

Committee: Performance & Audit

Agenda Item

Date: 23 June 2011

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Title: DCLG Consultation on the Future of Local Public Audit

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Item for decision

Summary

1. The external audit of local authorities is currently regulated by the Audit Commission. The Commission defines auditors' responsibilities, sets fee scales, and appoints auditors to local authorities. Some appointed auditors are private sector firms, but in the majority of cases, the appointed auditor is the Audit Commission itself, as is the case for UDC.
2. In August 2010 the Government announced plans to disband the Audit Commission. The stated aim is to replace the current, centralised audit systems with a new decentralised regime, which will support local democratic accountability, and one that will also cut bureaucracy and costs, while ensuring that there continues to be robust local public audit.
3. In March 2011 the Government published proposals for the new audit regime, with a consultation deadline of 30 June. The consultation questions and suggested answers are set out in this report for Members' consideration.
4. The key proposals are that Councils will be responsible for appointing their own auditors, and that the membership of the audit committee shall be required to include independent (i.e. non-elected) members.
5. The suggested consultation responses essentially support the proposals, apart from the proposal relating to the requirement to appoint independent members. This is not considered to be an appropriate or practical suggestion.
6. Responsibility for supervising the post-Audit Commission regime seems likely to be allocated to the National Audit Office. The Head of the National Audit Office, Amyas Morse, visited UDC in February to gain an understanding of district councils and to informally discuss our views on external audit. UDC was the only district council visited by Mr Morse.
7. On 2 June the Government announced that the Audit Commission has been asked to prepare for outsourcing all audits from 2012/13, leaving a small residual body overseeing the contracts until local public bodies are in a position to appoint their own auditors. What this means for the timetable of implementing the proposals being consulted upon is not clear.

Recommendations

8. The Committee is recommended to approve the draft consultation responses set out in the report, or suggest alternatives.

Financial Implications

9. No direct financial implications at this stage. The total cost of external audit for UDC in 2011/12 is estimated to be £178,005 (source: Audit Commission fee letter 12 April 2011). There is an expectation that this cost will reduce under the new audit regime but this cannot be guaranteed until the scope of the external auditors' responsibilities is defined, and the market is tested. In addition there is the possibility of remuneration for independent audit committee members, if the Government's proposals are confirmed following consultation.

Background Papers

10. The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

DCLG consultation – [Future of local public audit](#) (hyperlink)

(This is a 65-page document, printed copies can be provided to Members on request.)

Impact

Communication/Consultation	None
Community Safety	None
Equalities	None
Health and Safety	None
Human Rights/Legal Implications	The new audit regime will place new statutory responsibilities upon councils, most notably relating to appointing an external auditor.
Sustainability	None
Ward-specific impacts	None
Workforce/Workplace	None

Future of local public audit – summary of consultation document

11. The following is a summary of the key proposals in the [consultation document](#), on which 50 consultation questions have been asked. Suggested answers to the questions are appended.

Question 1 – Design Principles

Summary of proposals	The new audit framework will be designed to achieve: <ul style="list-style-type: none"> • Localism & decentralisation • Transparency • Lower Audit Fees • High standards of auditing
Summary of suggested UDC response	To support these principles

Question 2 – relates to Probation Trusts

Questions 3 to 10 – Regulation of Local Public Audit

Summary of proposals	National Audit Office to develop code of audit practice Audit firms to meet eligibility criteria and be properly registered Regulation to ensure that public bodies have proper audit arrangements
Summary of suggested UDC response	To support these proposals provided that arrangements ensure audit firms have the right skills & experience, and that regulation is proportionate

Question 11 – Duty to appoint an auditor

Summary of proposals	All larger public bodies will be under a duty to appoint an auditor Legislation will enable public bodies to collaborate in joint procurement
Summary of suggested UDC response	To support these proposals

Questions 12 to 14 – Structure of Audit Committees and Independent Members

Summary of proposals	<p>The Chair, Vice Chair and a majority of the members of the audit committee shall be independent (i.e. non-elected). This is to ensure a robust process to appoint the auditor.</p> <p>Independent members should apply for the position in response to an open advertisement</p> <p>A third of audit committee members should have relevant financial experience</p>
Summary of suggested UDC response	<p>To oppose these proposals on grounds of principle and practicality.</p> <p>The proposal is counter to the principle and philosophy of localism that the Government is seeking to encourage. It is taking decision making away of local democratically elected people.</p> <p>There is a serious risk of elected members on the Full Council in effect absolving responsibility for this vital function to the independent members.</p> <p>As a relatively small council our audit committee also has other delegated functions e.g. monitoring performance and risk management. It is not necessarily appropriate for independent members to be involved in such functions.</p> <p>The audit industry's code of ethics should be sufficient to ensure independence, supported by regulation.</p> <p>There are major concerns over the practicality of recruiting sufficient numbers of independent members with the right expertise. There would be remuneration costs.</p>

