Audit Committee, 9 October 2014

National Audit Office Audit planning report on the 2014-15 external audit

Executive summary and recommendations

Introduction

The National Audit Office (NAO) external audit planning report is provided to the Committee for its consideration.

Decision

The Committee is asked to discuss the report.

Background information

Auditing standards require external auditors to explain their planned audit approach to "those charged with governance", ie the Audit Committee, on behalf of the Council. The planning report sets out the scope and timing of the audit, and the approach including the auditors' assessment of the significant risks.

The approach and the timetable are similar to previous years, and the NAO intends to hold the fee at the same level as in previous years. The Executive is confident of being able to work with the NAO to deliver an unqualified audit to the planned timetable.

In our case, the only significant risks the NAO expect to address are risks that auditing standards require auditors to consider on *every* audit – the risk that management will override controls to misstate the results, and the particular risk that income will be deliberately misstated.

The external auditors are independent and it is their responsibility to determine the plan for the audit, so the Audit Committee does not approve or reject the audit plan, but the NAO will welcome the Committee's discussion and any feedback.

Resource implications

None

Financial implications

Audit fee of £39,000.

Appendix

National Audit Office Audit Planning Report 2014-15

Date of paper

25 September 2014

National Audit Office

Health and Care Professions Council

Audit planning report on the 2014-15 financial statement audit

REPORT TO THOSE CHARGED WITH GOVERNANCE
September 2014

http://www.nao.org.uk/

Contents

We have pleasure in setting out details of our proposed financial statement audit approach for Health and Care Professions Council for the year ending 31 March 2015.

We have prepared this report for the Health and Care Professions Council's sole use although you may also share it with the Privy Council Office. You must not disclose it to any other third party, quote or refer to it, without our written consent and we assume no responsibility to any other person.

Financial statement audit plan

What work will we complete?

Our audit, which will be conducted in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK and Ireland)), will enable the C&AG to give an opinion on the financial statements.

Further details of the scope of the audit, as well as our respective responsibilities in relation to this engagement, have been set out in our Letter of Understanding which has previously been provided to the audit committee.

OFFICIAL

How are we going to conduct the audit?

Risk-based approach

We plan our audit of the financial statements to respond to the risks of material[1]:

- misstatement to transactions and balances; and
- irregular transactions.

Our team

- Kate Mathers, portfolio director
- Catherine Hepburn, has overall responsibility for the audit
- Sarah Edwards, will manage the audit
- Emily Hopkinson, will lead the on-site work

Significant risks

The significant financial statement risks which we have identified are the ISA 240 presumed risks (for ALL clients) of fraud through:

- Management override of controls; and
- Revenue recognition

We will also consider the following matters:

- Further plans for 186 Kennington Park Road
- Upgrade to HCPC's accounting system
- Receiving Department of Health grant-in-aid
- New income model
- Registration processes review

Further details of these risks and our response are set out at Appendix 1.

[1] A matter is material if its omission or misstatement would reasonably influence the decisions of users of the financial statements. The assessment of what is material is a matter of the auditor's professional judgement and includes consideration of both the amount and the nature of the misstatement. Further information on materiality is included on page 7.

OFFICIAL

When do we plan to complete this work?

Timetable

The timetable comprises three short interim visits in November, January and March, and a final visit of two weeks in May. Certification is planned for early July 2015.

Date	Activity
September 2014	**Planning:** review HCPC's operations, assess risk for our audit and evaluate the control framework.
November 2014 to March 2015	**Interim audit work:** three short visits of 2 days in November, 1 week in January and 1 week in March to carry out controls and transaction testing.
March 2015	**Interim Report:** present any significant findings from interim.
May 2015	**Receipt of 1st draft account**
May 2015	**Final audit work:** 2 week visit to complete transaction testing and test year-end balances and disclosures.
June 2015	**Audit Completion Report:** present the results of our audit.
July 2015	**Certification:** seek representations and C&AG issues opinion.

Fees

We aim to hold our audit fee at £39,000.

