

Audit Committee 13 March 2012

National Audit Office external audit strategy 2011-2012

Executive summary and recommendations

Introduction

The National Audit Office (NAO) external audit strategy is provided to the committee for its consideration.

Decision

The Committee is asked to approve the external audit strategy.

Background information

The 2011-2012 audit will be the fourth time that the NAO have acted as HPC's external auditor as the Comptroller and Auditor General has responsibility to 'examine, certify and report on the annual accounts'. The appendix to this document lays out the NAO's audit approach, audit risks identified, timetable and fees.

Pages 9-10 of the appendix set out new requirements for an annual governance statement and a sustainability report within the annual report and accounts.

Resource implications

None

Financial implications

Quoted audit fee of £38,500 plus VAT.

Appendix

National Audit Office Audit Strategy 2011-12

Date of paper

1 March 2012



National Audit Office

**REPORT TO THE ACCOUNTING OFFICER
AND AUDIT COMMITTEE**
January 2012

Health Professions Council

Audit Planning Report

Our vision is to help the nation spend wisely.

We apply the unique perspective of public audit to help Parliament and government drive lasting improvement in public services.

The National Audit Office scrutinises public spending on behalf of Parliament. The Comptroller and Auditor General, Amyas Morse, is an Officer of the House of Commons. He is the head of the NAO, which employs some 880 staff. He and the NAO are totally independent of government. He certifies the accounts of all government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources. Our work led to savings and other efficiency gains worth more than £1 billion in 2010-11.

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Introduction

1.1 The Comptroller and Auditor General (C&AG) is appointed as the external auditor of the Health Professions Council (HPC) by the Health Professions Order 2001. The C&AG has also been appointed as the HPC's auditor by agreement with HPC to satisfy the requirement of the Health Professions Order 2001 for an auditor eligible under the Companies Act to be appointed to audit the accounts. Our audit is designed to allow the Comptroller and Auditor General to give a 'True and Fair' opinion on the financial statements, and an opinion that the underlying transactions comply with the authorities which govern them (regularity). The purpose of this document is to provide HPC's Accounting Officer and Audit Committee with a clear understanding of how the National Audit Office, on behalf of the C&AG, plans to carry out the audit of HPC's financial statements for the year ending 31 March 2012, and our respective responsibilities.

Independence

1.2 The NAO complies with relevant ethical requirements regarding independence and has developed important safeguards and procedures in order to ensure our independence and objectivity. These are set out in Annex 4: NAO quality standards and independence. We will reconfirm our independence and objectivity to the Audit Committee for the year ended 31 March 2012 in our Audit Completion Report.

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Actions for the Audit Committee

1.3 The Audit Committee are invited to consider and discuss:

- The completeness and coverage of our assessment of potential risks of material misstatement to the financial statements (Section 2.1);
- The risk that the financial statements could be materially misstated due to fraud and communicate any areas of concern to management and the audit team;
- The adequacy of management responses to these risks; and
- Our proposed audit plan to address these risks.

1.4 The Audit Committee, in order to comply with best practice, should review the accounting policies adopted by the organisation with the Finance Director and consider whether they remain appropriate to the organisation's circumstances and comply with the Health Professions Order 2001 and Privy Council Office Directions issued there under.

Significant Risks

2.1 Our initial assessment of HPC's operations and control environment has identified the following areas as being those which constitute significant risks and which require a specific audit response:

Risk 1 – The misstatement of deferred income

Risk

During the audit work on the 2010/11 financial statements a discrepancy between the deferred income balances as recorded on Sage and Net-regulate was identified. Additional work was undertaken by HPC to reconcile this difference which led to material adjustments being made that reduced the discrepancy between the two systems as at 31 March 2011 to a level which we considered to be immaterial to the accounts. The financial statements were subsequently certified with an unqualified opinion, although the following unadjusted errors remained:

- £42k unsupported balance relating to registration fees;
- £59k unsupported balances relating to deferred income over 1 year; and
- £21k error relating to applications.

The full explanation of why Net-regulate and Sage report different levels of deferred income is still being sought and we are aware that some Internal Audit work currently in progress is looking at this issue. There remains a risk that the two systems continue to report different amounts and that the deferred income balance as at 31 March 2012 is materially misstated.

Audit response

Following the issues identified in last year's audit HPC has introduced a number of additional controls that we will examine in detail. We will also review the work that HPC's Internal Auditors complete on this issue and use this to establish the most efficient and effective way to test the deferred income balance in 2011/12 financial statements.

