Audit Committee, 22 November 2016

National Audit Office Audit planning report on the 2016-17 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.

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 2016-17

Date of paper

11 November 2016

Health and Care Professions Council

Audit planning report on the 2016-17 financial statement audit

REPORT TO THOSE CHARGED WITH GOVERNANCE
November 2016

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

Contents

We have pleasure in setting out details of our proposed financial statement audit approach for the Health and Care Professions Council for the year ending 31 March 2017.

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 Understating dated April 2016.

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.

Under International Standard on Auditing (UK and Ireland) 240, there is a presumed significant risk of material misstatement owing to fraud arising from management override of controls.

There is also a presumed risk of fraud in revenue recognition, albeit rebuttable. Given the nature of HCPC's income streams (highly predictive) we do not believe the risk of fraud in revenue recognition is material to the financial statements. We have therefore rebutted this risk.

We have considered findings from the prior year audit as well as performing a provisional risk assessment as part of our planning work. We have not identified any additional significant risks as a result of this work. There are four risk factors that may impact the audit. These are detailed within Appendix 1.

Our team

The details of the key audit staff who will complete this audit are:

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[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 6

When do we plan to complete this work?

Timetable

The timetable comprises an interim visit in January and a final visit in May with certification planned for July 2017. Further details are provided in the table below.

Date	Activity
September/ October 2016	**Planning:** review HCPC's operations, assess risk for our audit.
November 2016	**Planning:** 2 day visit to update our understanding of the HCPC control framework
30 January 2017	**Interim Visit:** 2 week visit to perform in year transaction testing for the period to date
March 2017	**Interim Report:** present any significant findings from interim.
15 May 2017	**Receipt of 1st draft account** **Final audit work:** 2 week visit to complete our testing of transactions, year-end balances and disclosures, plus 1 week off site for completion.
14 June 2017	**Audit Committee Meeting** at which we present the results of our audit in the **Audit Completion Report**
5-6 July 2017	Council Meeting around which the **Accounting Officer signs** the Annual Report and Accounts
July 2017	**Certification:** seek representations and C&AG issues opinion.

Fees

The fee for the audit is £39,000 (2015-16 £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, subject to appropriate internal review on the date agreed;
- delivering good quality supporting evidence and explanations within the agreed timetable;
- making staff available during the audit.

If significant issues arise and we are required to perform additional work this may result in a change in our fee. We will discuss this with you before carrying out additional work.

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 £627,000. 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, our audit fee, comparative figures and related party transactions. 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 £6,200 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.

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 available on the NAO website: http://www.nao.org.uk/freedom-of-information/publication-scheme/how-we-make-decisions/our-policies-and-procedures/policies-and-procedures-for-conducting-our-business/
Using the work of internal audit	We liaise closely with internal audit throughout the audit process and will use their work to inform our ongoing risk assessment. In particular we will consider the findings and recommendations of the their planned: • Review of HCPC's registration transformation project; and • Review of HCPC's core financial controls We will not seek to take formal assurance from the work of Internal Audit as we do not consider this to be an efficient audit approach for our audit of HCPC.
Consolidation in to the Department of Health group accounts	Under the Government Resources and Accounts Act 2000 (Estimates and Accounts) Order 2016, HCPC has been classified as a designated body of the Department of Health. As a result, HCPC will be consolidated into the Department's group financial statements for the first time in 2016-17. We will be required to provide some assurance to the group auditors in relation to HCPC's return to the Department. We do not anticipate that this will have a significant impact on the audit timetable and it will not impact the audit fee.

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** Potential future transfer of social workers Classification of project expenditure (capital and operating split) Change to payment system for FTP partners New HR and partners system
Low impact/high probability	**Significant risk** Presumed ISA risk of fraud through management override of controls

Appendix 1: Financial statement risks:
Significant risks

ISA 240 presumed risk of fraud through management override of controls

Audit areas affected

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

Key features

Under International Standard on Auditing (UK and Ireland) 240, there is a presumed significant risk that management may override the system of internal controls. Management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and accounting estimates and prepare fraudulent financial statements by overriding internal controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls may vary from entity to entity the risk is presumed to be present in **ALL** entities. Now that HCPC is consolidated into the Department's group financial statements we will also consider this risk from the Departmental perspective.

