**Health Professions Council**
**Audit Committee Meeting – 28th February 2007**

# NATIONAL AUDIT OFFICE (NAO) AUDIT STRATEGY - PUBLIC PAPER

## Executive Summary and Recommendations

## 1. Introduction
In advance of the forthcoming audit of the March 31st 2007 Year End Financial Statements and Annual Report, the Audit Strategy is provided to the Committee for its consideration.

## 2. Decision
**The Committee is requested to approve the details of the NAO Audit Strategy as submitted.**

## 3. Background information
Under Section 46 (4) of the Health Professions Order 2001 "As soon as is reasonably practicable after the end of the financial year to which the annual accounts relate, the Council shall (b) send a copy of the annual accounts and of any such report to the Privy Council and to the Comptroller and Auditor General."
Under Section 46 (5) of the Health Professions Order 2001, "The Comptroller and Auditor General shall examine, certify and report on the annual accounts."
Under Section 46 (8), of the Health Professions Order 2001, "In this article, "financial year" means (b) each successive period of 12 months ending with 31st March."

The Appendix document contains details of NAO's scope of the audit, responsibilities for the preparation of accounts, audit approach, consideration of fraud, internal control, liaison with internal audit, timetable and annexes with audit staffing details, and audit approach to identified risks.

## 4. Resource implications
Nil

## 5. Financial implications
Yet to be provided.

## 6. Background papers
Nil

## 7. Appendices
NAO Audit Strategy for 2006-07

## 8. Date of paper
16th February 2007

# 2006-07
# Audit Strategy

## Health Professions Council

CONTENTS PAGE





National Audit Office

**HELPING THE NATION SPEND WISELY**

The National Audit Office scrutinises public spending on behalf of Parliament.

The Comptroller and Auditor General, Sir John Bourn, is an Officer of the House of Commons. He is the head of the National Audit Office, which employs some 800 staff. He, and the National Audit Office, 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 saves the taxpayer millions of pounds every year, at least £8 for every £1 spent running the Office.


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February 2007 Reference: C26139

# 1 Introduction

1. The C&AG is the statutory auditor under the provisions of the Health Professions Order 2001, which require him to examine, certify and report to Parliament on the Council's financial statements The purpose of this memorandum is to provide the Health Professions Council (HPC) with a clear understanding of how the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG) plan to carry out the audit of the financial statements for the year ending 31 March 2007.

2. The C&AG's statutory audit has been contracted by NAO to Baker Tilly (UK), the Council's appointed auditors, in order to reduce the audit burden and cost to the Council of its external audit. Under the contracting arrangement, Baker Tilly conducts the audit and reports separately to the C&AG, allowing him to issue an audit certificate that is included within the published accounts. The contracting arrangements are governed by a Framework Arrangement between NAO and Baker Tilly. NAO will visit Baker Tilly to carry out detailed reviews of the audit files and to discuss any significant audit issues.

# 2 Format of the Accounts

3. The 2006-07 financial statements should be prepared in accordance with the Government Financial Reporting Manual (FReM) guidance and relevant accounting standards.

# 3 Responsibility for the Preparation of Accounts

4. The Chief Executive of the HPC, as the appointed Accounting Officer, is responsible for the preparation of the financial statements and for ensuring the regularity of the financial transactions of the Council. Under the Health Professions Oder 2001, the HPC is required to prepare accounts for each financial year.

5. Prior to submitting the financial statements for audit, the HPC's senior management should review the accounts and confirm that the figures are "true and fair" and consider whether they are consistent with activities undertaken during the period. In particular, they should review the general format and disclosures and compliance with relevant accounting guidance.

6. In preparing the financial statements, the HPC is directed by the Privy Council's Accounts Direction which complies with HM Treasury Guidance on the preparation of accounts for non-Departmental Public Bodies. The HPC should take particular note of the changes to the FReM guidance for 2006-07. This manual continues to be soundly based in the principles of UK Generally Accepted Accounting Practice.

7. The NAO have distilled all the accounts disclosure requirements, laid down in the FReM guidance and in the various accounting standards, in a Disclosure Checklist which is available from the NAO website (www.nao.gov.uk). We would strongly encourage the HPC to use the checklist during preparation of the Annual Report and Accounts to identify any areas it needs to address.

# 4 Scope of the Audit

8. As noted above, the C&AG is required under the Health Professions Council Order 2001 to examine, certify and report on each of the statements comprising the financial statements of the HPC. We have a professional duty to report if the financial statements do not comply in any material respect with the International Standards on Auditing (UK & Ireland) issued or adopted by the Accounting Standards Board and relevant guidance issued by HM Treasury.

9. 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 2007 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').

