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Statement of responsibilities of auditors and of audited bodies

Local government, March 2010

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Introduction

1 The Audit Commission (the Commission) is responsible for appointing auditors and determining their terms of appointment, as well as for preparing a Code of Audit Practice (the Code), which prescribes the way auditors are to carry out their functions. The Commission has prepared a Code for the audits of local government bodies and a Code for the audit of local NHS bodies. From time to time, the Commission issues guidance to auditors under section 3(8) of the Audit Commission Act 1998 (the Act) and Paragraph 7(3) of Schedule 1 to the Act. This statement sets out guidance on general responsibilities relevant to audits of local government bodies and so supports the Code. A separate statement has been prepared for the audits of NHS bodies.

2 This statement serves as the formal terms of engagement between the Audit Commission's appointed auditors and local government bodies.ⁱ It summarises where the different responsibilities of auditors and of the audited body begin and end, and what is to be expected of the audited body in certain areas. Throughout this statement, the term 'audited body' covers both the members and senior officers of the body.

3 The responsibilities of auditors are derived from statute (principally the Audit Commission Act 1998) and from the Code. Nothing in this statement is intended to limit or extend those responsibilities. In particular, audited bodies should note that because auditors must not prejudice their independence of the audited body, the role of the appointed auditor does not include providing financial or legal advice or consultancy to the audited body.

4 Auditors may wish to refer to this statement in audit planning documents, annual audit letters, reports and other audit outputs.

Introduction to responsibilities

5 Those responsible for the conduct of public business and for spending public money are accountable for ensuring 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.

i This statement covers the audits of local government bodies. These include the various bodies that provide public services locally, including local authorities (and their pension funds, if applicable), fire authorities, police authorities, local councils, local probation boards and trusts and integrated transport authorities and passenger transport executives.

6 In discharging this accountability, public bodies are responsible for putting in place proper arrangements for the governance of their affairs and the stewardship of the resources at their disposal.ⁱ They are also required to report on their arrangements in their statement on internal control.ⁱⁱ

7 It is the responsibility of the audited body to ensure that proper arrangements are in place, but certain individuals may also have specific responsibilities. Local authorities have designated statutory officers, each of whom has a specific role in relation to accountability and control. For local authorities, these include:

- the head of paid service, usually the chief executive, responsible to the full council for the corporate and overall strategic management of the authority;
- the monitoring officer, who is responsible for reporting to the authority any actual or potential breaches of the law or any maladministration and for ensuring that procedures for recording and reporting key decisions are operating effectively; and
- an officer with responsibility for the proper administration of the authority's financial affairs.

8 In carrying out their work, auditors will:

- plan and manage the audit in a timely, professional and efficient manner;
- plan to complete work within agreed deadlines;
- maintain close liaison with the audited body; and
- provide appropriate and adequate resources and assign responsibilities to staff with the relevant expertise and experience.

9 In meeting their responsibilities, auditors obtain representations from management, both orally and in writing, on specific aspects of the audit.

10 The following paragraphs summarise the specific responsibilities of auditors and of audited bodies in relation to the responsibilities of auditors described in the Code.

Responsibilities in relation to the financial statements

11 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, and review the effectiveness of, its system of internal control, including arrangements to ensure the regularity and lawfulness of transactions;ⁱⁱⁱ

i The various local government bodies covered by this statement are constituted differently and their governance arrangements will vary accordingly.

ii Known as Annual Governance Statement for local authorities.

iii For example, Regulation 4(2) of the Accounts and Audit Regulations 2003, as amended, requires local authorities and other specified bodies to 'conduct a review at least once in a year of the effectiveness of its system of internal control'.

- maintain proper accounting records; and
- prepare financial statements that give a true and fair view of the financial position of the body and its expenditure and income and that they are in accordance with applicable laws, regulations and accounting policies.

12 A local authority that is the administering authority for a local authority pension fund must prepare pension fund financial statements and an annual report for each financial year. The financial statements must give a true and fair view of:

- the financial transactions of its pension fund during the year; and
- the amount and disposition of the fund's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year.

13 The audited body is also responsible for preparing and publishing with its financial statements a statement on internal control and, where required to do so, a remuneration report.ⁱ Local authorities and other specified bodies also prepare a whole of government accounts return. Although not required to do so, some local government bodies publish other information, such as an annual report, alongside the financial statements.

