



Code of Audit Practice

ICAEW welcomes the opportunity to comment on the consultation document *Code of Audit Practice (Draft)* published by the National Audit Office on 19 September 2014, a copy of which is available from this [link](#).

This response of 31 October 2014 has been prepared on behalf of ICAEW by the Regulatory Policy Team of the Professional Standards Department.

As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers, as statutory auditors under the Companies Act, all the firms that currently carry out work for the Audit Commission. We are currently in the process of making our RSB application to the Financial Reporting Council to regulate auditors of principal local public bodies under the Local Audit and Accountability Act 2014.

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For more information, please contact sumita.shah@icaew.com

icaew.com

MAJOR POINTS

1. ICAEW is broadly supportive of the proposed NAO's Code of Audit Practice and recognises the work that the NAO has done in its review of the Code to align it with auditing and ethical standards and PN10, *Audit of Financial Statements of Public Sector Bodies in the United Kingdom (revised)* where appropriate.
2. In preparing our response, ICAEW is providing a view in its role as a regulator. It has however, also taken account of the views of its member firms where appropriate. We are aware that some of ICAEW's views may not necessarily align with those of the member firms that are currently in the market, however, we are re-assured that firms are sending in their own responses to the NAO's consultation.

Clarity around the new regime

3. We note that the Code is likely to over-lap in the period when the Transitional Body (Public Sector Audit Appointments) will exist and monitor existing contracts as well as into the new regime and this draft of the Code tries to cover both regimes. However, this makes the Code confusing in places (as highlighted in paragraphs 10 and 11 below). It is important that the Code works for both regimes but doesn't unduly create responsibilities for auditors that will not exist under the new regime.

Status and process for guidance

4. ICAEW agrees with the Code remaining principles-based with additional guidance in relation to some of the detailed aspects of auditors' responsibilities. It will be important to clarify:
 - 4.1. What the guidance will cover;
 - 4.2. How prescriptive it will be;
 - 4.3. Its status; and
 - 4.4. Process and timetables for consultation and publication

Smaller bodies

5. As the NAO is aware, ICAEW has significant concerns about the use of the word 'audit' for the smaller bodies reporting regime, when the government actually wants 'limited assurance work' carried out. We note that Chapter 6 of the draft Code sets out very clear requirements for auditors carrying out Smaller Authority Assurance Engagements. However, Section 5(1) of the LAA Act states that '*the Secretary of State may by regulations make provision about the audit of the accounts of smaller authorities*'. We interpret this to mean that an audit is required. Section 5(2) then states that '*Regulations under subsection (1) may, in particular, provide for any provision of or made under this Act not to apply or to apply with modifications, in relation to smaller authorities*'. In our view, this gives Government the power to dis-apply the audit provision for smaller authorities'.
6. However, the Government has indicated that it does not intend to dis-apply the audit requirements and intends to continue to request an audit. If this is the case, then the Code will not be consistent with the Act and the draft Regulations. Our understanding is that DCLG intends to place reliance on the NAO Code to define the terms within the Act and then provide the related guidance and framework. ICAEW's view is that if the Act and regulations for smaller authorities continue to require an audit, then the Code will need to reflect the requirements of an audit. ICAEW would not be supportive of a move for a new definition for audit to be created, which does not currently exist within International and UK auditing standards.

DETAILED COMMENTS

7. We agree with the need for the Code to remain principles based although note that there are specific requirements within the Act that local auditors will need to comply with (e.g. under paragraph 2.5 in relation to the opinion on the accounts) – it would be helpful to reference these to the Act where appropriate. The Code also says that additional guidance will be issued

by the NAO to which auditors are required *'to have regard to'* (Page 5) as well as ad hoc guidance, some of which will come from the NAO's *'regular engagement with auditors'* (page 6). It would be helpful if the NAO were to clarify the areas this guidance will cover, how prescriptive it will be and the timetables for publication. It would also be useful to understand the consultation processes that will be in place with the wider profession to ensure that there is alignment with wider auditing practices. Finally, the Code is intended to be published prior to the start of the 2015/2016 audit year. We would like greater clarity on the timelines for the preparation of detailed guidance which will be important for the firms to plan their work and discuss any additional fee implications with their clients.

8. Our view is that there should be some reference to the regulatory framework that auditors will be monitored against under the new regime, i.e. the roles of the FRC and the RSB who will monitor compliance against the Code and audit regulations.