Risk 2 – Liability related to Flexiplan Pension Scheme

Risk

One of HPC's occupational pensions scheme is in the process of being closed. There

is an on-going court case to ascertain the liability to each of the employers involved. In HPC's 2010-11 accounts a contingent liability disclosure was made. Due to the changes that may occur during the year a risk remains that HPC's accounts do not adequately disclose its liability in relation to this scheme.

Audit response

The initial hearing of the court case is scheduled for January/February 2012. We will consider the need for a liability to be recognised in the financial statements, or if a contingent liability disclosure remains sufficient (as in 2010/11), once the outcome of this court case is known.

Risk 3 – Risk of Fraud through Management Override of Controls

International Standard on Auditing (UK and Ireland) 240 *The auditor's responsibilities relating to fraud in an audit of financial statements* 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:

- Journal entries
- Bias in accounting estimates
- Significant unusual transactions

Audit response

We will undertake specific testing to address the risk involved in these areas and establish HPC's processes for preventing any override of management controls.

Risk 4 – Revenue Recognition

There is a presumption in International Standard on Auditing (UK and Ireland) 240 *The auditor's responsibilities relating to fraud in an audit of financial statements* that there are risks of fraud in revenue recognition, in particular where performance is measured in terms of revenue growth or profit.

HPC's reliance on fee income to cover costs, and the issues we identified with respect to revenue recognition in 2010-11, mean that revenue recognition is a significant risk to the income area and the related figures.

Audit Response

We will undertake specific testing to address the risk of fraud in income recognition for income streams by reviewing HPC's processes and gaining assurance over cut-off and completeness of this income. Our audit response to Risk 1 above should also address this.

Areas of Audit Emphasis

We have identified the following key areas which may require special attention in our audit.

Transfer of Regulatory Function from the General Social Care Council

Subject to legislative changes, the regulatory function of the General Social Care Council (GSCC) is expected to transfer to HPC (which will then become the Health and Care Professions Council, HCPC). This transition is expected to occur during the 2012/13 financial year. No assets or liabilities will accompany this transfer but it is expected that some staff will transfer. The major impact on HPC's financial statements will be in 2012/13. In 2011/12, HPC will receive specific grant funding from the Department of Health (DH) for any expenditure required as a result of these planned changes. We review the treatment of this income to ensure that it is accounted for in accordance with the requirements of the Financial Reporting Manual (FRM).

Next Generation Case Management System

HPC is in the process of introducing a new case management system which will be entirely electronic. We will consider the valuation of this new system as part of our work on the Statement of Financial Position and examine which costs have been capitalised and which costs have been expensed as normal operational expenditure.

Fraud

2.2 The primary responsibility for the detection of fraud rests with management. Their role in the detection of fraud is an extension of their role in preventing fraudulent activity. The Accounting Officer is responsible for establishing a sound system of internal control designed to support the achievement of departmental policies, aims and objectives and to manage the risks facing the organisation; this includes the risk of fraud.

2.3 Under International Standard on Auditing (UK and Ireland) 240, there is a presumed significant risk of management override of the system of internal controls. Our audit is designed to provide reasonable assurance that the financial statements (as a whole) are free from material misstatement, whether caused by fraud or error.

8 Significant Risks Audit Planning Report

We are not responsible for preventing fraud or corruption, although our audit may serve to act as a deterrent.

2.4 We are required to make inquiries of those charged with governance in respect of your oversight responsibility for:

- Systems for monitoring risk, financial control and compliance with the law ; and
- The entity's assessment of the risks of fraud and of the internal control the entity has established to mitigate specific risks of fraud that the entity has identified.

Further Matters of Interest

Changes to the Financial Reporting Framework and to the Framework of Authorities

3.1 In addition to the key risks identified, there are a number of changes to financial reporting guidance issued by HM Treasury and/or the Accounting Standards Board, which will impact on our audit plan. These are detailed below:

Annual Governance Statement

In 2011-12, the Statement on Internal Control will be replaced by a requirement to produce an Annual Governance Statement. The main aim of the Annual Governance Statement is to consolidate all reporting on Risk and Governance matters by organisations into a single document. HM Treasury has not provided a standard template for the Annual Governance Statement but has instead left this as a matter for Accounting Officers to decide how they are to report. The purpose of this is to ensure that the Annual Governance Statement is as full and open a statement as is possible.