14 In preparing their financial statements, audited bodies are responsible for:

- preparing realistic plans that include clear targets and achievable timetables for the production of the financial statements;
- assigning responsibilities clearly to staff with the appropriate expertise and experience;
- providing necessary resources to enable delivery of the plan;
- maintaining adequate documentation in support of the financial statements and, at the start of the audit, providing a complete set of working papers that provide an adequate explanation of the entries in those financial statements;
- ensuring that senior management monitors, supervises and reviews work to meet agreed standards and deadlines; and
- ensuring that a senior individual at top management level personally reviews and approves the financial statements before presentation to the auditor. Specifically, the responsible financial officer must sign, date and certify the financial statements before they are approved by the body.

15 If draft financial statements and working papers of appropriate quality are not available at the agreed start date of the audit, the auditor is unable to meet the planned audit timetable and the start date of the audit will be delayed. The audit fee is calculated on the basis that the draft financial statements, and detailed working papers, are provided to an agreed timetable and are of an acceptable standard. If information is not provided

ⁱ Local authorities prepare an Annual Governance Statement which includes a statement on internal control. Regulation 4(4) of the Accounts and Audit Regulations 2003, as amended, requires that a statement on internal control is included with an authority's accounts.

to this timetable, or is provided to an unacceptable standard, the auditor will incur additional costs in carrying out any extra work that is necessary. The Commission will charge an additional fee if the additional work is substantial.

16 In carrying out their responsibilities in relation to the financial statements, auditors have regard to the concept of materiality.

17 Subject to the concept of materiality, auditors provide reasonable assurance that the financial statements:

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

18 Subject to the concept of materiality, auditors of local probation boards also provide reasonable assurance on the regularity of expenditure and income. In carrying out an audit, auditors do not perform detailed tests of all transactions. Therefore the audit process should not be relied upon to disclose all unlawful transactions or events that may have occurred or might occur.

19 Auditors plan and perform their audit on the basis of their assessment of risk. Auditors examine selected transactions and balances on a test basis and assess the significant estimates and judgements made by the audited body in preparing the statements.

20 Auditors evaluate significant financial systems, and the associated internal financial controls, for the purpose of giving their opinion on the financial statements. However, they do not provide assurance to audited bodies on the operational effectiveness of specific systems and controls or their wider system of internal control. Where auditors identify any weaknesses in such systems and controls, they draw them to the attention of the audited body, but they cannot be expected to identify all weaknesses that may exist.

21 Auditors review whether the statement on internal control has been presented in accordance with relevant requirements and report if it does not meet these requirements or if it is misleading or inconsistent with other information the auditor is aware of. In doing so, auditors take into account the knowledge of the audited body gained through their work in relation to the financial statements and through their work in relation to the body's arrangements for securing economy, efficiency and effectiveness in the use of its resources. They also have regard to the work of other regulators, to the extent that it is relevant to auditors' responsibilities. Auditors are not required to consider whether the statement on internal control covers all risks and controls, and auditors are not required to express a formal opinion on the effectiveness of the audited body's corporate governance procedures or risk and control procedures.

22 Auditors also review for consistency other information that is published by the audited body alongside the financial statements, such as an annual report. If auditors have concerns about the consistency of any such information they will report them to those charged with governance.

23 At the conclusion of the audit of the accounts, auditors give their opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its expenditure and income for the year in question;
- whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards;
- for probation boards, on the regularity of their expenditure and income; and
- for certain bodies, on whether the part of the remuneration report to be audited has been properly prepared.

24 In the case of local authorities and other specified bodies, auditors also give their opinion on whether the whole of government accounts return has been properly prepared.

25 Auditors of local authorities that are the administering authorities for a local authority pension fund include a separate opinion on the pension fund accounts within their report on the financial statements. They also issue a separate opinion on the financial statements contained in the pension fund annual report.

Electronic publication of the financial statements

26 Where the audited body wishes to publish its financial statements electronically, it is responsible for ensuring that the publication presents accurately the financial statements and the auditor's report on those financial statements. This responsibility also applies to the presentation of any financial information published in respect of prior periods. Similarly, where the audited body wishes to distribute electronic copies of the financial statements, and the auditor's report on those financial statements, to its stakeholders, it is responsible for ensuring that these are presented accurately.