Status of the Code, application and general principles

9. Under paragraph 1.5, the Code states, *'the auditor **should** use their professional judgement to apply the principles and requirements set out in the Code* ICAEW's view is that there needs to be greater clarity of expectation and we do not believe that the use of 'should' covers this sufficiently. We would prefer *'the auditor shall...'* which aligns with wording contained within the Clarity ISAs. In our view, this will avoid differing auditor interpretations or inconsistency, without fettering independence and professional judgement. It will also enable the RSB to ensure compliance with the Code.
10. Under paragraph 1.8, there is reference to *'auditors carrying out their work....in accordance with..... Any additional requirements set out by..... any other body charged with oversight of the auditor's independence.'* We understood this to mean Public Sector Audit Appointments, as that is the only body that we think may have oversight of the auditor's independence for perhaps a couple of years, in addition to the FRC and the RSB. It would therefore be helpful if this was made explicit in the Code. If indeed there is another body charged with oversight over the auditor's independence, then it would be useful to highlight which body that might be so that local auditors have clarity about this.
11. Under paragraph 1.10, it states, *'The auditor should conduct their work economically, efficiently and effectively, and in as timely way as possible.'* Whilst this may work under the current regime where the Audit Commission is the procuring body (and therefore may work under the Public Sector Audit Appointments, where both are monitoring contracts), in the new regime firms will be negotiating their own contracts and fees directly with the local body. Bearing in mind that RSBs will be measuring compliance of local auditors' work against the Code, then as a potential RSB, we would need to understand the definitions used and specific measurements behind these terms to enable us to assess whether the local auditor is conducting its work in accordance with the Code. It is not normal practice for any RSB to have views on how firms calculate their fees as there would be a number of factors involved in that negotiation. It would therefore be a difficult assessment to carry out. Auditors need to use their professional judgement, unfettered, to carry out whatever work is deemed necessary in order to reach their opinion. Procuring the audit contract will, under the new regime, be a duty of the local body. Therefore, it will be for the local body to make the assessment on how it considers auditors have conducted their work in line with the contract and fees that they negotiate.
12. Under paragraph 1.11, the last sentence states that, *'The auditor's work should meet the requirements of legislation, the Code and, **where appropriate**, professional standards....'* We would question when professional standards would not be appropriate. We therefore think that this wording should be amended to take out the words highlighted and insert, **'relevant'**.
13. Under paragraph 1.14, it states, *'the auditor should, likewise, consider the potential to **co-ordinate** their activities with other scrutiny bodies to prevent duplication and ensure that the demands on audited bodies are managed effectively.'* Our view is that the auditor shall be **'mindful of'** activities of other bodies and take account of them where relevant. We consider

that there is little scope for overlap between the auditor's duties and those of other bodies. In satisfying themselves as to whether proper arrangements for securing value for money, we consider that it would be appropriate for the auditor to consider relevant work undertaken by other review bodies. However, in terms of the opinion on the financial statements, the auditor's duties are not shared with any other bodies and therefore the auditor's work and judgements should remain unfettered by the work of any other bodies. We consider that the Code should reflect this.

14. Under paragraph 1.16, it states that, '*from time to time, the NAO may request information from the local auditor to assist the NAO in the performance of its functions.*' We noted the references in the footnote. Notwithstanding that, in some instances, the NAO may have a statutory right of access to certain information, it would be helpful to understand, within the related guidance (under these specific references in the footnote):
- the type/scope of information the NAO envisages it may request;
 - for what purpose it will use the information; and
 - how it intends to rely on this information.
15. The Act contains certain situations whereby auditors will be permitted to provide information, but they will still have a duty of confidentiality to their clients (as highlighted in paragraph 1.18 of the Code) which may take precedence over requests for information. Any such requests for information may therefore be considered as third party requests by the auditor and may need to be considered on a case by case basis.

Audit of the annual accounts

16. Under paragraph 2.5, there is reference to the components which should be included within the audit report. International Standards of Auditing (ISAs) also require the audit scope and responsibilities to be included. There may therefore be merit in either including these within this part of the Code or at the very least, referencing to the relevant ISA.

