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Dear Andrew,

**NAO consultation on Auditor Guidance Note AGN/03 – Auditor’s conclusion on arrangements to secure value for money in the use of resources**

Thank you for giving us the opportunity to respond to your consultation and for issuing a draft of this AGN. In general we think the AGN is well drafted and we support the NAO’s objectives as set out on pages 6-7 of the consultation document. However we have a number of specific comments which follow below. We have not answered every question.

*Question 1 – Do you agree with the proposal to align the approach with that of an assurance engagement designed to give reasonable assurance, consistent with the principles of the International Framework for Assurance Engagements?*

Yes. We agree with the NAO’s approach to relate the work on value for money to the terms used in ISAE 3000.

In the part of the AGN dealing with the legal and professional framework, the NAO states that (i) unlike for local government bodies, there is not a requirement for auditors of health bodies to state a positive conclusion and therefore (ii) the auditor must not refer to the work on value for money in the audit report unless there is an exception to report.

We assume this is taken from section 21 (5) of the Local Audit and Accountability Act which states “*a report ... must not contain the auditor’s opinion on the matter in subsection (1)( c ) or (3)(c ) if the auditor is satisfied as to that matter*”. This part of the Act does not apply to NHS foundation trusts.

Paragraph 4(1)(b) of Schedule 10 to the NHS Act 2006 requires the auditor to enter his opinion on the accounts. There is no restriction preventing an FT auditor expressing an opinion on the VFM arrangements which the auditor is required to consider by paragraph 1(1)(d) of Schedule 10.

In its former Audit Code for NHS foundation trusts, Monitor did not require a positive assurance conclusion to be expressed (consistent with other NHS bodies) but did require the auditor to confirm that they had nothing to report in respect of this matter, or report the exception.

While the precise layout has varied by audit firm (which has not concerned Monitor, as long as the content between firms is consistent), NHS foundation trust auditors have previously provided this confirmation in the audit report. Examples of this from 2014/15 are provided in the annex to this response.

We strongly believe that this should be maintained for 2015/16 and beyond. This is because:

- The audit report is a very important part of local and public accountability. It risks confusing the reader's understanding of the scope of the auditor's work if some FT audit reports make no reference to the value for money work.
- Equally, if a user is only reading the audit report for one particular trust, it is important that they can see this aspect of the auditor's work. The governors might not be experts in knowing the scope of the FT audit; the audit report should state the results of work clearly.
- Confirming that there is nothing to report is entirely consistent with the legislative requirements as applicable for NHS foundation trusts.
- There would be no impact on audit fees as the auditor is already doing this work.
- There is no good reason to remove this from FT audit reporting and change what has gone before.

We do not understand why the NAO proposes to change this element of FT audit reporting as this has not been explained. Or if the NAO has not realised it is proposing a change here this is surprising.

Separately, the NAO should also consider whether this could apply to health service bodies. As set out above, we believe there are strong reasons for having the auditor confirm that they have nothing to report. The NAO may wish to consider with DH whether stating that there is nothing to report would constitute an 'opinion' on the value for money arrangements as referred to in section 21(5) for CCGs and NHS trusts.

*Question 2 – Do you have any comments on the scope of proper arrangements as described in the draft AGN? If you think the scope of proper arrangements could be improved, please provide details.*

We appreciate the difficulty of compiling a list of what constitutes proper arrangements that can apply to all local bodies (as presented on pages 6-7 of the AGN). While we could suggest modifications to improve the applicability of the list to NHS foundation trusts, such amendments may be to the detriment of the list's applicability to other local bodies. The content of the AGN in this section is not unreasonable for NHS foundation trusts in defining what proper arrangements might look like and so we are content.

One point we would raise on this list is that we think it should place slightly more emphasis on the importance of organisations gathering relevant high quality data, which they can then use to make decisions. The section 'informed decision making' does include a point on the organisation 'understanding and using appropriate cost and performance information' but

there is not direct coverage of the organisation's approach to assure itself of the quality of data that is used to inform decision making. This is applicable to all local bodies and not just NHS foundation trusts.

It is worth noting that in having the NAO determine this list as applicable to auditors, the auditors have a list of defining proper arrangements that is different to which the audited body itself has. We appreciate that this list is for auditors rather than local bodies as 'proper arrangements' is not an audit concept so it would not be appropriate for the NAO to define this to be applied by local bodies themselves. But the NAO has not engaged relevant authorities (as defined by HM Treasury) in determining its list, and so we infer that the NAO does not consider this to be a risk. The NAO may wish to be aware that Monitor defines some aspects of value for money for NHS foundation trusts as part of its Risk Assessment Framework document.

*Question 3 – Do you have any comments in respect of the approach to the auditor's risk assessment?*

We strongly agree with the sentence in bold on page 7 of the AGN which states that "***if the auditor does not identify any significant risks there is no requirement to carry out detailed further work***".

