

AUDIT COMMITTEE

29 June 2011

FUTURE OF LOCAL PUBLIC AUDIT - CONSULTATION

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

None

EXECUTIVE SUMMARY:

The DCLG (Department for Communities and Local Government) has previously announced plans to disband the Audit Commission and to transfer the audit work from the Commission's in-house practice to the private sector. Proposals for the new audit framework are now being consulted on with a reply date of 30 June. Following this, DCLG plan to respond to the consultation in the autumn, followed by the publication of draft legislation, and then primary legislation "as soon as Parliamentary time allows".

Draft responses are appended for consideration.

RECOMMENDATION:

That the Audit Committee considers the proposed responses to the "Future of Public Audit – consultation" and determines any changes it requires to the responses to be made.

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FUTURE OF LOCAL PUBLIC AUDIT - CONSULTATION

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1. Introduction

- 1.1. In August last year the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission and to transfer the audit work from the Commission's in-house practice to the private sector.
- 1.2. Since the announcement a consultation on proposals for the new audit framework have been issued. The consultation period runs to 30 June with plans for a response to the consultation to be provided in the autumn, followed by the publication of draft legislation, and then primary legislation "as soon as Parliamentary time allows".
- 1.3. The consultation paper is fairly lengthy and asks 50 questions. A link to the full document is provided below under "Background Documents". A summary of the proposals is provided below.

2. Summary of proposals

Section 1 – Introduction (questions 1-3)

- 2.1. The current system for the audit of local public bodies is operated and overseen by the Audit Commission which acts as regulator, commissioner and provider; setting standards; monitoring quality; appointing external auditors, and acting as the main provider for 70% of local public audits.
- 2.2. The Government believes that the current arrangements with one organisation as the regulator, commissioner and provider are unnecessarily centralised.
- 2.3. Proposals are that principal local authorities appoint their own auditors, with decisions made by full council; taking into account advice from an independently chaired Audit Committee.
- 2.4. Four key "design principles" have been applied:
 - Localism and decentralisation
 - Transparency
 - Lower audit fees
 - Higher standards of auditing

2.5. The following principles of local public audit are also recognised:

- Independence of public sector auditor from the organisations being audited
- The wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money
- The ability of public auditors to make the results of their audits available to the public, to democratically elected representatives and other key stakeholders.

Section 2 - Regulation of local public audit (questions 4 – 10)

- 2.6 The Government considers that, to the extent possible, there should be a consistent regulatory regime for audit, covering the private sector and the local government and local health sectors. This local public audit regime should be focused on local accountability, in the way that the commercial sector is tailored to accountability to shareholders.
- 2.7 The Audit Commission's Codes contain additional standards to reflect the principles of public audit and its wider scope, particularly in terms of regularity and propriety and value for money. They specify the approach to audit for areas not already covered by professional audit standards, such as the 'value for money' conclusion. The Commission also publishes guidance and statements of responsibilities of auditors and audited bodies.
- 2.8 The proposals are that auditors of local public bodies would continue to follow the auditing and ethical standards set by the Auditing Practices Board and that the body best placed to develop and maintain the audit Codes of practice and supporting guidance would be the National Audit Office, given its role in providing Parliament with assurance on public spending, would be best placed the audit Codes, which would continue to be approved by Parliament.
- 2.9 It is proposed that, as under the Companies Act, an overall regulator would have responsibility for authorising professional accountancy bodies to act as recognised supervisory bodies for local public audit. Any such body would need to comply with the statutory requirements set out in the proposed primary legislation. It would have the roles of registration, monitoring, and discipline in relation to local public audit. The Financial Reporting Council is the regulator for Companies Act audit and it is proposed that it takes on a similar role for the local public audit regulatory regime in England, provided that it can assure the Government that it has both the resources and the expertise to undertake the role, and wishes to do so.
- 2.10 It is further proposed that recognised supervisory bodies for local public audit would have responsibility for monitoring the quality of audits undertaken by their members, as they do in the private sector.

This work would fall under the monitoring units of these bodies, and would include:

- reviews of individual audit engagements
- reviews of the policies, procedures and internal controls of those firms licensed to carry out the public sector audits
- reporting on the quality of audit to the registration body

2.11 The recognised supervisory bodies for local public audit would investigate complaints or disciplinary cases, as well as issues identified during their monitoring process. They would also be able to stop a firm being eligible for appointment as a statutory local public auditor and remove them from the register of eligible local public auditors.