The auditors work on value-for-money arrangements

17. We have noted the statement in paragraph 3.6, '*should evidence of poor value for money become apparent during the course of the audit, the auditor should consider the implications of this for their work.*' It would be helpful to clarify that this does not require auditors to search for evidence of poor value for money, but rather consider the underlying arrangements where a significant situation might arise which identifies that the value for money is not being achieved.
18. Under paragraphs 3.8 and 3.10, it states, '*where the auditor identifies risks that have the potential to cause the auditor to reach the **wrong** conclusion*'. There is also reference to an incorrect conclusion being reached. This is a matter of judgement. Our view is that another form of words that might be appropriate are '*where the auditor identifies risks that may potentially **impact on their** conclusion...*'
19. Under paragraph 3.12, there is reference to the auditor not questioning the merits of the audited body's policy decisions and how it has arrived at them but that the auditor may examine the arrangements by which the decisions are made and consider the **effects** of the implementation of the policy. We are unclear as to how the auditor would consider the effects and what this would mean in practice without there being a judgement on the policy itself. Our view is that the more appropriate wording might be for the auditor to consider, '*the **outcomes** of the implementation of the policy.*'
20. In the separate paper attached to the draft Code (with the consultation questions), on page 10, under the 2nd bullet point entitled, *quality, insight and audit cost*, we noted the sentence, *it should also provide assurance to central government bodies providing funding to local public bodies.* We are concerned that this suggestion may be adding an additional requirement to auditors' duties that does not currently exist within the legislation. As highlighted in paragraphs 14 and 15 of this response, any requests for additional information, or assurance outside of the

auditors' statutory duties would need to be clear about the purpose, scope and form of report for the request. Indeed where specific assurance is being requested by central government bodies for any specific funding to local public bodies, this should be requested as a separate tri-partite engagement, with a clear scope of work and with separate fees and would fall outside the requirements under the LAA Act 2014.

Reporting the results of the auditor's work

21. Under the bullet point, 'audit report' on page 17, there is reference to the engagement lead. In our audit regulations and related guidance we are referencing back to the term used in the Act, the Key Audit Partner' and have agreed with the FRC that they will include a definition within their guidance of what this means in practice.

The auditor's additional powers and duties

22. Under this section, one important point to note is that the auditor should be able to determine the extent of work required to fulfil their responsibilities and their judgement on this should not be subject to or fettered by fee restrictions. Therefore it will be important to have detailed guidance in this area to enable an auditor to respond to the challenge effectively and proportionately.

Smaller authority assurance engagements

23. As you know, ICAEW has had significant concerns about the government's proposals in relation to smaller authority assurance engagements. In particular, our concerns have centred around the mis-understanding of the difference between 'audit' and 'assurance' engagements.
24. Our most significant concern is that DCLG has indicated that it does not intend to amend the regulations to include the correct terminology and definitions. Their lawyers have confirmed that the definition of 'audit work' in the Act covers both audit and limited assurance work. This concerns us as we do not believe there is a definition for audit work which covers limited assurance. In our view, the two (audit and limited assurance) are very separate and distinct types of engagements with different scopes of work leading to different conclusions.
25. DCLG's view is that it is possible, for this particular part of local government in England, for the Government to change the definition of 'audit' to mean something else, in this case, 'limited assurance'. We disagree. Our view remains that there are already international standards that define assurance' engagements ([*ISAE 3000, \(revised\) Assurance Engagements Other than Audits or Reviews of Historical Financial Information*](#)) or [*ISRE 2400 Engagements to Review Financial Statements*](#), and indeed ICAEW has published additional guidance ([*TECH 09/13AAF, Assurance Review Engagements on Historical Financial Statements*](#)) which covers similar situations. There is also an understood profession-wide definition of 'audit' through international and UK auditing standards. These terms and standards are understood globally and to create something new for a very small part of one sector within England will
- create an expectations gap;
 - undermine the public perception of what an audit is; and
 - cause confusion in the profession.
26. Our understanding is that DCLG intends to place reliance on the NAO Code to define the terms within the Act and then provide the related guidance and framework. If this is the case and the Act and regulations for smaller authorities continue to require an audit, without any consideration of dis-applying the requirements of an audit, then this part of the Code, as drafted, will not align with the requirements of the Act and regulations. If an audit continues to be required, then our view is that the Code will need to reflect the requirements of an audit.
27. ICAEW would not be supportive of a change to the definition of audit as suggested by DCLG and we would strongly urge the NAO to also reject moves to create such confusion and to

create a new definition. Indeed, as indicated in our response to government on the smaller bodies' regulations ([ICAEW Rep 98/14, Local Audit](#)), we would not recommend that any ICAEW member firm take this work on if significant changes to the regulations are not made and that the definitions of audit and limited assurance continue to be mis-interpreted. Firms have already indicated to us that this is one of the riskiest areas of work that they undertake with no immediate benefits to them. With the added confusion in the definitions, scope of work, and subsequent reporting conclusions, this creates further risks which they will be unable to mitigate. There is also a possibility that firms' professional indemnity insurance will be affected if there is such ambiguity in the market place.