The use of the word 'detailed' is curious however. Without the word this would mean no further work, so it is not clear what scope of work the NAO envisages in this scenario.

In any case (including where there is no significant risk identified), an important part of the auditor's current work on value for money for NHS foundation trusts is to review the trust's annual governance statement to identify if it is inconsistent with their knowledge. This has been a key part of Monitor's former Audit Code for NHS foundation trusts. The NAO's AGN does highlight the annual governance statement as a part of the subject matter information prepared by the audited body. We would wish, however, to retain this important element of the auditor's work for review – including where there is no significant risk. The auditor's review of the annual governance statement is relied upon by:

- Monitor as part of our monitoring oversight over NHS foundation trusts;
- Monitor and the Department of Health in preparing consolidated governance statements; and
- the C&AG / NAO in obtaining assurance on regularity, governance disclosures and a number of other areas in performing their group audits.

The NAO could make reference to this in explaining what it considers to remain within the scope of required work even if there are no significant risks identified by the auditor.

On pages 7-8 of the AGN there is a list of inspectorates and review agencies that may publish information that should inform the auditor's risk assessment. We recommend that the point should be made more clearly that this means that the auditor's value for money risk assessment process should stay 'live' up to the date that the audit report is signed. This point is made in the foundation trust section at the bottom of page 10 (which we agree with), but consider it should be made more strongly and apply to all local bodies.

In the list of inspectorate and review agencies on page 8, the NAO should be aware that 'NHS Improvement' is proposed to be the operating name of an integration of Monitor and the NHS Trust Development Authority from 1 April 2016. While the details of these arrangements are still being finalised, the NAO may wish to add a note to this effect to its AGN here.

We also note that in the consultation document the NAO refers to "the differing performance management framework in place for foundation trusts". Monitor's current role for NHS foundation trusts is performance monitoring and regulation rather than performance management. The term 'monitoring' is used in the AGN itself and so this is a minor point.

*Question 4 – Do you agree that the illustrative risks included in the AGN are helpful? If yes, are there any further illustrative examples of significant risks that could usefully be included?*

On page 10 of the draft AGN the NAO refers to an FT being found in breach of its licence by Monitor or placed in special measures by the Secretary of State. NHS foundation trusts are placed in special measures by Monitor on recommendation of the CQC, not by the Secretary of State. This always involves enforcement action from Monitor rather than being a separate issue. We may also take action against an NHS foundation trust where there is a formal finding of reasonable grounds to suspect a breach. We recommend changing this wording to "an FT is subject to enforcement action in relation to a breach or suspected breach of its licence, including where it is placed in special measures".

Linked to this, as we have said previously to the NAO on a number of occasions, it is very important that the AGN includes the guidance that auditors should have regard to the scope of any regulatory or inspectorate finding and not just its severity. This applies wider than Monitor and could be added to the list on pages 7-8. Failure to include this may result in an auditor needing to consider any serious regulatory or inspectorate finding as a significant risk, even if it relates to a very small part of the audited body's overall operations.

*Question 5 – Do you have any comments on the wording of the overall criterion against which the subject matter will be evaluated?*

The overall criterion as drafted in the AGN is: "*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people*".

We have two comments to make.

Firstly, this covers economy and efficiency appropriately, but might not cover effectiveness sufficiently? In applying this overall criterion, the consideration of outputs looks at whether they were planned and sustainable, not the effectiveness of the outputs. We appreciate that the auditor is reviewing the arrangements to achieve economy, efficiency and effectiveness rather than the outputs themselves, but if one considers a hypothetical extreme case of a hospital performing poorly as judged by an inspectorate, if the audited body could say they always planned to perform that way, the audited body would still be considered 'effective' in applying this criterion? It may be that the NAO intended to cover this through the word 'sustainable', but to our reading that word applies more directly to medium term financial considerations.

Secondly, the criterion refers to “taxpayers and local people”. NHS foundation trusts (and other NHS bodies too) are concerned with the users of healthcare services (patients) as well as local people. The groups do not entirely overlap: a trust may treat patients who are not local. For health bodies we would therefore query whether it is outcomes for users of their services and not just local people that matter.

*Question 6 – Do you have any comments on the proposed sub-criteria which link to the description of proper arrangements in the draft AGN? If you think the sub-criteria could be improved, please provide details.*

In responding to question 2 of this consultation we noted that the list of what comprises proper arrangements on pages 6-7 of the AGN (in defining the subject matter) is not unreasonable for NHS foundation trusts.

But these are then used as part of the evaluation criteria on page 11, where auditors are required to form a conclusion on the sub criteria. With page 6 saying “proper arrangements comprise...” rather than “examples of”, we are very concerned that these two lists taken together become a prescriptive list for auditor work in performing their evaluation. Even taking on board the good points made on needing to perform a risk assessment and conduct proportionate work, the formality of these sub criteria with the detailed definitions provided risk being used as defining the way auditors need to perform their work given these are evaluation criteria. Monitor previously in setting the Audit Code for NHS foundation trusts did not set detailed evaluation criteria for NHS foundation trust audits in this way and there is no explanation of why the NAO is proposing this significant change for FT audits which may increase the scope of FT audit work. We disagree with the inclusion of sub criteria for evaluation as currently drafted.

