



REGISTERED SOCIAL LANDLORDS PANEL BULLETIN

SELECTING AND BUILDING A
RELATIONSHIP WITH YOUR
EXTERNAL AUDITOR

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AT THE HEART OF
PUBLIC SERVICES 

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1 Introduction

- 1.1 External Audit for relevant organisations is a statutory requirement. However there is still a need for Housing Associations to ensure that they achieve value for money from the service provided by the firm employed.
- 1.2 In line with Best Value principles, associations will want to periodically review their audit services, to ensure continuous improvement, having regard to economy, efficiency and effectiveness. Associations will want to regularly review and evaluate their auditors' performance on an annual basis, to confirm they are happy with work carried out and its timescale. Performance Indicators and targets may be set and published by associations. When setting a performance indicator for its audit services, an association will need to consider how such indicators would be monitored.
- 1.3 One outcome possible from a review of audit services is that you may decide to re-tender your association's audit contract. If so, questions of how often to re-tender audit contracts, or change the audit partner carrying out your association's audit, are covered in chapters 12 and 13 of The Housing Corporation's Good Practice Note 7 *External audit of housing associations* published in May 2007. This can be found on the following internet link:

http://www.housingcorp.gov.uk/upload/pdf/Good_Practice_Note_7_External_audit.pdf

In Scotland, Guidance Note 97/06 "Code of Audit Practice" was withdrawn in 2001 as the provisions of this Guidance Note were included in Chapter 10 of the SFHA "Raising Standards in Housing".

Reasons why an association may want to re-tender its audit contract could include if your association has expanded its operations.

In Wales, the "Code of Audit Practice" (1996) and circular HfW8/97 Internal Financial Control and Financial Reporting, lay down the requirements and guidance for external audit in Welsh RSLs.

In order to help achieve value for money from audit services, a good working relationship with the audit partners is important. One outcome of any review process may be to change the audit partner occasionally.

2 THE TENDER AND SELECTION PROCESS

- 2.1. Procurement of audit services needs to be in line with European Union requirements – relating to OJEU thresholds (currently a contract for services with a total value above £144,459, excluding VAT, needs to be advertised in the Official Journal of the European Union – however, as these thresholds are subject to change, and may not apply in all cases, each association should satisfy itself firstly that it is subject to the OJEU advertising process in general, and then whether the particular audit contract it is considering would trigger the OJEU advertising process).
- 2.2 Procurement processes often do not recognise the different approaches required when buying a range of services. Many traditional procurement processes relate to the purchase of a specified product or project and are not necessarily designed to cover the intangible issues relating to the appointment of a firm to provide a professional service.
- 2.3 This bulletin is designed to help Board members, and in particular Audit Committees, have the necessary input into the selection of an external audit service.
- 2.4 Deciding on whether to re-tender an audit contract, or to change the audit manager, office within the audit firm, or partner who carries out your audit, balances pro's and con's such as knowledge of your association's work (too much knowledge could make it hard for an auditor to be independent; too little could make it hard to make an accurate assessment). Such judgements are natural, and associations are entitled to assess their auditors in light of their own circumstances. Good auditors will always be able to balance the 'too close' with the 'too distant', as part of their professional approach. Problems arise when that balance is not maintained.
- 2.5 Housing associations are adept at risk management. Clearly any audit tender process includes risks. The following table sets out a number of these risks and ways to mitigate them.

External Audit Tender Process – Managing Risk

Potential Risks	Managing those Risks
<p>Insufficient number of firms respond to tender creating a weak competition:</p> <ul style="list-style-type: none"> - proliferation of March year ends; - reputation of organisation; - firm currently provides prohibited services; and - perception of no change in appointment. 	<ul style="list-style-type: none"> - write/phone firms to ascertain interest; - small organisations could change their year end; - proactively manage use of firms for non-audit services; and - be clear as to why audit is being tendered and what would cause you to change auditors.
<p>Process puts too much demand on the time of your association's people.</p>	<ul style="list-style-type: none"> - do not invite too many firms to tender (reduce numbers at pre-qualification stage) – 3 to 4 firms are ideal; - provide sufficient information to reduce queries from tenderers; - limit the length of proposals; - ensure access is reasonable, set out protocols for process/timing
<p>Lack of input into decision – making process by key stakeholders.</p>	<p>Put together an appointment panel that could include:</p> <ul style="list-style-type: none"> - Audit Committee member(s) - Chief Executive - Finance Director - Financial Controller
<p>Failure to use process to identify firm with the right qualities and "best fit".</p>	<ul style="list-style-type: none"> - establish the selection criteria at the outset and communicate to tenderers; and - do not leave the evaluation process until the presentation/questions. Evaluate fully against your criteria: <ul style="list-style-type: none"> • the approach to scoping the audit; and • the quality of the proposal
<p>Presentation ("beauty parade") is poorly run reflecting badly on the organisation.</p>	<ul style="list-style-type: none"> - allow sufficient time for presentation and questions; - ensure questions are asked by people who can understand and evaluate the answers and if necessary, ask supplementaries; - be clear about the balance of time

