2020/21 Auditor work on VFM arrangements -

March 2021

Background

The Local Audit and Accountability Act 2014 (the Act) makes the National Audit Office's (NAO) Comptroller and Auditor General responsible for the preparation, publication and maintenance of the Code of Audit Practice (the Code). The Code sets out what local auditors are required to do to fulfil their statutory responsibilities under the Act. Local auditors must comply with the Code of Audit Practice. The Code must be reviewed at least every five years, so the Code that applies will depend on the financial year being audited.

For audits of financial years from 2020-21 onwards, the 2020 Code of Audit Practice applies. The new Code came into force on 1 April 2020, after being approved by Parliament. It was developed following a consultation process in 2019. The Code will therefore apply to the audit of the Authority from 2020/21 and replace the 2015 Code which preceded it.

The new Code has introduced changes to the approach we are required to take to issue our judgement on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources – the statutory judgement on Value for Money (VFM) arrangements that forms part of our annual audit report.

The purpose of this paper is to provide a high level overview of some of the key changes in the new Code as they relate to our VFM approach at the Authority. At the time of writing there remains some further work to do, in discussion with the NAO, to fully understand the implications of the changes and their impact on our programme of work. We will also need to consider the continuing impact of Covid-19 on local public bodies and auditors as it pertains to our VFM responsibilities.

Auditor responsibilities under the new Code of Audit Practice

Under the 2020 Code of Audit Practice we are still required to consider whether an authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. However, there is no longer an overall evaluation criterion on which we need to conclude. Where auditor's identify a significant weakness in proper arrangements, we are required to report by exception within the audit report on the statement of accounts. The 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Authority a commentary against specified reporting criteria (see below) on the arrangements the Authority has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- **Financial sustainability**
  How the Authority plans and manages its resources to ensure it can continue to deliver its services;
- **Governance**
  How the Authority ensures that it makes informed decisions and properly manages its risks; and
- **Improving economy, efficiency and effectiveness**
  How the Authority uses information about its costs and performance to improve the way it manages and delivers its services.

Planning and identifying VFM risks

The NAO's guidance notes require us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Authority's arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations. This is a change to 2015 Code guidance where the NAO required auditors as part of planning, to consider the risk of reaching an incorrect conclusion in relation to the overall criterion.

In considering the Authority's arrangements, we are required to consider:

- The **Authority's** Annual Governance Statement
- Evidence that the Authority's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates and other bodies; and
- Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- Exposes – or could reasonably be expected to expose – the Authority to significant financial loss or risk;
- Leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on the Authority's reputation;
- Leads to – or could reasonably be expected to lead to – unlawful actions; or
- Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

We should also be informed by a consideration of:

- The magnitude of the issue in relation to the size of the Authority;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- The impact of the weakness on the Authority's reported performance;
- Whether the issue has been identified by the Authority's own internal arrangements and what corrective action has been taken or planned;
- Whether any legal judgements have been made including judicial review;

Planning and identifying VFM risks (contd)

- Whether there has been any intervention by a regulator or Secretary of State;
- Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- The impact on delivery of services to local taxpayers; and
- The length of time the Authority has had to respond to the issue.

Responding to identified risks

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the 2020 Code has the same requirement as the 2015 Code in that we should refer to this by exception in the audit report on the financial statements.

However, a new requirement under the 2020 Code is for us to include the commentary on arrangements in a new Auditor's Annual Report. The 2020 Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the Authority's attention or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

The new Code promotes more timely reporting by auditors. So where we have sufficient evidence to determine that there is a significant weakness on VFM related arrangements we can report that weakness, and an associated recommendation for improvement, at that time and not wait until we are issuing our Audit Results Report on the audit of the statement of accounts.

Summary of changes in VFM requirements between the 2015 and 2020 Codes of Audit Practice

We set out a summary of key changes in VFM requirements between the 2015 and 2020 Codes in tabular form over-page.

2015 Code requirement	2020 Code requirement
Overall requirement For auditors to satisfy themselves that the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.	**Overall requirement** No change in requirement.
Design of work The auditor's work should be designed to provide the auditor with sufficient assurance to enable them to report by exception if the auditor concludes that they are not satisfied that the audited body has put in place proper arrangements to secure value for money in the use of its resources for the relevant period. Where required, the auditor should report their conclusion on the audited body's arrangements having regard to specific reporting criteria.	**Design of work** The auditor's work should be designed to provide the auditor with sufficient assurance to enable them to report to the audited body a commentary against the specified reporting criteria on the arrangements the body has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period. Where the auditor is not satisfied in respect of arrangements to secure value for money, they should refer to this by exception in their audit report on the financial statements.
Assurance given In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period.	**Assurance given** No change in requirement. Our work remains arrangements based.
Other sources of relevant information Auditors need to consider: • The audited body's governance statement • Evidence that the audited body's arrangements were in place during the reporting period; • Evidence obtained from the auditor's other work • The work of inspectorates and other bodies and • Any other evidence source that the auditor regards as necessary to facilitate the performance of their statutory duties	**Other sources of relevant information** No change in requirement.