Given the drafting of the AGN we fear that a risk averse auditor who needs to satisfy an external quality review would see these sub criteria for evaluation, together with the detail on pages 6-7, as setting a detailed scope for auditor work on value for money. This goes against the earlier points made on performing a risk assessment.

Instead of evaluation sub criteria, we think there should be more detail on the subject matter information and what the auditor should do in different circumstances, including guidance on reviewing the annual governance statement.

*Question 7 – Do you think that the expanded section on reporting will help audited bodies to get more value out of the work auditors undertake on vfm arrangements?*

As noted in our response to question 1, we strongly disagree on the NAO’s proposal to change FT audit reporting such that there would no longer be negative reporting on the results of value for money audit work. This applies in three places in the reporting section of the AGN.

*Question 9 – Do you agree with the proposal to maintain the supporting information separately from the statutory guidance set out in the draft AGN?*

The AGN states that the supporting information will be made available to auditors via the NAO’s secure LACG extranet. We would question why this is not provided on a public external website. It would be advantageous for audited bodies to be able to see what

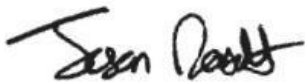
information is being provided against which they will be assessed. It is not clear what the NAO envisages publishing on its Extranet that would not be suitable for everyone to see.

*Question 10 - Are there any other ways in which you think that the guidance could be further strengthened or improved?*

Given the points we have raised, we would question whether the NAO has conducted sufficient engagement with the local bodies this affects or their representative bodies. For NHS bodies including NHS foundation trusts we think the NAO should obtain the views of NHS Providers and the Healthcare Finance Management Association among others.

I hope our comments are helpful. If you would like to discuss our response further please contact Ian Ratcliffe.

Yours sincerely

A handwritten signature in black ink, appearing to read "Jason Dorsett". The signature is written in a cursive, slightly slanted style.

Jason Dorsett

Finance, Reporting and Risk Director

(Annex follows)

## Annex: Examples of FT audit reports 2014/15

This relates to our response to question 1.

*Extract from a KPMG audit report for an NHS foundation trust for 2014/15*

### ***5 We have nothing to report in respect of the matters on which we are required to report by exception***

Under the International Standards for Auditing (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- We have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for patients, regulators and other stakeholders to assess the group's performance, business model and strategy; or
- the audit committee's commentary included in section 5 of the annual report does not appropriately address matters communicated by us to the audit committee.

Under the Audit Code for NHS Foundation Trusts we are required to report to you if in our opinion:

- The annual governance statement does not reflect the disclosure requirements set out in the *NHS Foundation Trust Annual Reporting Manual 2014/15*, is misleading or is not consistent with our knowledge of the group and other information of which we are aware from our audit of the financial statements.
- The trust has not made proper arrangement for securing economy, efficiency and effectiveness in its use of resources.

We have nothing to report in respect of the above responsibilities.

Extract from a PwC audit report for an NHS foundation trust for 2014/15

**Economy, efficiency and effectiveness of resources and Quality Report**

Under the Audit Code for NHS Foundation Trusts we are required to report to you if, in our opinion:

- we have not been able to satisfy ourselves that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources; or
  
- we have qualified, on any aspect, our opinion on the Quality Report.

We have no exceptions to report arising from this responsibility

We have no exceptions to report arising from this responsibility

Extract from a Deloitte audit report for an NHS foundation trust for 2014/15

**Matters on which we are required to report by exception**

*Annual Governance Statement, use of resources, and compilation of financial statements*

Under the Audit Code for NHS Foundation Trusts, we are required to report to you if, in our opinion:

- the Annual Governance Statement does not meet the disclosure requirements set out in the NHS Foundation Trust Annual Reporting Manual, is misleading, or is inconsistent with information of which we are aware from our audit;
- the NHS foundation trust has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources; or
- proper practices have not been observed in the compilation of the financial statements.

We have nothing to report in respect of these matters.

We are not required to consider, nor have we considered, whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

Extract from a Grant Thornton audit report for an NHS foundation trust for 2014/15

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following:

Under the Code we are required to report to you if, in our opinion:

- the Annual Governance Statement does not meet the disclosure requirements set out in the NHS Foundation Trust Annual Reporting Manual or is misleading or inconsistent with the information of which we are aware from our audit;
- we have not been able to satisfy ourselves that the Trust has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources; or
- the Trust's Quality Report has not been prepared in line with the requirements



set out in Monitor's published guidance or is inconsistent with other sources of evidence.

Under the ISAs (UK and Ireland), we are also required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to report to you if:

- we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable; or
- the annual report does not appropriately disclose those matters that were communicated to the Audit Committee which we consider should have been disclosed.