Audit response

The introduction of the Annual Governance Statement provides an opportunity for the Accounting Officer and the Council to review their approach to governance reporting. The role of the NAO in the new Annual Governance Statement will remain much the same as it was with the Statement on Internal Control. Namely, the external auditor will report whether the Annual Governance Statement is consistent with the findings of audit work and their knowledge of the business and we will report whether the Annual Governance Statement accurately reports any departures from the Corporate Governance Code in Central Government

(http://www.hm-treasury.gov.uk/d/corporate_governance_good_practice_july2011.pdf) or other authoritative guidance.

Sustainability Reporting

From 2011-12, HM Treasury have introduced a new requirement for central Government bodies to produce a Sustainability Report within their Annual Report and Accounts.

The main elements which are required to be reported in a Sustainability Report

consist of information on consumption of Greenhouse Gases, waste and finite resources. Both financial and non-financial information is required to be provided under these headings. HM Treasury has now issued draft guidance at http://www.hm-treasury.gov.uk/d/psar_sustainability_reporting_draft_guidance20112.pdf which details the requirements for Sustainability Reporting in 2011-12.

Audit response

The new Sustainability Report will become an integral part of the Annual Report. As such, the role of the NAO with regards to the Sustainability Report will be to review it to ensure that the information disclosed within it is consistent with the findings of audit work and our knowledge of the business.

Audit Approach

3.2 The NAO audit approach is risk-based, informed by a good understanding of the operations of HPC and an assessment of the risks associated with the financial statements and of the regularity of underlying transactions.

3.3 Our audit approach will be based on a mixture of reliance on controls and substantive testing. At the planning stage we will confirm the details with HPC. Any high level controls that we plan to rely on will be tested at this stage to confirm effectiveness, with any deficiencies reported to management.

3.4 We expect HPC to produce a template account, including notes, for our interim visit in January (see timetable at Annex 2). This will enable us to consider the disclosure notes that support the account and provide advice as to what is required in the final draft financial statements. During our interim visit we will examine the following;

- Deferred income
- Bank reconciliation
- Substantive testing for expenditure and income
- Comparatives

3.5 Our final visit will be in May when we will complete our audit of the year end draft financial statements.

3.6 We will review other accounting systems and management controls operated by HPC only to the extent we consider necessary for the effective performance of the audit. As a result, our review may not detect all deficiencies that exist or all

improvements that could be made. Where we do uncover any significant deficiencies weaknesses we will report these to you, with our recommendations for improvements

3.7 Annex 3 provides a statement on the NAO's management of personal data. We will agree with management how we handle sensitive data, where appropriate.

3.8 We have also reviewed progress against issues we raised last year in Annex 5.

Reliance on others

3.9 We continue to liaise closely with Internal Audit and place reliance on their work where their objectives cover areas of joint interest. We also carry out a review of the Internal Audit structure and function in accordance with International Standard on Auditing (UK and Ireland) 610.

3.10 We will consider the tax information provided to HPC from Mazars and carry out a review in accordance with International Standard on Auditing (UK and Ireland) 620.

Regularity and propriety

3.11 Our audit of regularity is conducted 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. We test that the transactions entered into by the organisation comply with the regularity framework within which HPC operates. This means gaining assurance that transactions are in accordance with appropriate authorities, including the statutory framework for the organisation, managing public money and other requirements of Parliament and HM Treasury.

3.12 We will also have regard to the concept of propriety in conducting our audit, which is concerned with Parliament's intention as to the way in which public business should be conducted, and concerning the avoidance of waste and extravagance.

Annex 1 - Timetable, Staffing & Fees

Audit timetable & fees

1 The timetable set out in this section has been agreed in discussion with management during audit planning.

Item	Timing	Responsibility
Planning meeting with HPC	23 November 2011	NAO and HPC
Planning work	November/December 2011	NAO
Audit planning report to HPC for audit committee on 13 March 2012	6 January 2012	NAO
Interim audit visit	23 January – 3 February 2012	NAO
Interim washup meeting	w/c 6 February 2012	NAO and HPC
The section of the Annual Report and Accounts that require auditing (Management Commentary, Remuneration Report, Annual Governance Statement, Financial Statements and accompanying notes) presented to NAO for audit	30 April 2012	NAO
Final audit visit	30 April - 11 May 2012	NAO
Wash up meeting	w/c 14 May 2012	NAO and HPC
Remainder of Annual report to NAO	6 June 2012	HPC
Final draft of Annual report and accounts including all changes required as a result of audit to NAO	11 June 2012	HPC
Draft Completion report to HPC and clearance on final accounts	14 June 2012	NAO
Draft completion report with management responses to NAO	15 June 2012	HPC
Final completion report including management responses issued to HPC for Audit Committee on 21 June 2012	15 June 2012	NAO

Accounting Officer signs Annual Report and Accounts	After Council meeting on 5 July 2012	HPC
C&AG certifies accounts	After 7 July 2012	NAO

2 The estimated audit fee for HPC account is £38,500 (2010/11 original £36k increased to £41k as a result of the deferred income issues)

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

- HPC delivering on 30 April the sections of the Annual Report and Accounts requiring audit which is of sufficient quality that have been subject to appropriate internal review ;
- HPC delivering good quality supporting documentation and evidence within the agreed timetable; and
- appropriate HPC staff are available during the audit.