2015 Code requirement	2020 Code requirement
Quantum of work Determining how much work to do on arrangements to secure value for money is a matter of auditor judgement.	**Quantum of work** Determining how much work to do on arrangements to secure value for money remains a matter of auditor judgement, but we expect the enhanced risk assessment process and reporting requirements to require more time to be input.
Reporting criteria The NAO's supporting Auditor Guidance Note 3 defines proper arrangements as: 1. *Informed decision making* • Acting in the public interest, through demonstrating and applying the principles and values of sound governance • Understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management • Reliable and timely financial reporting that supports the delivery of strategic priorities • Managing risks effectively and maintaining a sound system of internal control 2. *Sustainable resource deployment* • Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions • Managing and utilising assets effectively to support the delivery of strategic priorities • Planning, organising and developing the workforce effectively to deliver strategic priorities 3. *Working with partners and other third parties* • Working with third parties effectively to deliver strategic priorities • Commissioning services effectively to support the delivery of strategic priorities • Procuring supplies and services effectively to support the delivery of strategic priorities	**Reporting criteria** The Code specifies that auditors need to focus on these reporting criteria: 1. *Financial sustainability*: how the body plans and manages its resources to ensure it can continue to deliver its services. Specifically: • How the body ensures that it identifies all the significant financial pressures that are relevant to its short and medium-term plans and builds these into them; • How the body plans to bridge its funding gaps and identifies achievable savings; • How the body plans finances to support the sustainable delivery of services in accordance with strategic and statutory priorities; • How the body ensures that its financial plan is consistent with other plans such as workforce, capital, investment, and other operational planning which may include working with other local public bodies as part of a wider system; and • how the body identifies and manages risks to financial resilience, e.g. unplanned changes in demand, including challenge of the assumptions underlying its plans. 2. *Governance*: how the body ensures that it makes informed decisions and properly manages its risks. Specifically: • How the body monitors and assesses risk and how the body gains assurance over the effective operation of internal controls, including arrangements to prevent and detect fraud; • How the body approaches and carries out its annual budget setting process;

2015 Code requirement	2020 Code requirement
Reporting criteria (continued) See previous page	**Reporting criteria (continued)** • How the body ensures it makes properly informed decisions, supported by appropriate evidence and allowing for challenge and transparency. This includes arrangements for effective challenge from the audit committee; and • How the body monitors and ensures appropriate standards, such as meeting legislative/regulatory requirements and standards in terms of staff or member behaviour (such as gifts and hospitality or declarations/conflicts of interests). 3. *Improving economy, efficiency and effectiveness*: how the body uses information about its costs and performance to improve the way it manages and delivers its services. Specifically: • How financial and performance information has been used to assess performance to identify areas for improvement; • How the body evaluates the services it provides to assess performance and identify areas for improvement; • How the body ensures it delivers its role within significant partnerships, engages with stakeholders it has identified, monitors performance against expectations, and ensures action is taken where necessary to improve; and • Where the body commissions or procures services, how the body ensures that this is done in accordance with relevant legislation, professional standards and internal policies, and how the body assesses whether it is realising the expected benefits.
Risk assessment As part of planning, auditors should consider the risk of reaching an incorrect conclusion in relation to the overall criterion.	**Risk assessment** The auditor will need to gather sufficient evidence and document their evaluation of it in order to enable them to draft their commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations.

2015 Code requirement	2020 Code requirement
Reporting The auditor should report to the audit committee the results of their work. The Annual Audit Letter should provide a clear, readily understandable commentary on the results of the auditor's work and highlight any issues that the auditor wishes to draw to the attention of the public.	**Reporting** Auditors are required to report in a commentary each year under the specified reporting criteria and the Code expects that where auditors identify significant weaknesses in arrangements as part of their work, they will raise them promptly with the audit committee. The auditor's annual report should bring together all of the auditor's work over the year. A core element of the report will be the commentary in accordance with the specified reporting criteria. The commentary should be clear, readily understandable and highlight any issues that the auditor wishes to draw to the attention of the body or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with the auditor's view as to whether they have been implemented satisfactorily.

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