Detailed comments on smaller authorities

28. In relation to Section 6 as drafted, our view is that there should be a separate Code for smaller authorities. Given that the intention is to have different regulatory, procurement and reporting requirements then we would ask the NAO to consider keeping this part of the overall framework separate. We also think the detailed guidance that is referred to within this section could then form part of one overall document making it easier to access for all parties involved in the smaller authorities regime.
29. Under paragraph 6.4, there is reference to additional guidance for auditors provided by the NAO in relation to the smaller authority assurance engagements. We would urge the NAO to consult with the profession on this guidance to ensure that the scope of work is clearly aligned to the requirement of the Act and that the form of report clarifies the work that has been carried out and the conclusion of that work.
30. We think there may be some contradiction between paragraphs 6.4, 6.5 and 6.6. In paragraphs 6.4 there is reference to specified procedures that will be set out in NAO guidance and in paragraph 6.5; there is reference to the auditor using their professional judgement to determine additional work that may be necessary. We are assuming that this section is referring to limited assurance engagements which align to the international standards.
31. However, paragraph 6.6, which discusses the form of report, then refers to '*confirmation that the auditor has completed specified procedures and the results of those procedures.*' In international standards, the form of report that falls out of a limited assurance engagement is a negatively worded conclusion, rather than a report highlighting the results of the procedures. The latter form of report would only be given if an agreed upon procedures engagement is carried out.

RESPONSES TO SPECIFIC QUESTIONS

Preface

Q1: Is there any further information that you consider should be included within the preface to the Code?

32. It would be useful for the Code to clarify the Regulatory Framework and the role of the FRC and RSBs in the overall regime as these bodies will be monitoring compliance against the Code and standards in the new regime.

Q2: Do you agree that a single code can work well for all the types of audited body that need to be covered? If not, what would be your preferred alternative

33. Given some of the difficulties and risks presented by the smaller authorities' regime and because of the different procurement, regulatory and reporting framework for smaller authorities, our view is that there should be a separate Code for these bodies. Indeed a separate Code for smaller bodies would be easier to understand for smaller bodies themselves.

Q3: Do you agree that the Code should be struck at a principles-based level, to be supported as required by more detailed guidance to auditors provided by the National Audit Office on behalf of the C&AG?

- 34.** Yes we agree that the Code should remain as a principles-based document. It would be useful to have clarification on how much guidance there will be, how prescriptive it will be and what consultation processes will be in place before publication of the guidance?
- 35.** In addition, it isn't immediately clear to us that supplementary guidance for an NHS Foundation Trust will be issued by the NAO. Is there a possibility that Monitor will issue guidance as setting the corporate governance requirements for FTs will rest with Monitor. Our view is that it is important to learn the lessons from the past where both Monitor and the Audit Commission have tried to issue subtly different guidance. Our recommendation is that, where Monitor is thinking of issuing particular guidance, it will be important for both bodies (Monitor and the NAO) to consult jointly wherever possible.

Q4: Do you agree with the proposed structure and content of the Code?

- 36.** Yes, we agree with the proposed structure and content of the Code subject to the comments we have raised within this response.

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

Q5: Does Chapter One of the draft Code provide a clear description of the status and application of the Code? If you think it could be improved, please provide details.

- 37.** Subject to our comments outlined in paragraphs 9 - 15 in this response, yes.

Q6: Does Chapter One of the draft Code identify the correct general principles? Please provide details if you think that additional principles are required or if you consider that any of the principles identified in Chapter One are inappropriate.

- 38.** Subject to our comments in paragraphs 9 - 15, we agree that the right principles have been identified. We have commented on areas where we think there needs to be more clarification or amendment to the wording within the Code.

Chapter Two – Audit of the annual accounts

Q7: Does Chapter Two of the draft Code address clearly the auditor's statutory duties in respect of the audit of annual accounts? If you think it could be improved, please provide details.

- 39.** Subject to our comments in paragraph 16, we agree that this Chapter does address the auditor's statutory duties in respect of the audit of the annual accounts. We have suggested an improvement for clarification.