	<p>between presentation and questions; and</p> <ul style="list-style-type: none"> – be clear about the timetable for communicating the results and offer feedback to unsuccessful firms (for example, a tender process starting in September/October may be a problem for some RSLs, if their rules require the AGM to appoint the auditor before that date)
A “deselected” auditor becoming demotivated for work on the next year end.	<p>Check your association’s rules regarding when a tendering process can begin & on the confirmation of auditor appointments by your AGM, bearing in mind the need to comply with deadlines for returns to the Housing Corporation. Whilst one option allowed under your rules may be to change your year end date, this may have knock-on effects, such as on the availability of audit firms and on your ability to meet Housing Corporation deadlines.</p>
Excessive demands on your staff, i.e. the finance team, following a change of auditor.	<ul style="list-style-type: none"> – Ensure new firm can demonstrate a track record of “mobilising with the new client”

2.6 All invitations to tender must set out a clear process and timetable. By focusing on the above risk table you will be able to ensure that your process and timetable manages some of the related risks.

2.7 Having understood the risks in the process, the Audit or other responsible Committee should set out requirements for the audit service and how these will be evaluated. The following table provides some thoughts on each of the key criteria.

Requirement	Possible selection criteria
The right firm with appropriate strengths	<ul style="list-style-type: none"> – experience in housing (there are differences in the requirements of the regions); – clients in sector/references; – broader commercial/public/not for profit sector experience; – local office capability;

	<ul style="list-style-type: none"> - relationships and cultural fit; and - confirmation of independence/objectivity.
<p>The audit team</p>	<ul style="list-style-type: none"> - independent/robust reporting; - makes respected contributions at Audit Committee meetings; - demonstrates technical excellence; - understands housing sector/regulatory requirements; and - involvement of/access to specialists (eg. tax) when appropriate. - Hours to be provided at each level of team, i.e. partner, senior manager, manager etc.
<p>Audit Methodology An approach to the audit that maximises assurance and will add value.</p>	<ul style="list-style-type: none"> - audit approach will address your specific risks; - approach to liaising and working with relevant partners such as internal auditors and others who form part of the RSL's control mechanisms, given that no one firm should provide both internal and external audit; and - contribution to accounting, financial reporting, governance, benchmarking, good practice
<p>Transition A smooth process for introducing the firm and taking on a new audit.</p>	<ul style="list-style-type: none"> - Experience and approach to mobilising the audit service.
<p>Quality Consistent high quality service.</p>	<ul style="list-style-type: none"> - approach to sector specific technical issues - measuring performance; and - how firm obtains customer feedback and acts on it - How can the firm "add value" to your

	business
<p>Tender process</p> <p>The firm will have minimised disruption to your business during the tender process.</p>	<ul style="list-style-type: none"> - quality of meetings with executives/Board members; - preparedness for meetings; - clarity of communications; and - demonstrates innovation.
<p>Liaising with advisors</p>	<p>whether tax advice is provided by the same firm of external advisors, the external auditors should cooperate fully with them, sharing the working papers as appropriate to ensure efficient production of the annual accounts.</p>

2.8 The table deliberately excludes fees. Of course the association will wish to ensure that its external audit is competitively priced. However we suggest that the principle should be to select the best firm to meet your individual requirements, based on non-financial criteria, then ensure you are paying an appropriate amount for the service. Where audit fees are published in annual accounts, not only does this provide a good example of transparency, but also provides associations with an opportunity to compare their own fees to those of other RSLs. Benchmarking is one method to help assess fees.