27 The auditor's report on the financial statements should not be reproduced or referred to electronically without the auditor's prior written agreement. This enables the auditor to review the process by which the financial statements to be published electronically are derived from the financial information contained in the manually signed financial statements, check that the proposed electronic version is identical in content with the manually signed financial statements and check that the conversion of the manually signed financial statements into an electronic format has not distorted the overall presentation of the financial information.

28 The examination of the controls over the electronic publication of audited financial statements is beyond the scope of auditors' responsibilities in relation to the financial statements and the auditor cannot be held responsible for changes made to audited information after the initial publication of the financial statements and the auditor's report.

Responsibilities in relation to arrangements for securing economy, efficiency and effectiveness in the use of resources

29 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:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and procuring quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and demonstrating the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help it deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

30 The audited body is responsible for reporting on these arrangements as part of its annual statement on internal control.

31 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 doing so they are required to have regard to criteria specified by the Audit Commission.ⁱ In meeting this responsibility auditors review and, where appropriate, examine evidence that is relevant to the audited body's corporate performance management and financial management arrangements.

ⁱ These criteria are published on the Commission's website.

32 In planning this work, auditors consider and assess the significant risks of giving a wrong conclusion on the audited body's arrangements for securing economy, efficiency and effectiveness. 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 discuss their assessment of these risks with the audited body.

33 When assessing risk auditors consider:

- the relevance and significance of the potential business risks faced by all bodies of a particular type. 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;
- other business risks that apply specifically to individual audited bodies;
- 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.

34 In assessing risks auditors 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.

35 Where auditors rely on the reports of statutory inspectorates as evidence relevant to the audited body's corporate performance management and financial management arrangements, the conclusions and judgements in such reports remain the responsibility of the relevant inspectorate or review agency.

36 In reviewing the audited body's arrangements for the 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. It is the responsibility of the audited body to decide whether and how to implement any recommendations made by auditors and, in making any recommendations, auditors must avoid giving any perception that they have any role in the decision-making arrangements of the audited body.

37 Auditors do not provide assurance to audited bodies on the operational effectiveness of specific aspects of their arrangements for the use of resources. Neither can they be relied on to have identified every weakness or every opportunity for improvement. Audited bodies should consider auditors' conclusions and recommendations in their broader operational or other relevant context.

38 In reviewing audited bodies' arrangements for producing relevant and reliable data and information to support decision making and manage performance, auditors may review the data supporting specific performance information. Audited bodies are responsible for applying appropriate data quality standards, collecting data that is fit for purpose and, where applicable, conforms to prescribed definitions. Audited bodies are also responsible for satisfying themselves that performance information is reliable and accurate.

39 Where auditors identify significant misstatements or errors in specific performance information or the underlying data, they draw them to the attention of the audited body, but they do not provide assurance to audited bodies on the accuracy or reliability of performance information or the underlying data.

40 Audit work in relation to the audited body's arrangements to ensure it promotes and demonstrates the principles and values of good governance and does not remove the possibility that breaches of proper standards of financial conduct, or fraud and corruption, have occurred and remained undetected. Neither is it the auditors' responsibility to prevent or detect breaches of proper standards of financial conduct, or fraud and corruption, although they are alert to the possibility and act promptly if grounds for suspicion come to their notice.

41 The reviews arising from national studies developed by the Commission, and the extent to which auditors are expected to apply them at relevant bodies, are prescribed by the Commission and are notified to audited bodies each year by the Commission in its annual work programme and by auditors in their audit planning documents. When carrying out national studies, auditors are required to follow the methodologies and, for certain studies, use comparative data provided by the Commission. Responsibility for the adequacy and appropriateness of these methodologies and the data rests with the Commission.

42 At the conclusion of the audit, auditors report their value for money conclusion on:

- the audited body's arrangements for securing economy, efficiency and effectiveness in its use of resources; and
- whether significant matters have come to their attention which prevent them from concluding that the audited body has put in place proper arrangements.

Specific powers and duties of auditors

43 Auditors have specific powers and duties under the Audit Commission Act 1998 (the Act) in relation to matters of legality and, for local authorities, electors' rights.

44 Auditors must:

- consider whether to issue a public interest report concerning any matter that comes to the auditor's attention during the course of the audit, which they judge should be considered by the audited body or brought to public attention (section 8 of the Act); and
- give electors the opportunity to raise questions about a local authority's accounts, and consider and decide upon objections received from electors in relation to the accounts (sections 15 and 16 of the Act).