Completion of our audit in line with the timetable and fee is dependent upon HCPC:

- delivering a complete Annual Report and Accounts of sufficient quality that have been subject to appropriate internal review on the date agreed;
- delivering good quality supporting evidence and explanations within the agreed timetable; and
- making appropriate staff available during the audit.

If significant issues arise and we are required to perform additional work which would result in a change in our fee, we will discuss this with you as soon as possible.

OFFICIAL

Our audit approach

Our assessment of materiality

Materiality	The concept of materiality recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. For the purposes of determining whether the financial statements are free from material misstatement or irregularity we consider whether: 1. the magnitude of misstatement; or 2. the nature and cause of misstatements (e.g. because of the sensitivity of specific disclosure or regularity requirements) would influence the users of the accounts. In line with generally accepted practice, we have set our quantitative materiality threshold as approximately 2% of expenditure, which equates to £513,000. Other elements of the financial statements that we consider to be more sensitive to users of the accounts will be assessed using a lower qualitative materiality threshold. These elements include the remuneration report and our audit fee. We apply the concept of materiality in planning and performing our audit and in evaluating the effect of misstatements on our audit and on the financial statements. As the audit progresses our assessment of both quantitative and qualitative materiality may change.
Error reporting threshold	For reporting purposes, we will treat any misstatements below £5,000 as “trivial” and therefore not requiring consideration by the Audit Committee. Please note that this is a separate threshold to our consideration of materiality as described above. It is materiality, not the error reporting threshold, which is used in forming our audit opinion.

OFFICIAL

Our audit approach

Other matters

Independence	We comply with relevant ethical requirements regarding independence and have developed important safeguards and procedures in order to ensure our independence and objectivity. Information on NAO quality standards and independence can be found on the NAO website: http://www.nao.org.uk/about-us/role-2/what-we-do/audit-quality/audit-quality/ We will reconfirm our independence and objectivity to the Audit Committee following the completion of the audit.
Management of personal data	During the course of our audit we have access to personal data to support our audit testing. We have established processes to hold this data securely within encrypted files and to destroy it where relevant at the conclusion of our audit. We confirm that we have discharged those responsibilities communicated to you in the NAO's Statement on Management of Personal Data at the NAO. The statement on the Management of Personal Data is on the NAO website: http://www.nao.org.uk/freedom-of-information/wp-content/uploads/sites/13/2013/05/data_protection_review.pdf
Using the work of internal audit	We liaise closely with internal audit through the audit process and seek to take assurance from their work where their objectives cover areas of joint interest. Following our review of internal audit's plans we will aim to take assurance from the following audit assignments: • Review of HCPC's corporate governance arrangements • Review of HCPC's core financial systems

Appendix 1: Financial statement risks: Overview

We plan our audit of the financial statements to respond to the risks of material misstatement and material irregularity. We are required to perform additional audit work for the most significant risks. Our assessment of the level of risk for the particular issues we consider relevant to the financial statements is shown below.

Impact →

Probability ↓

Low impact/probability	**High impact/low probability**
Receiving grant-in-aid New income model Registration processes review	Further plans for 186 Kennington Park Road Upgrade to HCPC's accounting system
Low impact/high probability	**Significant risk**
	Presumed ISA risk of fraud through management override of controls and revenue recognition

Appendix 1: Financial statement risks: Significant risks

ISA 240 presumed risk of fraud:
- **through management override of controls; and**
- **in income recognition**

Audit areas affected

- Pervasive risk (i.e. could impact all areas of the financial statements if the risk was to be realised)

Key features

The Auditing Standard ISA 240 states that there is a risk in all entities that management override controls to perpetrate fraud. The standard requires that auditors perform audit procedures to address this risk in the following areas for **ALL** clients:
- Journal entries
- Bias in accounting estimates
- Significant unusual transactions

There is also a presumed risk of fraud in income recognition.