3 INITIAL STEPS TO TAKE

3.1 Associations should be imaginative in obtaining added value from their auditor, setting clear requirements/terms of reference, discussing with audit firms how they foresee the audit work may grow with the association's planned and potential future activities, income and expenditure developing over time. In the shorter term, hourly fee rates need to be agreed early in negotiations, with "like for like" pricing, avoiding unexpected rises in fees during a contract.

3.2 Associations may want to obtain audit firms' commitments on cost increases to be at or below the Retail Price Index.

- 3.3 It is well worth reaching agreement during the bid stage with an auditor about what certificates, technical updates and forward looks will be provided if the contract is awarded to them.
- 3.4 Associations should be clear in advance of agreeing a contract on what the interim audit, if appropriate, should deliver. For example, what "mix" between pure information and more detailed recommendations?
- 3.5 Another point for prior agreement is how and when auditors provide feedback ahead of the main audit, enabling action to be taken early on areas for improvement.
- 3.6 A prospective auditor can be asked for a timeline, indicating steps in the audit and expected dates for completion of each, including an interim audit(s) or report(s) "en route" to the final end of year report and management letter. This can then be used by audit committees and / or boards to measure progress. In general, associations are advised to start planning the audit process in January / February, and to complete the audit around June, to have the audit ready ahead of AGMs. Precise timetables will vary, depending on associations' rules. Some associations' rules require the AGM to formally appoint auditors, rather than the board or an audit committee. The key point is to ensure your timetable fits your rules.
- 3.7 Potential auditors can be asked what if any non-audit work, such as training or consultancy services, they offer. Why not set a clause that the auditor will provide a free annual training day, to help staff meet audit requirements and deadlines? Similarly, would the auditor provide a newsletter or helpline to assist staff in meeting audit requirements? RSLs may want to insist that auditors tender for any non-audit work. Auditors can be asked to clarify whether they would undertake non-audit work. For example, would either party feel that non-audit tasks undertaken for payment threaten the auditor's real or perceived independence?
- 3.8 The contract length is open to associations to decide with a prospective auditor, alongside the appropriate frequency for reviewing contract performance. For example, an association may choose to enter into a contract up to 5 years, with annual renewal at the AGM.
- 3.9 It is well worth having discussions involving both the internal auditor and prospective external auditors, to help avoid unnecessary duplication of

work and to ascertain how external auditors may place reliance on internal audit work.

- 3.10 The frequency and the formality of the relationship between the Association and the external auditors will often depend on the size of the organisation and its financial health, and should be agreed at the outset. Throughout the year the external auditors and the Association should keep in touch either in person, at relevant audit committee or board meetings, by telephone / email, and this may occur on a quarterly basis or be event-led. The external auditors may wish to receive all or specific board/committee reports.

4 THE ONGOING RELATIONSHIP OF THE RSL WITH THE AUDITOR

- 4.1 It is important to understand the relationship between association and auditor as a partnership, rather than a simple “client and contractor” arrangement. Positive participation by the association and staff in the process, rather than perceiving external audit as something which happens “to” the organisation, will help associations to gain maximum benefit. This could mean early action when audit identifies areas for improvement, ensuring board members and staff are aware of how the audit helps improve work and efficiency, avoiding a collection of points left for consideration only at year end. Circulating information about what will happen at different stages of the audit to staff and board members is important. The overall aim should be to use audit to add value to the way the association operates.
- 4.2 The Housing Corporation’s Good Practice Note 7 *External audit of housing associations/Chapter 10 of the SFHA “Raising Standards in Housing”*, provides useful background on the requirement from international accounting standards for the auditor’s “management letter” to the board. This is a formal requirement, even if simply stating there are no significant matters to bring to the board’s attention. Whilst an important part of audit, the management letter cannot alone be relied upon as full assurance of the organisation’s internal control, since it can only report matters which have come to the external auditor’s attention. Good management of staff and resources, assisted by internal audit, **together with robust embedded risk management processes** remain important alongside external audit.
- 4.3 Ongoing work and findings of internal auditors, and of risk management processes within the organisation, should be used to prepare for external audit.