No change in risk from prior year

Audit response

- Evaluate any significant transactions that are outside the normal course of business or that otherwise appear to be unusual. Such evaluation will have as its objective, to determine whether management has entered into these transaction to engage in fraudulent financial reporting or misappropriation of assets.
- Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the accounts.
- Review accounting estimates for evidence of bias; and where such bias is identified, evaluate the circumstances producing the bias to assess whether there is a risk of material misstatement to the accounts
- We will liaise with the Departmental Group audit team in specifically considering the appropriateness of any accounting or budgeting treatments mandated by the Department, in the context of applicable accounting standards and the Consolidated Budgeting Guidance.

Appendix 1: Financial statement risks:
Risk factors and matters to keep in view

Risk factors represent developments or ongoing issues in HCPC that are potential risks to the financial statements or the C&AG's audit opinion. They differ from significant risks as they do not currently require a specific audit response either as they have not yet occurred or they are already covered by our standard audit approach.

Classification of project spend (capital and operating split)	The HCPC is undertaking a number of projects, including refurbishment of 186 Kennington Park Road and registration transformation, which include both capital and operating costs. There is a risk that the split of this expenditure within the accounts is not in line with accounting standards, for example, costs which meet the definition of capital expenditure recognised as operating expenditure and vice versa. We will consider the classification of expenditure as part of our standard testing of both operational expenditure and in year asset additions.
New HR and partners system	The new HR and partners system is currently in development with roll out of the HR element planned for November 2016 followed by the partners element in early 2017. The first payroll run under the new system will be carried out in December. We will document and walkthrough the new system and HCPCs systems and controls associated with payroll and consider the implications for our audit
Change to payment system for FTP partners	The changes in the payment system may give rise to incorrect payments to partners. Although we have not identified problems with partner payments in the past (including when the new process was rolled out to other areas of the business in 2015-16), there is an increased risk as staff use a new process. We will gain assurance over this expenditure stream through our normal expenditure testing.
Potential future transfer of social workers to a different regulatory body	In January 2016, the government announced its intention to establish a new regulatory body for social work which would over time take on HCPC's role in this sector. Social work regulation is a significant component of HCPC's business and therefore the loss of this function could impact on the entity's going concern assessment. The transfer of the regulatory function requires a change to legislation. This is included within the Children and Social work Bill which is currently being debated in the House of Lords. The precise scope and timing of any change cannot be determined until the legislative process is complete. We therefore do not consider this to be a significant risk at this stage and will continue to monitor the progress of the Bill and any further announcements in relation to the potential transfer and consider the impact of these on our audit.

Appendix 2: Follow up to recommendations we made in the previous year

Title	Area	What was the recommendation?	Response/Progress	Status
Internal Control	**Management Accounts**	We recommend that HCPC should agree on the level of granularity and type of detail in needed in its management accounts for budget holders and for council.	HCPC has provided the NAO with a response to the recommendation that was taken to their Audit Committee. The granularity for HCPC wide management accounts has been set such that variances greater than £30,000 and 5% require explanations. At a budget holder level, the granularity is a matter of judgement for the budget holder, due to the variety of budget sizes. The July management accounts as presented to the Board show a variance analysis with explanations covering both over and understatements covering the majority of the total overall variance. Were we to seek to rely on the management accounts control we would need to clarify a number of the explanations. In particular, we note that in some cases the explanations, while analysing the overall variance into its various elements, do not always explain the underlying reasons behind the identified movements (for example, whilst it might be noted that there is favourable variance on income due to increased international applications there is no explanation as to what lies behind this increase in the applications). This could provide additional business insight. We have concluded that we will not seek to rely on the control for this year. However, we note that both the Audit Committee and Council have considered the management accounts process and have concluded they are content that it is adequate for internal monitoring. We are therefore content to consider this matter as closed.	Closed

Appendix 3: 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 dated April 2016, but are summarised here.

Area	Accounting Officer/management responsibilities	Our responsibilities as auditor
Scope of the audit	• Prepare financial statements in accordance with the Health and Social Work Professions Order 2001 and HM Treasury guidance and give a true and fair view. • 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 3: 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 the 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 3: 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. • Other than the presumed significant risks to the financial statements (ISA 240) of management override of controls as set out in appendix 1, we have not identified any significant risks at this stage.