Questions 15 to 28 – appointment of auditors

Summary of proposals	<p>Audit Committee responsibilities to be specified in legislation</p> <p>Public to be allowed to make representations about candidate audit firms</p> <p>Controls to ensure that public bodies appoint an auditor</p> <p>Auditor appointments limited to a maximum of two consecutive five-year periods</p> <p>Audit contracts may only be terminated in exceptional circumstances e.g. serious breach of ethics</p> <p>Controls to ensure reasonable limitation of liability for auditors</p>
Summary of suggested UDC response	To support these proposals

Questions 29 to 41 – Scope of audit and the work of auditors

Summary of proposals	<p>Various options ranging from a 'basic' audit of the accounts up to an in depth examination of accounts, regularity, resilience and value for money</p> <p>To retain existing duties on auditors to make public interest reports when required</p> <p>Controls to ensure non-audit services provided by the audit firm do not impair independence</p> <p>Modernising the public's right to object to the accounts; the public would retain the right to raise issues with the auditor</p> <p>To bring auditors within the remit of the Freedom of Information Act</p>
Summary of suggested UDC response	<p>The scope of audit work should include a 'basic' accounts audit and a forward looking review of budget and financial plans. Other work e.g. value for money should be discretionary.</p> <p>Generally to support the proposals, except those relating to the FOI act, which could incur costs without necessarily improving transparency.</p>

Questions 42 to 50 – Arrangements for Smaller Bodies

Summary of proposals	Proportionate arrangements for smaller public bodies (e.g. town/parish councils)
Summary of suggested UDC response	To support these proposals, although they could go further to ensure greater proportionality.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
New audit arrangements do not achieved desired objectives of greater proportionality and lower cost	2	3	<p>Submit consultation response</p> <p>Make representations to DCLG and NAO</p>

1 = Little or no risk or impact

2 = Some risk or impact – action may be necessary.

3 = Significant risk or impact – action required

4 = Near certainty of risk occurring, catastrophic effect or failure of project.

	Question	Suggested response
	DESIGN PRINCIPLES	
1	Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?	Yes, the design principles identified are appropriate. The proposals largely meet these principles but we have concerns over the appropriateness and practicality of requiring independent audit committee members. This is addressed by our responses to later questions.
2	Do you agree that the audit of probation trusts should fall within the Comptroller and Auditor General's regime?	No opinion.
	REGULATION OF LOCAL PUBLIC AUDIT	
3	Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?	Yes.
4	Do you agree that we should replicate the system for approving and controlling statutory auditors under the Companies Act 2006 for statutory local public auditors?	Yes.
5	Who should be responsible for maintaining and reviewing the register of statutory local public auditors?	National Audit Office.
6	How can we ensure that the right balance is struck between requiring audit firms eligible for statutory local public audit to have the right level of experience, while allowing new firms to enter the market?	A criterion could be introduced requiring audit firms to employ staff with experience of working in public sector finance and/or who are CIPFA qualified. This would help auditors currently employed by the Audit Commission and ensure that their experience is retained.
7	What additional criteria are required to ensure that auditors have the necessary experience to be able to undertake a robust audit of a local public body, without restricting the market?	Please see answer to Q6.
8	What should constitute a public interest entity (i.e. a body for which audits are directly monitored by the overall regulator) for the purposes of local audit regulation? How should these be defined?	In local government, all local authorities above a certain size e.g. precept £0.5 million.
9	There is an argument that by their very nature all local public bodies could be categorised as 'public interest entities.' Does the overall regulator need to undertake any additional regulation or monitoring of these bodies? If so, should these bodies be categorised by the key services they perform, or by their income or expenditure? If the latter, what should the threshold be?	No additional regulation of local public bodies is necessary. The regulator's role should be restricted to proportionate supervision of the external audit function. Important to bear in mind the design principles and ensure that no unnecessary cost falls upon the public bodies.
10	What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?	Please see answer to Q9.