4 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.

Key audit staff

Title	Name and contact information	Responsibilities
Director	Kate Mathers kate.mathers@nao.gsi.gov.uk 020 7798 7918	Overall responsibility for ensuring audit work is sufficient and complies with appropriate standards and for recommending an appropriate audit certificate and report to the C&AG.
Manager	Martin Burgess martin.burgess@nao.gsi.gov.uk 020 7798 7229	Responsible for detailed review of the audit plan and work undertaken to ensure that sufficient and appropriate audit evidence is obtained to support the audit opinion.
Lead	Sarah Edwards sarah.edwards@nao.gsi.gov.uk 020 7798 7849	Ensuring the work is completed to plan, on-site supervision of junior staff and completion of more complex audit areas.

Annex 2 - Briefing on Audit Matters

Respective Responsibilities

1 In line with Auditing Standards we are required to agree the respective responsibilities of the C&AG, HPC's Accounting Officer, and the NAO. These responsibilities are set out in the Letter of Understanding dated 16 November 2010.

2 The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Preparation of the financial statements

3 The primary responsibility for the preparation of the financial statements and the regularity of financial transactions lies with HPC.

4 The financial statements should be prepared in accordance with the Health Professions Order 2001 and Privy Council Office Directions issued there under.

Supporting Records

5 All relevant general ledger transactions should be processed to allow trial balances to be made available for audit purposes with the draft financial statements. Any amendments made to the trial balances after the close of books should be discussed with NAO staff and supported by a journal voucher and any other underlying documentation. Further adjustments may be required as a result of our audit findings.

6 We will require access to schedules and documentation which support the figures and disclosures within the financial statements, and we would expect the draft account to have been subject to appropriate management review prior to submission for audit. A list summarising the key items of audit information required will be provided to the finance team prior to each audit visit.

Scope of the Audit

7 The C&AG is required to examine, certify and report on the financial statements of HPC. Our audit procedures are designed primarily to provide an opinion on whether the financial statements provide a true and fair view of the activities reported for the year ended 31 March 2012, and that the expenditure and income have been applied to the purposes intended by Parliament and that the transactions conform to the authorities which govern them (regularity).

8 Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK and Ireland) (ISAs). These standards represent best practice in auditing and aim to promote uniformity of practice throughout the world, thereby increasing public confidence in the audit process. We have a professional responsibility to report if the financial statements do not comply in any material respect with the Financial Reporting Manual (FRoM) issued by HM Treasury.

9 As part of the audit we will review the information published with the financial statements, including information contained in the Annual Report, the Management Commentary, Remuneration Report and Governance Statement, to ensure it is consistent with the accounts and information obtained during the course of our audit. We will consider whether the Governance Statement has been prepared in accordance with HM Treasury guidance.

Materiality

10 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. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement and includes consideration of both the amount and the nature of the misstatement. In determining materiality, we consider a range of measures relevant to the account.

11 The level of error which we have identified as clearly trivial has been set at £1700. We will report to you all errors in the financial statements above this amount.

Management of personal data

12 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 (Annex 3).

Annex 3 - Statement on the Management of Personal Data at the NAO

1 The C&AG and the National Audit Office have privileged and wide-ranging access to data and information to support the discharge of the audit function and ensure that the C&AG's reports to Parliament are factual, accurate and complete. This data relates both to public servants and individual citizens. We have a duty to respect this privileged access and to ensure that the personal information entrusted to us is safeguarded properly.

2 We take our obligations under the Data Protection Act 1998 seriously. We have a body of data policies and IT standards, guidelines and procedures designed to ensure compliance with the Act. We keep our requests for personal data to the minimum necessary to complete our work and retain any personal information we obtain only for as long as we need it. We take appropriate measures to safeguard the integrity and confidentiality of data we hold from unauthorised access. All of our staff and contractors have an obligation to comply with our data protection policies.