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Appendix 4: Future accounting standards (for information)

IFRS 9: *Financial instruments* *Effective from 2018-19* IASB project summary	Replacing IAS 39, IFRS 9 aims to simplify financial instrument accounting and more closely align accounting and practices with how instruments are used in the business. Specifically: • **classification and measurement** rules have been adapted to incorporate a more principles-based model with fewer categories – with measurement at fair value except for some debt instruments depending on characteristics; • **impairments** due to changes in credit quality will result in earlier remeasurement, on an 'expected loss' basis; and • **hedge accounting** will become more principles-based, with the elimination of the 80-125% effectiveness test and a greater reliance on assessing the purpose of transactions within businesses' risk management strategies.
IFRS 15: *Revenue from Contracts with Customers* *Effective from 2018-19* IASB project summary	IFRS 15 aims to replace a significant amount of existing guidance and reduce inconsistencies by setting a new principles-based Standard. The step by step process in IFRS 15 involves identifying contractual performance obligations, allocating the transaction price to those obligations, and recognising revenue only when those obligations are satisfied. Impact for most central government clients will be limited.
IFRS 16: *Leases* *Effective from 2019-20* IASB project summary 2013 exposure draft (now superseded by issued Standard) *Decisions remain for HM Treasury on if or how to interpret/adapt this Standard for FReM bodies, and what allowances to make for transitional relief.*	IFRS 16 eliminates the operating/finance lease distinction and imposes a single model geared towards the recognition of all but low-value or short term (<12m) leases. The proposals arise partly from the IASB's view that: • disclosures around operating lease commitments have lacked prominence and tended towards understatement; and • even in leases where the underlying asset is not acquired for its whole useful life, the lessee nevertheless acquires an economic right to its use, along with obligations to make good on minimum lease payments. These will now be recognised on the Balance Sheet as a **'right of use'** asset and **lease liability**. The lease liability will be measured at initial recognition as the value of future lease payments, with the asset additionally including any initial direct costs incurred by the lessee, plus an estimate of any dismantling/restoration costs. Subsequent measurement of both asset and liability will need to respond to any changes in lease terms, and the accounting for the asset can be on a *cost less depreciation and impairment* model or a *revaluation (*fair value) model. **Successful transition will depend on organisations pro-actively capturing additional information** about leases – new and existing – which they expect to remain in place at 1 April 2019, especially regarding future minimum lease payments. Organisations should also ensure systems for capturing cost information are fit for purpose, can respond to changes in lease terms and the presence of any variable (e.g. RPI-based) lease terms where forecasts will need to be updated annually based on prevailing indices.

Appendix 5 - Key messages from our wider work

Cross Government Fraud Landscape Review **(February 2016)**	The UK government detected fraud figure of 0.02% of expenditure is significantly lower than some estimates of 3-5% in the EU and US. While comparisons should be treated with caution, this suggests there could be significant fraud and error which is unreported or undetected and losses which are not being adequately addressed. Concludes that, overall, the Government lacks a clear understanding of the scale of the fraud problem and departments vary in their ability to identify and address fraud risks. The data that does exist is patchy, inconsistent and of variable quality. The most comprehensive data relates to areas of known risk – tax credit and benefit fraud – but information across the rest of government is clearly incomplete. It is difficult to formulate solutions if the scale and nature of the problem is unknown. www.nao.org.uk/report/fraud-landscape-review
Departments' oversight of arm's-length bodies: a comparative study **(July 2016)**	We looked at and compared how four departments oversee and manage the relationships with their arm's-length bodies (ALBs). These departments are BIS (now BEIS), MoJ, Defra and DCMS. There is no single list of ALBs across government nor a common understanding of when ALBs should be used or what type of ALB is most appropriate for particular circumstances. Although the Cabinet Office is building on its Public Bodies Reform Programme and taking further steps to address these shortfalls, the prevailing inconsistency hampers a coherent approach to overseeing ALBs that is consistent with their purpose. To get the best from ALBs we recommend the Cabinet Office works with departments to improve understanding of the costs and benefits of different approaches, and develop and implement a guiding framework for effective oversight. We propose a principles-based approach. We do not argue for a one size fits all approach, but it's clear that the broad range of approaches cannot all be equally good at getting value from ALBs. www.nao.org.uk/report/departments-oversight-of-arms-length-bodies-a-comparative-study