No change in risk from prior year

Audit response

We will review the controls in place and carry out substantive testing on:
- Material journals
- Accounting estimates
- Significant unusual transactions
- Income

Appendix 1: Financial statement risks: Matters of audit emphasis

We will track a number of 'matters of audit emphasis', which could potentially have an impact on the accounts, but are not expected to present a significant risk to the audit.

Further plans for 186 Kennington Park Road	HCPC is reviewing options for the new building (whether to renovate, sell, relocate etc.). The Council is expected to make a decision by the end of the financial year. Depending on the decision, HCPC may need to make a disclosure in its accounts. However, there are unlikely to be any significant transactions relating to this in 2014/15, and so we do not consider it to be a significant risk to the financial statements.
Upgrade to HCPC's accounting system	HCPC will upgrade Sage in March 2015, as the existing operating system will no longer be supported in 2015/16. As it is a straightforward upgrade, the impact on the financial statements should be minimal. However, if any issue arose then this could have a significant impact on the accounts production process and accuracy of the financial statements. We will carry out controls testing in March to gain additional assurance over the switchover.
Receiving Department of Health grant-in-aid	We understand that HCPC may receive some grant-in-aid from the Department of Health to set up a new public health specialist register. Although this is unlikely to be a material amount, HCPC will need to ensure it uses the correct financial reporting treatment for this grant.
New income model	HCPC has, with the assistance of consultants, constructed a new fee income model as part of the development of the Five Year Plan model. Although we do not expect this to have any impact of the 2014/15 financial statements, we will consider this new model in our work on high level controls of income.
Registration processes review	We understand that HCPC has begun a project to review its registration processes. Other than the costs of the project itself, this is not expected to have any impact on the 2014/15 financial statements, but we will keep this matter in view as plans progress.

OFFICIAL

Appendix 2: Scope and responsibilities

In line with ISAs (UK and Ireland) we are required to agree the respective responsibilities of the C&AG/NAO and the Accounting Officer/Client, making clear that the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

These responsibilities are set out in the Letter of Understanding of November 2010, but are summarised here.

Area	Accounting Officer/management responsibilities	Our responsibilities as auditor
Scope of the audit	• Prepare financial statements that give a true and fair view in accordance with the Health and Social Work Professions Order 2001. • Process all relevant general ledger transactions and make these, and the trial balance, available for audit. • Support any amendments made to the trial balance after the close of books (discussing with us). • Agree adjustments required as a result of our audit. • Provide access to documentation supporting the figures and disclosures within the financial statements. • Subject the draft account to appropriate management review prior to presentation for audit.	• Conduct our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK and Ireland)). • Report if the financial statements do not, in any material respect, give a true and fair view. • Review the information published with the financial statements (e.g. annual report) to confirm it is consistent with the accounts and information obtained during the course of our audit.

Appendix 2: Scope and responsibilities

Area	Accounting Officer/management responsibilities	Our responsibilities as auditor
Regularity	• Ensure the regularity of financial transactions. • Obtain assurance that transactions are in accordance with appropriate authorities, including the organisation's statutory framework and other requirements of Parliament and HM Treasury.	• Conduct our audit of regularity in accordance with Practice Note 10 (revised), 'Audit of financial statements of public sector bodies in the United Kingdom', issued by the Auditing Practices Board (Financial Reporting Council). • Confirm the assurances obtained by HCPC that transactions are in accordance with authorities. • Have regard to the concept of propriety, i.e. Parliament's intentions as to how public business should be conducted.
Fraud	• Primary responsibility for the prevention and detection of fraud. • Establish a sound system of internal control designed to manage the risks facing the organisation; including the risk of fraud.	• Provide reasonable assurance that the financial statements (as a whole) are free from material misstatement, whether caused by fraud or error. • Make inquiries of those charged with governance in respect of your oversight responsibility.