- 4.4 The audit committee / board needs to understand what points may be included in a letter of representation. Typical points to address include:
- are there any contingent liabilities other than ones covered in the notes to the consolidated balance sheet?
 - are there any cases of non-compliance with laws or regulations which would be likely to have a significant impact on the finances, or operation, of the association?
 - are there any significant events which have occurred after the completion of the balance sheet, which would need some adjustment to the statement of accounts (or to be disclosed in the statement of accounts), other than ones already covered in the notes to the statement of account and consolidated balance sheet?
 - are there any other material transactions with related parties, apart from ones already recorded and disclosed?
 - are there any significant claims pending, or litigation proceedings, apart from those covered in the statement of accounts?
 - are there any significant cases of known irregularities, including known cases of fraud, apart from ones already disclosed to the auditor?
- 4.5 International standards mean that associations should receive a good deal of information ahead of Board meetings on audit findings, before signing off accounts.
- 4.6 Boards and audit committees should keep up to date on possible Companies Act changes to timings of audit processes, and any impacts these would have on their own audit. For example, if many more organisations in the public sector, and other sectors such as RSLs which receive public funds, will in future have March year-ends, this may well impact on audit firms' capacity, requiring forward planning with the auditor to meet deadlines.

5 WHAT TO DO IF PROBLEMS ARISE

- 5.1 Planning ahead for each year's audit includes regular communication within the association, and between the organisation and the external auditor. This planning helps iron out questions and problems, but there will inevitably be some cases where more difficult problems arise.
- 5.2 These could, in a worst case scenario, include the following types of issues:
- an audit contract may be broken by the auditor
 - insufficient communication in either direction between the association and its auditor may occur (for example, do both parties have contingencies in place should a key member of staff leave the association or the audit firm during the audit?)
 - recourse may be needed to the complaints procedure of the audit firm or to the advice of bodies such as the Audit Commission or the Housing Corporation/Scottish Housing Regulator/Welsh Assembly Government

6 CONCLUSIONS

- 6.1 The purpose of external audit is to provide assurance to members of the board of the RSL's financial position, along with the contributions of related assurance activities such as internal audit, to help improve future performance. Despite the attention RSLs should give to providing clear expectations to their external auditor, Boards and management teams need to always bear in mind that the RSL ultimately controls and "owns" the audit process. RSLs should always look at the process as one from which they can assess current performance, as well using any identified weaknesses as learning points.
- 6.2 Whilst the reputation of a particular audit partner or audit firm within the RSL sector can be a helpful indicator when appointing external auditors, ultimately each organisation needs to remember that its auditors have to be able to provide an appropriate audit service for its own specific needs, understanding its operations and being able to identify areas of improvement.
- 6.3 Value for money and Best Value are not only points for the audit process to consider how far these are provided by the RSL to its tenants

and funders, but are also features for each RSL to seek from their external auditors.

6.4 The value of effective links between the internal and external auditors lies in the ability of each to inform the other's work, to avoid duplication of effort and to provide a genuinely value-added audit process for the RSL. Whilst separate components, internal and external audit are still parts of a single overall process.

6.5 Valuable information can be found in the Housing Corporation's Good Practice Note 7 on *External audit of housing associations/Chapter 10 of the SFHA "Raising Standards in Housing"* and its related guidance.

7 CIPFA'S RSLs Panel

The RSLs Panel reports to the Institute's Public Finance and Management Board. Its areas of interest and activity are:

- consideration of finance and policy issues relating to registered social landlords
- the production and dissemination of relevant advice and material on best practice for members and employers on social housing issues
- responding to government, professional bodies' and other bodies' consultation and discussion papers.

The Panel meets four times a year. Its meetings consider technical issues in the field of social housing finance, responses to government and others' consultation papers, and Panel projects.

Panel Members

The Panel membership includes practitioners and consultancy firms working in and for RSLs, along with representatives from the National Housing Federation and national regulators. Its current membership consists of:

Anne Turner (Chair)
Charles Brotherton
Arthur Cockburn
Tony Deakin
Bob Hartness
Lakhbir Jaspal
Mei Lee

Orbit Housing Group
Rooftop Housing Group
Prospect Community Housing Association
The Wrekin Housing Trust Ltd
Scottish Federation of Housing Associations
Accord Housing Group
Community Housing Cymru