3 In addition to those items specifically identified in the Act, our definition of sensitive personal data includes data which, when held alone or in combination, could cause embarrassment, harm or financial loss to the data subject if disclosed to or tampered with by an unauthorised third party. We have separate arrangements in place for classified data.

4 To help you understand our commitment, we have developed a series of Personal Data Statements, which all our staff subscribe to:

- We will only request personal data for use in discharging our statutory and other audit functions and for lawful purposes. These requests are kept to the minimum necessary to carry out our work.
- Our requests for personal data will be authorised by a senior employee. Each of our audits is led by a Director who is personally responsible for authorising any request for personal data in connection with that audit; maintaining records of the data held; ensuring it is securely and appropriately processed; ensuring it is securely and appropriately retained; and for certifying its destruction.
- We will agree with you in advance how we will use, secure, destroy and account for the personal data you provide to us. We have a series of protocols which specify the measures for protecting personal data during transfer from the

information provider, whilst we retain the information for audit purposes, for secure destruction of the data and for long term storage where this is required by law and professional standards.

- We will notify you when we destroy personal data you have provided to us.
- We ensure our contractors operate suitable procedures for personal data protection before we pass such data to them. From time to time we contract with third parties who support us in discharging our statutory and other audit responsibilities. Access to personal information will only be given to organisations which can show that they are capable of maintaining the standards defined in these statements.
- We audit our compliance with our data protection policies, in order to be assured that protection is in accordance with the terms of this Code. These include checks on compliance carried out independently of the NAO Directors responsible for the security of data on their audits.
- Where information identifying individuals must be given up by law, it will be released only to those legally entitled to receive it following the approval of the data controller.

Annex 4 - NAO quality standards and independence

Audit quality

- 1 Auditing Standards require that we communicate at least annually with each body we audit on how we maintain our audit quality and our independence.
- 2 Quality is strongly embedded in the NAO culture and manifests itself through:
 - Continued Professional Development (CPD) – all staff are expected to meet a target of 40 hours CPD per year across the range of professional, management and personal effectiveness training and development, representing a significant investment for the NAO; and
 - specialist skills – our audit team can call as necessary on NAO in-house specialists, including statisticians, computer experts and economists.
- 3 We have well established review procedures to ensure that appropriate audit work is undertaken efficiently and in accordance with International Standards on Auditing:
 - all planning decisions and fieldwork are reviewed by NAO management and directorate;
 - all significant matters are dealt with promptly and will be raised with HPC management as necessary; and
 - progress on the audit is monitored on a continuous basis to ensure that the work is completed efficiently, effectively, to time and within budget. We have well established review procedures to ensure that appropriate audit work is undertaken efficiently and in accordance with International Standards on Auditing.
- 4 In addition, the NAO has additional procedures for our public interest audits which include the review of key judgements by an NAO Director who is fully independent of the audit team.
- 5 Each year the NAO executes a programme of post-certification internal Quality Control Reviews. The objective of these reviews is to establish whether sufficient and appropriate evidence has been collected and evaluated and whether the NAO's financial audits comply with professional standards and internal policies.

6 To seek an external view, NAO has invited the Audit Inspection Unit of the Professional Oversight Board, to undertake an annual programme of post-certification audit quality reviews. The results of these reviews are regularly brought to the attention of all staff.

Independence policies and safeguards

7 The NAO is independent of government and differs from other professional audit bodies in that it has additional public service responsibilities.

8 All public sector bodies are required to observe high standards of probity in the management of their affairs, and the Committee on Standards in Public Life has identified seven key principles which should be followed: selflessness; integrity; objectivity; accountability; openness; honesty; and leadership. The combination of professional ethics and public sector principles therefore places the NAO in a unique position.

9 There are three crucial values which underpin the work of the NAO:

- **Accountability** - everything done by those who work in the NAO must be able to stand the test of parliamentary scrutiny, public judgments on propriety, and professional codes of conduct;
- **Probity** - there should be an absolute standard of honesty and integrity in handling NAO work and resources; and
- **Objectivity and Impartiality** - The C&AG's independence is secured in statute. This underlines the need for us to be objective and impartial in all our work, including accurate, fair and balanced reporting.

10 We need to apply these values to retain our credibility with Parliament, audited bodies and other stakeholders in our work and therefore a code of conduct is issued annually for all staff to complete a return confirming that they have complied with its provisions.

The NAO assesses any threats to objectivity and potential safeguards to combat these threats prior to acceptance of any non-audit engagements. This would include particular focus on threats arising from self-interest, self-review, advocacy and over-familiarity.