Appendix 2: Scope and responsibilities

Area	Accounting Officer/management responsibilities	Our responsibilities as auditor
Governance statement	• Review the approach to the organisation's governance reporting. • Assemble the governance statement from assurances about the organisation's performance and risk profile, its responses to risks and its success in tackling them. • Board members, with the support of the Audit Committee, evaluate the quality of internal control and governance, and advise on any significant omissions from the statement.	• Confirm whether the governance statement is consistent with our knowledge of the organisation, including its internal control. • Consider whether the statement has been prepared in accordance with HM Treasury guidance, including Managing Public Money.
Accounting estimates and related parties	• Identify when an accounting estimate, e.g. provisions, should be made. • Appropriately value and account for estimates using the best available information and without bias. • Identify related parties. • Appropriately account for and disclose related party transactions.	• Consider the risk of material misstatement in respect of accounting estimates made by management. • Perform audit procedures to identify, assess and respond to the material risks of not accounting for or disclosing related party relationships appropriately.

Appendix 3: Matters from the prior period

The table below sets out significant matters which were identified in the prior year audit and how management intend to address these issues in producing this year's financial statements.

	Details	Update
Effectiveness of the control environment	HCPC changed its governance structure in 2013/14, and also some key finance staff. There was a risk that this would impact on the overall effectiveness of the control environment during the year.	• New governance structure now fully established. • Permanent Finance Director recruited in February 2014, and Management Accountant in July 2014. • No longer a significant risk in 2014/15.
Procurement	Correspondence in 2011/12 raised concerns over the procurement process. There was a risk that without a defined, robust and implemented policy, unauthorised expenditure could take place, leading to irregular transactions in the financial statements.	• Procurement policy now in place, having been approved by the Council. • We saw the process was operating effectively in our testing of procurement in 2013/14. • No longer a significant risk in 2014/15.

OFFICIAL

Appendix 4: Sector updates: FReM changes for 2014/15

FReM Presentational Changes

Format

The format of the FReM has been updated for 2014-15. The flow of the new FReM is much clearer, avoiding duplication of adaptations and interpretations, improving internal consistency and as a result is more concise. Chapter 6 provides a useful summary of each accounting standard and whether it has been adopted, adapted or interpreted by the FReM.

Table of contents

FReM Content Changes

Consolidation Standards – IFRS 10, 11 and 12 (FReM 4.2.1 to 4.2.9)

There are three new standards which consider consolidated financial statements, joint arrangements and disclosure of interests in other entities. These standards are applicable for accounting periods beginning on or after 1 January 2014. These standards are interpreted for use in the public sector. Key interpretations are set out in the FReM and could result in an ALB included within the departmental boundary consolidating a body not in the departmental boundary. In these circumstances (subject to materiality), the departmental group accounts will need to be adjusted to remove the body not listed in the designation order. We do not see this as a change in principle and we do not envisage significant changes to consolidation.

There are additional disclosure requirements around the significant judgements and assumptions an entity has made.

Remuneration report – compensation payments (FReM 5.2.25)

The 2014-15 FReM provides additional guidance on the disclosure of compensation payments. It requires entities to disclose if payments have been made under the terms of an approved Compensation Scheme for compensation on early retirement or for loss of office. This disclosure should include a description of the compensation payment and details of the total amounts paid or receivable. The amounts should include any top-up to compensation provided by the employer to buy out the actuarial reduction on an individual's pension.

Impairment of assets (FReM 7.3)

The FReM has been re-drafted to bring greater clarity to the accounting treatment of impairments and when these should be recognised in the Statement of Comprehensive Net Expenditure (SoCNE). For those impairment losses that do not result from a clear consumption of economic benefit or reduction of service potential, the impairment loss continues to be treated as a decrease to the revaluation reserve (to the extent that it does not exceed the amount in the revaluation reserve for the same asset). This will apply to impairments arising from changes in market price. When the loss arises due to a consumption of economic benefit or a reduction in service potential the impairment should be taken to the SoCNE. The FReM clarifies that loss of service potential includes reductions due to a loss or damage arising from normal business operations.

