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Mr Tom Jackson
Clerk to the Public Accounts Committee
National Assembly for Wales
Cardiff Bay
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Dear Tom

Caldicot & Wentlooge Levels Internal Drainage Board

At the evidence session on 11 June 2013 I agreed to provide the Public Accounts Committee with some additional information. Specifically, the date when Newport City Council Internal Audit Department became involved with the drainage board and details of our audit escalation procedures.

Internal Audit

From our records it appears that Newport City Council Internal Audit Department first undertook internal audit work at the drainage board during 2007-08. The appointed auditor's report on the 2006-07 accounts had been modified to reflect that the drainage board did not have an internal audit function. It was as a direct result of this that the drainage board then appointed internal auditors. Our records show that the internal auditors made two visits during 2007-08; the first being in October 2007 and the second in February 2008. The Annual Internal Audit report for 2007-08 presented to the drainage board indicates that the total charge for that year was £3,000 for a total of 10 days internal audit work.

More precise details should be available from the drainage board, in the event that the Committee requires this.

Audit escalation procedures

The key output from the audit of the annual financial statements is the auditor's report/opinion on those statements. As prescribed by professional auditing standards, there are a variety of actions available to the auditor with regards to the form of that opinion. These range from an unqualified ('clean') opinion to disclaiming any opinion at all.

This letter considers with the way in which other (i.e. non opinion-related) recommendations should be dealt with. The comments in this paper are limited to local government bodies, since this is relevant to the PAC's consideration of the Drainage

Board report. (There are different statutory provisions relating to other types of public bodies and, whilst the same broad principles will apply to other bodies, the specific details will differ.)

For local government bodies, typically the process will consist of the following stages:

Stage 1 – the auditor makes a recommendation to those charged with governance within the public body concerned.

Stage 2 – during the following year's audit, the auditor will perform work to establish whether or not the recommendation has been adequately acted upon. If this is not the case, and there are no sound reasons for the failure to act, then the auditor will generally repeat the recommendation whilst highlighting that the recommendation was also made in the previous year but not appropriately actioned. However, and depending on the seriousness of the issue, the auditor may instead opt to go straight from Stage 1 to Stage 3.

Stage 3 – during the subsequent year's audit, the auditor finds that the recommendation has still not been adequately acted upon (again, without good reason). At this point the auditor should consider additional audit action. This will typically involve either (i) the making of statutory recommendations under Section 25 of the Public Audit (Wales) Act 2004; or (ii) the issuing of a report in the public interest. In practice, the difference between these two courses of action is based on the seriousness of the issue and the auditor's assessment of the likelihood that those charged with governance within the authority will take appropriate action.

Appointed auditors (including myself) have used statutory recommendations in the past in respect of local government bodies in Wales. For example at a unitary authority where the auditor was of the view that a decision was legally reasonable and lawful, but the processes and actions that underpinned the decision were significantly flawed in some respects. At another authority, deficiencies were reported to the authority with regards to two separate decision-making processes. On the third occasion that such deficiencies were identified by the auditor, a report in the public interest was subsequently issued.

Although not strictly part of the escalation process, an appointed auditor also has the power to issue an Advisory Notice (under Section 33 of the Public Audit (Wales) Act 2004). Such a Notice may be issued where the auditor believes that:

- the body, or an officer of the body, is about to make or has made a decision which involves or would involve the body incurring expenditure which is unlawful;
- the body, or an officer of the body, is about to take or has begun to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency; or
- the body, or an officer of the body, is about to enter an item of account, the entry of which is unlawful.

Once an Advisory Notice is issued, it is not lawful for the body or officer concerned to pursue the course of action until certain conditions set out in Section 34 of the 2004 Act have been met.

Quality Assurance Processes

I would also like to provide the Committee with a little more detail on the changes that we have recently made to our quality assurance processes within WAO Financial Audit. Our arrangements for ensuring audit quality essentially mirror those of the other public audit bodies in the UK, and those of the accountancy firms in the private sector. All audits are required to comply with the International Standards on Auditing (ISA) and Ethical Standards. Our internal processes and procedures are designed to support this.

All audit work is subject to review by a more senior member of the audit engagement team prior to issuing the audit opinion. The engagement lead is able to seek an independent 'second opinion' from another audit director (a 'hot' review) on any matters of contention or difficult audit judgement, prior to recommending the audit opinion to the AGW or Appointed Auditor. Advice and support from our central Technical Group is also available on request at any stage in the audit process.

A sample of WAO audits is subjected to post-completion quality assurance review ('cold' review) by an independent Quality Assurance (QA) team. The QA teams comprise experienced WAO staff and staff of other audit offices from across the UK. The lessons learned from our annual programme of quality assurance work are collated and both reported to our senior management and shared with all of our financial audit staff. Our audit tools, training methods and materials are updated annually as a result.

From this autumn, we have also decided to subject ourselves to external quality assurance reviews. These will be conducted by the Quality Assurance Department (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW). The QAD team will review our overall quality assurance arrangements, will re-perform a sample of our 'cold' reviews to ensure that they are robust, and also conduct their own QA reviews of a sample of completed audits.

Quality Assurance improvement actions

Arising from our 2011 QA work, we identified the need to deliver specific training to our audit staff on enhancing professional audit scepticism. (This was a common QA finding across the UK auditing profession, both in the public and private sectors.) Training was rolled out in a series of mandatory training events during 2012.

In our training courses, we are making greater use of case studies and are giving additional prominence to the inherent and specific risk factors that may be associated with smaller audits, including the risk of an over-dominant Chief Executive, or of a weak Board and governance arrangements.

We have reviewed our approach to the allocation of staff to smaller audits and we are increasing the relative proportion of time to be spent on those audits by senior staff.

Finally, I have also commissioned some further work on providing technical advice and guidance to our audit teams working on smaller audits, and I anticipate that this will be rolled out via training events in the autumn, in readiness for our 2013-14 audit planning cycle.

I trust this information will support the Committee in its enquiry.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'AJB' followed by a flourish and a small 'H'.

Anthony Barrett
Assistant Auditor General