10. Within FReM there is guidance on what should be included with the financial statements in an Annual Report. The Annual Report should incorporate a Management Commentary on operating and financial activities, a Remuneration Report and other disclosures.

11. The Remuneration Report will be subject to audit. We will review other financial information contained in the Annual Report, as appropriate, to ensure that it is consistent with the financial statements. We will also review the Statement on Internal Control to ensure it has been prepared in accordance with Treasury guidance and that the statement is consistent with the financial statements and other information gained during the course of the audit.

12. We are not required to form an opinion on the effectiveness of the Council's corporate governance procedures, although we will provide the HPC with a Management Letter at the completion of our audit, containing observations and recommendations on significant matters which have arisen in the course of the audit.

13. We will also report to management and the Audit Committee, under International Standards on Auditing 260, any other relevant matters arising from our audit. This will include a summary of our audit findings, areas where judgement was required in agreeing accounting treatment, key changes to the account presented for audit, and unadjusted misstatements which are not trivial.

### International Standards on Auditing

14. We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISA plus") as issued by the UK Auditing Practices Board ("APB"). These auditing standards require auditors to:

- assess the design and implementation of controls, regardless of whether they plan to adopt a substantive approach, and
- look at an organisation's ability to identify risk and assess the impact which this may have on the financial statements.

15. The ISAs also place an increased emphasis on identifying and assessing the risk of fraud. This is detailed in the section on fraud.

## 5 Audit Approach

16. International Standard on Auditing (UK & Ireland) ISA 330 *"Obtaining an Understanding of the* Entity *and its Environment and Assessing the Risks of Material Misstatement"* requires that auditors:

- assess the design and implementation of controls, regardless of whether they plan to adopt a substantive approach; and
- look at an organisation's ability to identify risk and assess the impact which this may have on the financial statements.

17. Under the NAO risk-based approach, we will complete a review of our understanding of the Agency's business in order to identify the issues that, in our view, present a risk of material misstatement in the financial statements. This will inform our discussions with BakerTilly on the audit approach to be adopted. Through co-operation with Baker Tilly we will keep up to date with developments that affect the HPC's business.

18. The control environment at the HPC will be assessed and assurance will be taken from management's controls where there is evidence that they have operated effectively.

### Area of audit emphasis

19. From our audit planning work and discussions with Baker Tilly the following areas have been highlighted which will require further consideration as part of our audit. These risks are described in more detail in Annex 2.

    - Income recognition
    - PAYE/NIC deductions
    - Authorisation of expenses and cut off
    - Regularity of expenditure
    - BDO Settlement
    - 22/26 Stannary Street Limited
    - IT Systems Expenditure
    - Pension Scheme

20. We will feed back to you in our management letter our findings in respect of all key areas of audit emphasis we identify.

## 6 Consideration of fraud

21. The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

22. ISA 240 – *'The auditor's responsibility to consider fraud in an audit of financial*

*statements'* requires us to consider the risk of fraud affecting financial statements and to maintain an attitude of professional scepticism recognising the possibility that a material misstatement due to fraud could exist. To meet these requirements we will carry out a range of procedures during the audit, including:

- Reviewing management's processes for identifying and responding to the risks of fraud, including any specific risks of fraud that management has identified and the controls in place to prevent and detect fraud;
- Reviewing management's assessment of the risk that the financial statements may be materially misstated due to fraud;
- Reviewing the role of those charged with governance in mitigating the risks of fraud;
- Reviewing the details of any actual, suspected or alleged fraud affecting HPC of which management or others are aware.

### Corporate Governance and fraud

23. We are required to document an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the HPC and the internal control that management has established to mitigate these risks.

24. We will make inquiries of management, internal audit and others within the HPC as appropriate, regarding their knowledge of any actual, plus suspected or alleged fraud affecting the group. In addition we are required to discuss the following with the Audit Committee:

25. Whether the Audit Committee has knowledge of any fraud or suspected fraud?

26. The role that the Audit Committee exercises in oversight of:

    - the Agency's assessment of the risks of fraud; and
    - design and implementation of internal controls to prevent and detect fraud?

27. The Audit Committee's assessment of the risk that the financial statements may be materially misstated as a result of fraud.

28. We will be seeking representations in this area from the Chief Executive in due course.

### Management override of controls

29. The ISA specifically recognises that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and override controls. We are required to design and perform audit procedures to respond to the risk of management's override of controls which will include:

- having understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, testing the appropriateness of a sample of such entries and adjustments;
- conducting a review of accounting estimates for bias that could result in material misstatement due to fraud, including where those estimates, even if individually reasonable, indicate a possible bias on the part of management. We will also perform a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtaining an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the Agency and its environment.

30. We are also required to presume that there are risks of fraud in revenue recognition and conduct our audit testing accordingly.