IFRS 13 – Fair Value Measurement (FReM table 6.1)

IFRS 13 has not been adopted by the FReM for 2014-15. It will be adopted prospectively for periods beginning on or after 1 April 2015. Early adoption is not permitted. Final details are currently under consultation. The FReM includes details to allow users to start to prepare for IFRS 13 adoption.

Subsidiaries (FReM 5.5.6)

The FReM includes guidance on the new audit exemption available in the Companies Act to subsidiary companies. The new provision (s.479A) allows exemption from audit for subsidiary companies, provided that the parent company provides a guarantee for the subsidiary's liabilities, and the subsidiary is included in the consolidated accounts of the parent.

This exemption does not apply to limited-by-guarantee companies. Any limited-by-shares companies who wish to apply the exemption will need to obtain prior approval from Treasury.

Appendix 4: Sector updates: FReM changes for 2014/15

On 1 October 2013 the Companies Act 2006 (Strategic Report and Directors' Report) Regulation 2013 came into force. Sections 5.2.2 to 5.2.20 of the FReM describe how these requirements have been interpreted for bodies covered by the FReM. The Strategic Report and the Directors' Report should be separately signed and dated by the Accounting Officer.

Content of the Strategic report

Full details of the FReM interpretation are detailed in chapter 5 (sections 5.2.6 to 5.2.11). Some of the key matters are summarised below:

- The strategic report should be comprehensive and self-standing, but where information is provided in other parliamentary reporting it can be summarised in the strategic report with a cross reference to the full information.
- There should be disclosure of any significant changes in the department's objectives and activities, its investment strategy and its long term liabilities in light of the spending review settlement.
- Environmental matters are covered by the sustainability report within the strategic report.
- Social, community and human rights issues should be disclosed to the extent necessary for the understanding of the business.
- Departments should disclose performance against their key performance indicators. Other reporting entities should report performance against the indicators agreed with the Minister.

Content of the Directors' report

The interpretation of the Companies Act requirements for the Directors' report is in sections 5.2.12 to 5.2.20 of the FReM. Some of the key items to be disclosed are summarised below:

- An indication of how pension liabilities are treated in the accounts – a cross-reference to the accounting policy will normally suffice.
- Details of company directorships and other significant interests held by Board members should be disclosed.
- Sickness absence data.
- Personal data related incidents.

The reporting of Greenhouse Gas Emissions is not required in the Director's report.

Appendix 4: Sector updates: NAO guidance and toolkits

Understanding central government accounts

Our introductory guide is aimed at helping readers better understand government accounts.
http://www.nao.org.uk/report/understanding-central-governments-accounts-introductory-guide-oversight-role/

Support to Audit Committees

We have developed a range of guidance and tools to help public sector Audit Committees achieve good corporate governance.

http://www.nao.org.uk/search/pi_area/support-to-audit-committees/type/report/

Sustainability reporting

We have prepared a fact sheet that highlights the findings from our work on good practice in sustainability reporting.

http://www.nao.org.uk/report/sustainability-reporting-factsheet/

The NAO's role in local government audit

In 2014 the NAO took on responsibilities in the new framework for the audit of local bodies. This leaflet provides information on our new role.

http://www.nao.org.uk/report/the-naos-role-in-local-audit/

Guidance for governance

Developments in government internal audit and assurance

Our factsheet provides further details on grouped IA services, the adoption of new IA standards and other developments.

http://www.nao.org.uk/report/fact-sheet-recent-developments-in-government-internal-audit-and-assurance-spring-2013/

Governance Statements

To assist those responsible for producing Governance Statements, we have prepared a fact sheet highlighting the key messages and good practice we identified from our audit.

http://www.nao.org.uk/report/fact-sheet-governance-statements-good-practice-observations-from-our-audits-3/

Disclosure Guides

Our disclosure guides for clients help audited bodies prepare an account in the appropriate form and that has complied with all relevant disclosure requirements.

http://www.nao.org.uk/report/nao-disclosure-guides-for-entities-who-prepare-financial-statements-in-accordance-with-the-government-financial-reporting-manual-frem/