013

Local Audit & Accountability bill is published
- May 2013
Local Audit Bill - Key proposals

Key principles

Localism

Lower audit fees

High standards of audit

Appointment process

Auditor Panels

Independent Chair & members

5 year appointments

Resignation & removal

Regulation & standards

Eligibility requirements

Register of eligible auditors

NAO to define *Code of Audit Practice*

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Key conclusions in Ad Hoc Committee report

- Proposed arrangements are workable, but...
  - Complexity exposes a number of gaps
  - Self-appointment risks compromising independence of auditors
  - Economies of scale in audit fees may be lost
  - Must ensure governance structures are not duplicated
  - Auditor panels should be replaced by statutory requirement to strengthen audit committees
  - Most concerns addressed by retaining procurement capacity, but if not...
Any Questions?

Further guidance:

• Previous audit committee papers

• [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)
Thank you

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