## 7 Internal control

### Obtaining an understanding of internal control relevant to the audit

31. Under ISAs, for controls considered to be 'relevant to the audit' we are required to evaluate the design of the controls and determine whether they have been implemented.

32. The controls that are determined to be relevant to the audit are those:

- where we plan to obtain assurance through operating effectiveness;
- relating to identified risks (including this risk of fraud in revenue recognition) or areas of audit focus (as detailed in section 6); and
- where we are unable to obtain sufficient audit assurance through substantive procedures alone.

33. The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

## 8 Liaison with Internal Audit

34. The NAO and Baker Tilly will liaise with your internal auditors, PKF LLP. To date reports on IT Health Check and Human Resources have been finalised and issued. We currently understand that PKF are reviewing the systems of the Finance Department, Fitness to Practise and the 22-26 Stannary Street Building Project. The reports of the three systems which are currently in progress are expected to be available in draft while we plan our audit work and are expected to be finalised before the financial statements are finalised.

35. From informal discussions with PKF, we understand that no fundamental problems or errors have been found relating to the finance department systems review. Should these findings alter when their draft report is issued, this will have a bearing on our audit approach.

36. We will review the reports to ensure where appropriate we can minimise testing during on-site audit work Where areas of weakness have been identified which could have a potential impact on the financial statements additional audit work will be performed to ensure sufficient audit evidence in these area have been obtained.

## 9 Materiality

37. Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. From the auditor's point of view, a matter is material if its non-disclosure, misstatement, inclusion or omission would be likely to distort the overall view given by the financial statements to their intended users. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition as it has both qualitative and quantitative aspects. Assessing materiality is essentially a matter of judgement.

38. If the total unadjusted errors arising from the audit work were of a level deemed to be material in the context of the accounts as a whole, there would be significant doubt as to the accuracy of the financial statements. In such circumstances we would need to consider whether a clear audit opinion was appropriate.

39. We have designed our audit procedures to provide reasonable but not absolute assurance that the financial statements are free from material misstatement

## 10 Records to be provided for audit

40. Details of accounting records and other related information required for the audit will be discussed with the finance team.

41. The accounts presented for audit and the supporting schedules should be subject to stringent quality review by HPC, so that management has its own assurance that they are demonstrably "true and fair". All relevant general ledger transactions should be processed to allow trial balances to be made available for audit purposes with the financial statements. The final accounts should be available on the first day of the final audit visit.

42. Any amendments that HPC might wish to make to the financial statements after they have been made available for audit should be separately recorded and accumulated. We will review those, together with any adjustments that may be required as a result of our audit findings, and discuss with HPC which amendments are necessary.

## 11 Timetable

The key dates agreed are:

| | |
|---|---|
| Audit team to carry out initial planning | Jan 07 (completed) |
| Confirm audit scope approach with the HPC Audit Committee | 28 Feb 2007 |
| Audit team to commence onsite audit work at HPC | 1 May 2007 |
| NAO review of Baker Tilly's audit files | 29 May 2007 |
| Circulate final audit report findings | 7 June 2007 |
| Audit and Risk Committee to discuss and finalise accounts | 26 June 2007 |
| Council meeting to formally approve financial statements, and AO to sign accounts | 5 July 2007 |
| C&AG certification | w/c 9 July 2007 |

# ANNEX 1: Staffing

The key personnel for this audit are:

| NAO | | |
|---|---|---|
| Title | Name | Responsibilities |
| Assignment Director<br>020 7798 7489 | Sid Sidhu | Overall responsibility at NAO for the assignment, and reporting to the C&AG. Attendance at Audit and Risk Committee meetings. |
| Assignment Manager<br>020 7798 7356 | Steve Ecroyd | Management of the assignment and liaison with Baker Tilly. Attendance at Audit and Risk Committee meetings. |

| Baker Tilly | | | |
|---|---|---|---|
| Title | Name | Telephone | Email |
| Audit Partner | David Blacher | 020 7413 5107 | david.blacher@bakertilly.co.uk |
| Audit Manager | Mark Harris | 020 7413 5187 | mark.harris@bakertilly.co.uk |
| Audit Senior | John Bole | 020 7413 5100 | john.bole@bakertilly.co.uk |
| Corporation Tax Manager | Stephen Brown | 020 7314 6975 | stephen.brown@bakertilly.co.uk |
| Employer Consulting Group Partner | Martin Benson | 020 7314 6813 | martin.benson@bakertilly.co.uk |
| VAT Partner | Anna McLaren | 020 7413 6814 | anna.mcLaren@bakertilly.co.uk |