	Question	Suggested response
11	<p>COMMISSIONING LOCAL PUBLIC AUDIT SERVICES</p> <p>Do you think the arrangements we set out are sufficiently flexible to allow councils to cooperate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?</p>	<p>The new arrangements should facilitate collaboration between local authorities. It is important that the legislation confirms the intent expressed in paragraph 3.7 of the consultation. We have concerns about the expectations regarding independent members, as set out below.</p>
12	<p>Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?</p>	<p>We strongly disagree that independent audit committee members should be a requirement of the new system.</p> <p>We feel this proposal is counter to the principle and philosophy of localism that the Government is seeking to encourage. It is taking decision making away of local democratically elected people.</p> <p>There is a serious risk of elected members on the Full Council in effect absolving responsibility for this vital function to the independent members.</p> <p>As a relatively small council our audit committee also has other delegated functions e.g. monitoring performance and risk management. It is not necessarily appropriate for independent members to be involved in such functions.</p> <p>The audit industry's code of ethics should be sufficient to ensure independence, supported by the regulation being proposed.</p> <p>We also have major concerns over the practicality of recruiting sufficient numbers of independent members with the right expertise.</p>
13	<p>How do we balance the requirements for independence with the need for skills and experience of independent members? Is it necessary for independent members to have financial expertise?</p>	<p>As stated in our response to Q12, we do not agree with the proposals to require independent members.</p> <p>Independence of the audit committee and the auditor appointment process can be achieved through:</p> <ul style="list-style-type: none"> • Ensuring audit committee members are non-cabinet members • Effective and proportionate regulation and oversight by the National Audit Office and/or Financial Reporting Council

	Question	Suggested response
		<ul style="list-style-type: none"> • Restrictions on length of contracts and the degree to which non-audit work can be commissioned from the appointed audit firm • Allowing public representations as suggested paragraphs 3.27-3.29. • Use of reciprocal arrangements between authorities to observe and report on the robustness of the auditor appointment process e.g. Section 151 Officers
14	Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?	<p>Yes, we think it will be extremely difficult to source independent members.</p> <p>Remuneration would be necessary. If aligned to payments made to independent Standards Committee members, the cost would be £3,750 for the Chairman and £500 for other members – a total of cost of over £5,000. The Audit Committee business is more onerous so there is an argument for offering a higher level of remuneration.</p> <p>Replicated across all councils this would represent a significant additional cost and offset some of the savings that the Government expects to accrue from changing the audit regime.</p>
15	Do you think that our proposals for audit committees provide the necessary safeguards to ensure the independence of the auditor appointment? If so, which of the options described in paragraph 3.9 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?	<p>As noted above we have misgivings about the concept of requiring independent members, but of the options set out in paragraph 3.9, option (a) is the most appropriate.</p> <p>Our response to Q13 sets out ways in which independence could be achieved.</p>
16	Which option do you consider would strike the best balance between a localist approach and a robust role for the audit committee in ensuring independence of the auditor?	Please see response to Q15.
17	Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?	The responsibilities set out in paragraph 3.24 are appropriate but should have the status of best practice guidance rather than specified in legislation.
18	Should the process for the appointment of an auditor be set out in a statutory code of practice or guidance? If the latter, who should produce and maintain this?	The appointment process should be a statutory code of practice to ensure quality and robustness.

	Question	Suggested response
19	Is this a proportionate approach to public involvement in the selection and work of auditors?	Yes.
20	How can this process be adapted for bodies without elected members?	No opinion
21	Which option do you consider provides a sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?	Option 2. Under Option 2 there is no longer a requirement to ensure the audited body fulfils its duty.
22	Should local public bodies be under a duty to inform a body when they have appointed an auditor, or only if they have failed to appoint an auditor by the required date?	Yes.
23	If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?	DCLG
24	Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?	Yes.
25	Do the ethical standards provide sufficient safeguards for the rotation of the engagement lead and the audit team for local public bodies? If not, what additional safeguards are required?	Existing standards are sufficient.
26	Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and audited body to build a relationship based on trust whilst ensuring the correct degree of independence?	Yes.
27	Do you think this proposed process provides sufficient safeguard to ensure that auditors are not removed, or resign, without serious consideration, and to maintain independence and audit quality? If not, what additional safeguards should be in place?	Yes.
28	Do you think the new framework should put in place similar provision as that in place in the Companies sector, to prevent auditors from seeking to limit their liability in an unreasonable way?	Yes.

