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Sent via email only

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Dear Darren

Audit of small bodies

In October 2012 as the Appointed Auditor for Caldicot and Wentlooge Levels Internal Drainage Board (IDB), I issued a report in the public interest on various aspects of the IDB's activities. In the report, I recognised that 'the number of issues identified within the current audit and the scale and significance of some of these issues raises legitimate questions regarding the effectiveness of previous audits.' I went on to explain that I was considering 'what improvements needed to be made to our methodology for the audit of small public bodies and for staff training to ensure that key audit issues are identified and reported on as early as possible.'

In its subsequent report on the IDB, the Committee stated that:

'We are disappointed that the Wales Audit Office failed to address issues at Caldicot and Wentlooge Levels Internal Drainage Board earlier. However, we note that the Wales Audit Office has recognised these failings and has committed to reviewing its auditing methodology to better ensure that key audit issues are reported and addressed as soon as possible.'

The report recommend that the 'Wales Audit Office appear before the Public Accounts Committee with the results of the review of its auditing methodology and proposals on how it intends to make improvements in the future.'

I anticipate that I will appear before the committee on 4 February 2014 to provide an update regarding our response to the recommendation in the report about changes to our audit approach.

The aim of this letter is to brief the committee, in advance of my scheduled evidence session, on the work we have undertaken to review and develop aspects of our approach to financial audit work, in particular those that are relevant to smaller audits.

Better recognition of the risks related to small audits

In light of the relatively small amount of public money spent by small bodies, we have historically regarded such bodies as being of lower risk. This may not, however, always be the case. We have therefore:

- revisited our arrangements for staffing the audits of smaller entities to ensure that more experienced staff are utilised where appropriate;
- undertaken a review of the audit approach in a sample of small audits. Our 2013 annual round of mandatory auditor training stressed the issues identified in our review of small audits, including recognition of and responding appropriately to specific risks;
- held a 'raising our game in financial audit' seminar with Engagement Leads and Audit Managers in November 2013. This drew on the findings from our internal quality reviews of audits with the aim of identifying areas where we can improve the quality of audit work and the actions required to achieve these improvements; and
- reviewed and enhanced our quality control review policy, to ensure that in future at least one smaller audit is subject to review each year. We have also revised our method of scoring audit quality, so we can better identify audits where improvements are required.

External reviews of audit quality

As part of our commitment to improving the quality of our audit work, over the past year we commissioned two external reviews of our quality arrangements:

- In February 2013 a senior officer of the Audit Commission undertook a review of our overall quality framework, and we are now implementing his recommendations.
- We have also appointed the Quality Assurance Directorate of the Institute of Chartered Accountants of England and Wales on a 3 year contract to undertake independent reviews of our financial audit work (in the same way as they undertake reviews of audit firms undertaking Companies Act audits). They undertook their review of our overall arrangements in September 2013, and in early 2014 they will undertake their first reviews of individual audits.

Accreditation of financial audit staff

A further development designed to improve the quality of audit work will be the introduction, from 2014, of an accreditation scheme for all financial audit staff. This will

provide enhanced assurance that staff have the technical skills required to undertake the financial audit of public sector entities.

In order to obtain and retain accreditation to undertake financial audit work, staff will be required to:

- undertake a minimum amount of relevant audit work each year;
- attend specific mandatory training courses; and
- provide evidence of compliance with their professional body's Continuing Professional Development scheme.

New Code of Audit Practice

Most of the issues identified in the public interest report related to the governance of the IDB.

The extant version of the Auditor General's Code of Audit Practice does not specifically identify considerations of governance issues as a responsibility of auditors (with the exception of limited work regarding the Annual Governance Statement). However and specifically in order to clarify the role of auditors regarding governance issues, the draft revised Code (on which we are currently consulting) states that 'auditors will provide assurance on the effectiveness of governance arrangements and, where appropriate, on other issues of public interest.' This is likely to include overviews of governance arrangements across all organisations supplemented by specific risk based themes and probes designed to provide a deeper level of assurance on particular aspects of the governance.

Revised fee model

In my evidence to the Public Accounts Committee, I noted that our audit work on the IDB had been constrained 'because it is a small body, and, if you are going to add more time to the audit, it is going to cost even more.'

The Public Audit (Wales) Act 2013 introduces a slightly revised fee-setting basis for all our audit work. The Wales Audit Office 'may not exceed the full cost of exercising the function to which the fee relates'. Full costs include direct costs such as salary, employer pension and national insurance contributions, alongside an appropriate proportion of organisational overheads. In response to these provisions, we have revised our cost allocation methodology to ensure we comply with the requirements when exercising each audit or inspection activity at each audited body for each year of audit, including for small bodies. The necessary revisions to our cost allocation methodology, coupled with changes made following a review of our zero-based approach to audit planning, will ensure that fees are sufficient to allow audit work at small bodies to be undertaken to an appropriate standard.

I trust that this reassures the Committee that we have taken the issues seriously and learned from them. I remain committed, both professionally and personally, to enhancing

the quality of our audit work. We will not be complacent and will strive to always deliver the very highest standards of audit work for the people of Wales.

Yours sincerely

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

Anthony Barrett
Assistant Auditor General