Chapter Three – The auditor's work on value-for-money arrangements

Q8: Does Chapter Three of the draft Code address clearly the auditor's statutory duties in respect of their work on value-for-money arrangements? If you think it could be improved, please provide details?

- 40.** Subject to our comments in paragraphs 17 - 20, we agree that this Chapter does address the auditor's work on value-for-money arrangements. We have suggested some improvements for clarification. We agree that the auditor's work should be limited to considering the arrangements that are in place at the audited body. We have noted the statement in paragraph 3.6, 'should evidence of poor value for money become apparent during the course of the audit, the auditor should consider the implications of this for their work.' It would be helpful to clarify that this does not require auditors to search for evidence of poor value for money, but rather consider the underlying arrangements where a significant situation might arise which identifies that the value for money is not being achieved.

Q9: Do you agree that the approach set out in Chapter Three of the draft Code is appropriate for auditors of the different types of local public body covered by this Code?

- 41.** We agree that the Code outlines a suitable approach for auditors of the different types of bodies covered by the Code. We agree that there should be separate guidance for the different types of bodies depending on their differing statutory duties. It will be important for there to be effective consultation processes on any detailed guidance.

Q10: Do you agree that the NAO's detailed guidance on how the auditor should approach their work on value-for-money arrangements should focus on key reporting criteria, and, if so, what criteria should these be? If not, what alternative approach would you propose?

- 42.** We agree that the detailed guidance should focus on key criteria, but that the criteria should be consistent across the board to enable consistency of treatment within the year and consistency of approach for clients over time, although we recognise that if a cyclical approach is used, there may be a case for additional specific criteria for a particular year.

Q11: (for audited bodies) How valuable do you find the work carried out each year on value-for-money arrangements? How might this be improved? To what extent would you be prepared to pay more in support of a different approach?

- 43.** N/A

Chapter Four – Reporting the results of the auditor's work

Q12: Does Chapter Four of the draft Code address clearly the auditor's statutory duties in respect of their reporting requirements for the different types of body covered by the Code?

- 44.** Subject to the comment in paragraph 21, we believe that the auditor's statutory duties are sufficiently addressed in this Chapter.

Chapter Five – The auditor's additional powers and duties

Q14: Does Chapter Five of the draft Code address clearly the auditor's use of the additional powers set out in this chapter?

- 45.** This chapter does address the auditor's use of additional powers, however one important point to note is that the auditor should be able to determine the extent of work required to fulfil their responsibilities and their judgement on this should not be subject to or fettered by fee restrictions. Therefore it will be important to have detailed guidance in this area to enable an auditor to respond to the challenge effectively and proportionately.

Q15: Are there specific aspects of the auditor's additional powers and duties set out in Chapter Five that you consider should be supported by more detailed guidance to auditors? Please provide details of those areas where you consider additional guidance is required.

- 46.** Our view is that there needs to be additional guidance on each of the powers and duties which help guide the auditor to decisions about whether or not they should carry out further investigative work. The guidance could include example case studies. Ultimately, however, the decision and judgement rests with the auditor.

Chapter Six – Smaller authority assurance engagements

Q14: Does Chapter Six of the draft Code address clearly the auditor's statutory duties in respect of their work on smaller authorities?

- 47.** Currently we do not think that the draft Code addresses the auditor's statutory duties. The Act requires an audit and we understand that DCLG's regulations will continue to require an audit. If this is the case, then ICAEW's view is that the Code needs to reflect the requirements of an audit. If however, DCLG do dis-apply the requirements of an audit and instead require a limited assurance engagement within the regulations, then, subject to our comments in paragraphs 23 to 31, the Code will reflect the duties.

- 48.** Our view is that there should be a separate Code for smaller authorities to differentiate between the different procurement, regulatory and reporting framework. It would perhaps also be helpful to have one document which incorporates the Code and the related guidance, to make it easily accessible.

Schedules, Annex and Glossary

Q17: Do you have any comments on the material provided in the Schedules and Annex to the draft Code?

- 49.** No.

Q18: Do you have any observations on the completeness or accuracy of the Glossary?

- 50.** The glossary could usefully include the definitions of audit and assurance for clarification.
- 51.** The definition for the Recognised Supervisory Body should also include reference to the responsibility for licensing; registering and monitoring the work of auditors carrying out local audit work as well as supervising the conduct of their members.