Redmond Lee	<i>Kensington & Chelsea TMO</i>
Harry Lloyd	<i>Welsh National Assembly</i>
Brian Logan	<i>Bield Housing Association</i>
Nigel Martin	<i>Guinness Trust Group</i>
Patrick McCarthy	<i>Wirral Partnership Homes</i>
Arthur Merchant	<i>Grant Thornton</i>
Pascale Mezac	<i>Plan2moro</i>
Katrina Michael	<i>Mid Wales Housing Association</i>
Michael Rafferty	<i>N. Ireland Federation of Housing Associations</i>
Deb Reynolds	<i>Adullam Homes Housing Association</i>
Julie Robinson	<i>Orbit Housing Group</i>
David Taylor	<i>Consultant / Teachers Housing Association</i>
Norman Thomas	<i>Places for People Group</i>
Bob Wilson	<i>National Housing Federation</i>
Philip Winter	<i>The Housing Corporation</i>
Roy Yates	<i>Scottish Housing Regulator</i>

Further Details

Details about the RSLs Panel and its activities can be found on the Panel website www.cipfa.org.uk/panels/RSL

The Panel thanks Arthur Merchant for preparing the original outline for this bulletin, and editorial group members Arthur Cockburn, Pascale Mezac, Katrina Michael and David Taylor for their assistance in its preparation.

Comments

If you have any comments or suggestions regarding this bulletin please contact Julian Smith, Policy Support Officer, CIPFA, 3 Robert Street, London WC2N 6RL (tel 020 7543 5795 or email julian.smith@cipfa.org).

Appendix A. A checklist to help assess the quality and performance of audit delivery

To help find the right firm with appropriate strengths, points to consider include:

experience in housing (there are differences in the requirements of the regions)
 clients in sector/references
 broader commercial/public/not for profit sector experience
 local office capability
 relationships and cultural fit and
 confirmation of independence/ objectivity

To help assess the audit team, points to consider include:

independent/robust reporting
 makes respected contributions at Audit Committee meetings

demonstrates technical excellence
understands housing sector/regulatory requirements
involvement of/access to specialists (eg. tax) when appropriate and
hours to be provided at each level of team, i.e. partner, senior manager,
manager etc

To help assess the audit methodology, points to consider include:

an audit approach that will address your specific risks
an approach to liaising and working with relevant partners such as internal
auditors and others who form part of the RSL's control mechanisms, given that
no one firm should provide both internal and external audit and
a contribution to accounting, financial reporting, governance, benchmarking,
good practice

To help assess a transition, points to consider include:

Experience and approach to mobilising the audit service

To help assess quality, points to consider include:

approach to sector specific technical issues
measuring performance
how firm obtains customer feedback and acts on it and
how the firm can "add value" to your business

To help assess the tender process, points to consider include:

quality of meetings with executives/Board members
preparedness for meetings
clarity of communications and
demonstrates innovation

To help assess liaison with advisors, points to consider include:

whether tax advice is provided by the same firm of external advisors, the
external auditors should cooperate fully with them, sharing the working papers
as appropriate to ensure efficient production of the annual accounts

Appendix B. A checklist to help clarify points which may be included in a letter of representation.

- are there any contingent liabilities other than ones covered in the notes to the consolidated balance sheet?
- are there any cases of non-compliance with laws or regulations which would be likely to have a significant impact on the finances, or operation, of the association?
- are there any significant events which have occurred after the completion of the balance sheet, which would need some adjustment to the statement of accounts (or to be disclosed in the statement of accounts), other than ones already covered in the notes to the statement of account and consolidated balance sheet?
- are there any other material transactions with related parties, apart from ones already recorded and disclosed?
- are there any significant claims pending, or litigation proceedings, apart from those covered in the statement of accounts?
- are there any significant cases of known irregularities, including known cases of fraud, apart from ones already disclosed to the auditor?

Appendix C. Existing CIPFA publications on audit which may also be of interest:

The Financial Management and Audit of Construction Contracts: A Practical Guide (1999)

Performance Management for Audit (2000)

It's a Risky Business: A Practical Guide to Risk Based Auditing (Fully Revised Second Edition) (Book or CD-Rom format) (2005)

Audit Viewpoint - Annual subscription

Accounting & Auditing Standards: A Public Services Perspective (Fully Revised Third Edition 2007) (2007) (Book or PDF formats)

CIPFA Publications can be ordered via the online “CIPFA Shop” section of the website at <http://www.cipfa.org.uk/>