Appendix 5 - Key messages from our wider work

Protecting information across government **(September 2016)**	Protecting information while re-designing public services and introducing new technology to support them is a complex challenge for government. The responsibility for protecting information held by government from unauthorised access or loss must increasingly be balanced with the need to make information available to other organisations, users and citizens via new digital services. We considered the effectiveness of government in managing the risk of information loss, including cost, breach reporting and deployment of the right skills. We found that some departments have made significant improvements in information governance, but most have not given it the same attention as other forms of governance. We also found that few departments have the skills and expertise to risk manage their information by themselves and will continue to depend on effective support from the centre of government. But at present too many bodies, with overlapping responsibilities, operate in the centre of government, confusing departments about where to go for advice. Although the new National Cyber Security Centre (NCSC) will bring together much of government's cyber expertise, wider reforms will be necessary to further enhance the protection of information. www.nao.org.uk/report/protecting-information-across-government/
Performance Measurement by Regulators **(November 2016)**	Performance measurement is important to enable any organisation to ensure it is achieving its objectives, and making the best possible use of resources. With good reporting, it also enables accountability, which in the case of regulators, includes accountability to Parliament and to the taxpayers and other stakeholders who fund their activities and have a keen interest in their effectiveness. Performance measurement by regulators is particularly complex because their intended outcomes (for example protection of consumers) are generally delivered by the organisations that they regulate. There are also many external factors outside regulators' control, and outcomes can take a long time to become evident. This good practice guide aids improvement in performance measurement and reporting by regulators and other organisations seeking to deliver outcomes through third parties. It has been developed in collaboration with regulators and includes the NAO's experience from working with them and examples of good practice provided by regulators themselves https://www.nao.org.uk/report/performance-measurement-by-regulators/

Appendix 5 - Key messages from our wider work

Sustainability and Financial Performance of Acute Hospital Trusts **(December 2015)**	Repeats earlier conclusions that the trend of NHS Trusts' and NHS Foundation Trusts' declining financial performance is not sustainable. Running a deficit appears to be becoming normal practice for acute trusts and there is a risk that poor financial performance is seen as the least worst option compared with poor healthcare provision. Recommends that the Department and NHS England, along with regulatory bodies, take a rounded view of how to improve trusts' finances. The commitment to give the NHS more funding could be a significant step towards financial sustainability if it can be devoted to improving the financial position of trusts rather than being allocated to new costs. Continued demand for healthcare services means that the pressure on acute trusts will not go away. www.nao.org.uk/report/sustainability-and-financial-performance-of-acute-hospital-trusts
Managing the Supply of NHS Clinical Staff in England **(February 2016)**	Ensuring there are enough clinical staff with the right skills to meet the demand for high-quality, safe healthcare is essential to the operation of the NHS. There is a reported shortfall of around 5.9% - a gap of around 50,000 clinical staff. The extent of the shortfall varies between staff group and regions. The creation of Health Education England means that, for the first time, there is a national body specifically tasked with making strategic decisions about planning the future workforce, working collaboratively with local healthcare providers to do so. www.nao.org.uk/report/managing-the-supply-of-nhs-clinical-staff-in-england
The Commissioning of Specialised Services in the NHS **(April 2016)**	NHS England's spending on the 146 specialised services it offers has increased at a much greater rate than other parts of the NHS. There is no overarching service strategy and increasing demand for effective but expensive new drugs is adding to existing financial pressures. Governance arrangements for specialised commissioning are ineffective and there are concerns over the transparency of decision making. Concludes that if NHS England is unable to control spending on specialised services this will affect its ability to resource other services, such as primary care. Without consistent information from all providers on costs, access to services and outcomes, it cannot manage the ongoing pressure on its budget for specialised services, make effective strategic decisions or gain assurance that its objectives are being met. www.nao.org.uk/report/the-commissioning-of-specialised-services-in-the-nhs

Appendix 6: Guidance for Governance

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/

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/

Guidance for governance

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/