# ANNEX 2: Audit Approach where material risks have been identified

| Risk | Audit Approach |
|---|---|
| **1. Income recognition**<br>Ensuring registrant income is correctly recognised over the appropriate period, as there are a variety of ways a registrant can pay.<br>The registrant fee is for two years creating a significant deferred income balance at the year end. | Analytical review of the registrant income by ensuring income is consistent with the number of members and membership rates. A review of a recent internal audit report, by PKF, on the registrant system will provide an indication of whether assurance can be taken on the controls.<br>Analytically review of year end deferred income to ensure that it is in line with expectations of registrant numbers, the period of the renewal dates and payment plans. This will be supported by substantively testing a sample of deferred income back to source documentation. |
| **2. PAYE/NIC deductions**<br>A significant provision was required at 31 March 2005 and 2006 following issues with PAYE/NIC on Council Members/Partners fees and expenses. A new system for deducting PAYE/NI was introduced in July 2006, to help mitigate the previous issues. | Review of the process for the payment and calculation of the Council members'/Partners' fees and expenses. This may involve the testing of the new system to ensure that PAYE/NIC are paid as appropriate, and in line with formal procedures introduced at the beginning of the financial year. |
| **3. Authorisation of expenses and cut off**<br>There is a risk that some items of expenditure have not been correctly authorised and may be classified in an incorrect accounting period.<br>Where provisions have been made in relation to expenses in the accounts consideration will be given as to whether these are general or specific in accordance with FRS12. | Analytical review of expenditure to ensure it is in line with our expectations based on the year's HPC budgets and forecasts, information obtained during our planning process and our knowledge gained from prior years.<br>We will review the PKF internal audit report on controls over expenditure. Assuming there are no control issues which have been identified by PKF, we plan to perform a walk through test to ensure our understanding of the system is correct.<br>We will review purchase cut off to ensure costs are treated in the correct accounting period, and we will consider all material provision to ensure they comply with FRS 12 |
| **4. Regularity of expenditure**<br>We are required to provide an opinion on the regularity of HPC's expenditure: income must have been used for the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. | We will conduct compliance testing of the internal controls relating to expenditure and substantively test a sample of expenditure items to ensure they been correctly approved in line with HPC's guidelines. |
| **5. BDO Settlement**<br>During the year, we understand that a settlement has been agreed with the former auditors, BDO Stoy Hayward LLP with regard to the fraud relating to the former finance director, Paul Baker. | We plan to review the settlement agreement to ensure that the disclosure of the transaction in the accounts does not breach the terms of the agreement. If a potential conflict arises between the disclosure requirements in the financial statements and the settlement agreement we will draw this to the attention of management as soon as practicable |

| Risk | Audit Approach |
|---|---|
| **6. 22/26 Stannary Street Limited**<br>Following the purchase of 22/26 Stannary Street via the acquisition of the corporate entity in 2005/06, we understand that preliminary work has been carried out in the year in advance of the full development of the building. | We plan to review a sample of the costs incurred in the year which relate to 22/26 Stannary Street to ensure they have been correctly accounted for as either capital or expenditure. We expect the majority of these costs to be of capital nature and recorded as assets under construction. We will ensure the VAT has been accounted for correctly in both entities for our sample of expenditure.<br>We plan to review the year end carrying value of 22/26 Stannary Street Limited to ensure that there is no indication that impairment in value is required. |
| **7. IT Systems Expenditure**<br>There have been significant levels of expenditure, by the HPC, to develop their computer systems and databases increases the risk of inappropriate treatment for capital or expenditure items. For capitalised items have appropriate depreciation policies and rates been applied. | We plan to review a sample of costs incurred on the development of the systems and confirm the correct accounting treatment has been applied. We will also consider the depreciation policies for each capitalised project and verify that adequate disclosure has been made in accordance with UK GAAP. |
| **8. Pension Scheme**<br>The Trustees of the Federated Flexiplan No 1 Pension Scheme (the Scheme), to which HPC are a sponsoring employer, issued an update following a recent actuarial valuation of the scheme. They have confirmed through legal advice that the scheme is a defined benefit scheme and therefore subject to FRS17 "Retirement Benefits" accounting standards, which would require HPC to recognise the full extent of any pension deficit on the balance sheet. There is a risk of inappropriate disclosure of the Scheme in the financial statements.<br>The HPC have previously accounted for the scheme as a money purchase scheme which offers targeted final salary benefit. | We understood from discussions with HPC and review of associated documents that the pension scheme is a multi employer scheme with many organisations participating in the fund. On the basis that individual employers share of the scheme cannot be separately identified the correct current accounting treatment adopted will be appropriate. We have requested the HPC confirm this in writing from the actuary.<br>The scheme is currently in deficit which will now need to be disclosed in the accounts along with the implications of the deficit for the HPC. |