45 Auditors may decide:

- that the audited body should consider formally, and respond to in public, recommendations made in an audit report (section 11(3) of the Act);
- to issue an advisory notice or to apply to the court for a declaration that an item of account is unlawful (sections 17 and 19A of the Act), if they have reason to believe that unlawful expenditure has been or is about to be incurred by an audited body; and
- to apply for judicial review with respect to a decision of an audited body or a failure of an audited body to act, which it is reasonable to believe would have an effect on the accounts of that body (section 24 of the Act).

46 Fees arising in connection with auditors' exercise of these powers and duties, including costs relating to the appointment of legal or other advisers to the auditors, are borne by the audited body.

Reporting the results of audit work

47 Auditors provide:

- audit planning documents;
- 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;
- a report to those charged with governance, normally submitted to the audit committee, summarising the work of the auditor;
- an audit report, including the auditor's opinion on the financial statements 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;
- a certificate that the audit of the accounts has been completed in accordance with statutory requirements; and
- an annual audit letter addressed to the audited body, which is based on the report to those charged with governance.

48 Audit reports are addressed to officers or members of the audited body, as appropriate. Auditors do not have responsibilities to officers or members in their individual capacities (other than observing the rules of natural justice in the exercise of auditors' specific powers and duties in relation to electors' rights) or to third parties that choose to place reliance upon the reports from auditors.

49 In addition, the following outputs, the need for which may arise at any point during the audit process, are issued where appropriate:

- a report under section 8 of the Act;
- recommendations under section 11(3) of the Act; and
- information to be reported to the Commission in a specified format to enable it to carry out any of its functions, including assessments of performance at relevant bodies, or to assist other bodies, such as the National Audit Office, in carrying out their functions.

50 When considering the action to be taken on audit reports, audited bodies should bear in mind the scope of the audit and responsibilities of auditors, as set out in the Code and as further explained in this statement. Matters raised by auditors are drawn from those that come to their attention during the audit. The audit cannot be relied upon to detect all errors, weaknesses or opportunities for improvements in management arrangements that might exist. Audited bodies should assess auditors' conclusions and recommendations for their wider implications before deciding whether to accept or implement them.

Ad hoc requests for auditors' views

51 There may be occasions when audited bodies seek the views of auditors on the legality, accounting treatment or value for money of a transaction before embarking upon it. In such cases, auditors are as helpful as possible, but are precluded from giving a definite view in any case because auditors:

- must not prejudice their independence by being involved in the decision-making processes of the audited body;
- are not financial or legal advisers to the audited body; and
- may not act in any way that might fetter their ability to exercise the special powers conferred upon them by statute.

52 In response to such requests, auditors can offer only an indication as to whether anything in the information available to them at the time of forming a view could cause them to consider exercising the specific powers conferred upon them by statute. Any response from auditors should not be taken as suggesting that the proposed transaction or course of action will be exempt from challenge in future, whether by auditors or others entitled to raise objection to it. It is the responsibility of the audited body to decide whether to embark on any transaction.

Grant claims and returns – certification

53 Auditors may be required by the Commission to carry out work to support certification of grants or returns. Auditors carry out this work on an agency basis on behalf of the Commission. A separate statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors covering this work can be found at www.audit-commission.gov.uk

Access to information, data security and confidentiality

54 Auditors have wide-ranging rights of access to documents and information in relation to the audit. Such rights apply not only to documents and information held by the audited body and its members and staff, including documents held in electronic form, but also to the audited body's partners and contractors, whether in the public, private or third sectors. Auditors may also require a person holding or accountable for any relevant document to give them such information and explanation as they consider necessary.

55 There are restrictions on the disclosure of information obtained in the course of the audit, subject only to specific exemptions. The Freedom of Information Act 2000 does not apply to the Commission's appointed auditors, as they have not been designated as 'public authorities' for the purposes of that legislation, although they are subject to the Environmental Information Regulations 2004. Audited bodies wishing to disclose information obtained from an auditor, which is subject to a statutory restriction on its disclosure, must seek the auditor's consent to that disclosure.

56 Auditors protect the integrity of data relating to audited bodies and individuals either received or obtained during the audit. They ensure that data is held securely and that all reasonable steps are taken to ensure compliance with statutory and other requirements relating to the collection, holding and disclosure of information.

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We welcome your feedback. If you have any comments on this report, are intending to implement any of the recommendations, or are planning to follow up any of the case studies, please email: nationalstudies@audit-commission.gov.uk



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