	Question	Suggested response
	SCOPE OF AUDIT AND THE WORK OF AUDITORS	
29	Which option would provide the best balance between costs for local public bodies, a robust assessment of value for money for the local taxpayer and provides sufficient assurance and transparency to the electorate? Are there other options?	Of the four, Option 1 is the most appropriate. Options 2, 3 and 4 are disproportionate and to a greater or lesser extent replicate the current unwieldy regime. We would favour a combination of Option 1 and Option 3 – an opinion on the accounts and a conclusion about future financial sustainability. A forward looking audit of budgets and financial plans is essential.
30	Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?	No. This should be voluntary.
31	Would an annual report be a useful basis for reporting on financial resilience, regularity and propriety, as well as value for money, provided by local public bodies?	No. The Statement of Accounts is the appropriate document for people to form a judgement on the financial performance of their council.
32	Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?	Not applicable as we do not agree that an annual report should be required to be published, let alone audited.
33	What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?	Not applicable, please see response to Q30.
34	Do these safeguards also allow the auditor to carry out a public interest report without his independence or the quality of the public interest report being compromised?	Yes.
35	Do you agree that auditors appointed to a local public body should also be able to provide additional audit-related or other services to that body?	Yes.
36	Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?	Yes.
37	Do you agree that it would be sensible for the auditor and the audit committee of the local public body to be designated prescribed persons under the Public Interest Disclosure Act? If not, who do you think would be best placed to undertake this role?	Yes for the auditor but no for the audit committee. The 'prescribed persons' should be independent of the audited body. This role could be undertaken by the Local Government Ombudsman.
38	Do you agree that we should modernise the right to object to the accounts? If not, why?	Yes.

	Question	Suggested response
39	Is the process set out above the most effective way for modernising the procedures for objections to accounts? If not, what system would you introduce?	Yes, apart from the proposal to bring auditors within the remit of the Freedom of Information Act. Please see answer to Q40.
40	Do you think it is sensible for auditors to be brought within the remit of the Freedom of Information Act to the extent of their functions as public office holders? If not, why?	No. This could lead to unproductive work and an increase in audit fees. A lot of FOI requests are blanket enquiries by under-graduates or journalists who do not live in the area served by the audited body. Devoting resources to such enquiries would not necessarily achieve the objectives of transparency and accountability to the local council tax payer.
41	What will be the impact on (i) the auditor/audited body relationship, and (ii) audit fees by bringing auditors within the remit of the Freedom of Information Act (to the extent of their functions as public office holders only)?	Please see answer to Q40.
	ARRANGEMENTS FOR SMALLER BODIES	
42	Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?	Option 1. Fees could reduce if there is a competitive procurement process.
43	Do you think the county or unitary authority should have the role of commissioner for the independent examiners for smaller bodies in their areas? Should this be the section 151 officer, or the full council having regard to advice provided by the audit committee? What additional costs could this mean for county or unitary authorities?	Yes, although in two-tier areas, the option of the district council being the commissioner should be considered. This should be an Audit Committee function.
44	What guidance would be required to enable county/unitary authorities to: a.) Appoint independent examiners for the smaller bodies in their areas? b.) Outline the annual return requirements for independent examiners? Who should produce and maintain this guidance?	A statement of examiners' responsibilities would be required. This should be produced and maintained by the National Audit Office.
45	Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?	No.
46	Are there other options given the need to ensure independence in the appointment process? How would this work where the smaller body, e.g. a port health authority, straddles more than one county/unitary authority?	No opinion.

	Question	Suggested response
47	Is the four-level approach for the scope of the examination too complex? If so, how would you simplify it? Should the threshold for smaller bodies be not more than £6.5m or £500,000? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?	Four levels are appropriate, but as currently designed, that too many parish councils will undergo a disproportionate audit process. The threshold between Level 1 and Level 2 should be £20,000.
48	Does this provide a proportionate, but appropriate method for addressing issues that give cause for concern in the independent examination of smaller bodies? How would this work where the county council is not the precepting authority?	Yes. Sanctions relating to precepts are probably not appropriate, but the power to appoint additional and/or replacement councillors could be an option in the event of serious failings.
49	Is the process set out above the most appropriate way to deal with issues raised in relation to accounts for smaller bodies? If not, what system would you propose?	Yes.
50	Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?	Yes.