2.12 It is being considered whether the overall regulator should have a role in assuring the quality, and undertaking independent investigation of the audit of local public bodies that might be considered analogous to public interest entities for the public sector. The overall regulator would have powers to investigate and discipline in these cases. The process undertaken would be similar to that above, but would provide an additional level of assurance in respect of those bodies.

Section 3 – Commissioning local public audit services (questions 11 – 28)

2.13 The Government believes that a localist approach, without an independent central body having a role in appointing an auditor, is an important element of driving accountability to local people rather than to central government. However, maintaining the independence of the auditor in the new system is central to the principles of public audit. Proposals therefore include measures to safeguard the independence of the auditor.

2.14 It is proposed that all larger local public bodies (those with income/ expenditure over £6.5m) will be under a duty to appoint an auditor from a register of local public statutory auditors.

2.15 It is recognised that, as in other sectors, those to whom audit is directed should have influence but that the independence of the auditor remains paramount. Therefore, for larger public bodies, appointment by full council or equivalent, on the advice of an audit committee with opportunities for the electorate to make an input, is being proposed.

2.16 Also as local public bodies may wish to co-operate to ensure that there is wide competition for external audit contracts, and may want to work together to procure an external auditor, it is proposed to ensure that legislation provides for both joint procurement and joint audit committees.

2.17 As part of a new local audit regime, it is proposed that each larger local public body should have an audit committee with a majority of members independent of the local public body and, with some elected members to strike a balance between objectivity and in-depth understanding of the issues.

2.18 A possible structure is set out below. However, there could be alternative arrangements, for example:

- a) only the chair and perhaps a minority of members are independent of the local public body
- b) a chair and a majority of members independent of the local public body, as described below
- c) as for (b), but with independent selection of the members independent of the local authorities

2.19 Whilst it is recognised that local public bodies need to have flexibility in the way that they constitute and run audit committees it is considered that there is a need to ensure that the minimum requirements for an audit committee set out in legislation provide for an independent audit appointment. Set out below is an extract from the consultation document showing the possible structure and role for the audit committee, some of which may be prescribed in legislation and some of which we would put forward as best practice

Structure of audit committees

We envisage that in the new system, an audit committee could be structured in the following way:

- The chair should be independent of the local public body. The vice-chair would also be independent, to allow for the possible absence of the chair.
- The elected members on the audit committee should be non-executive, non-cabinet members, sourced from the audited body and at least one should have recent and relevant financial experience (it is recommended that a third of members have recent and relevant financial experience where possible).
- There would be a majority of members of the committee who were independent of the local public body.

Independent members of the committee

When choosing an independent member of the committee, a person can only be considered for the position if:

- he or she has not been a member nor an officer of the local authority/public body within five years before the date of the appointment
- is not a member nor an officer of that or any other relevant authority
- is not a relative nor a close friend of a member or an officer of the body/authority
- has applied for the appointment
- has been approved by a majority of the members of the council
- the position has been advertised in at least one newspaper distributed in the local area and in other similar publications or websites that the body/local authority considered appropriate

- 2.20 The Financial Reporting Council currently produces guidance for the establishment of audit committees for companies, stating that they should be made up of at least three, or in the case of smaller companies two, independent non-executive directors. The main role and responsibilities of a company's audit committee are set out in written terms of reference and can include a number of roles, including:
- providing advice to the board in relation to the appointment of external auditors
 - approving the remuneration and terms of engagement of the external auditor
 - reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process
 - developing and implementing policy on the engagement of the external auditor to supply non-audit services
- 2.21 The expanded role of the audit committee would include the provision of advice and guidance to the full council or equivalent (the audit committee may wish to have regard to advice from the section 151 officer) on appropriate criteria for engaging an auditor and advice as to how these criteria could be weighted. The audit committee would be given copies of the bids to evaluate in order that they may advise the full council or equivalent on the selection process and may, if they wish, indicate which auditor, in their view, presents the best choice.
- 2.22 The full council or equivalent would need to have regard to the advice of the audit committee but would not need to follow its advice. The full council or equivalent would be responsible for selecting an auditor and engaging that auditor on a contractual basis. Advice provided by the audit committee to the full council or equivalent would be published, although consideration will need to be given to the treatment of commercially confidential material.
- 2.23 If the full council or equivalent did not follow the advice of the audit committee, then it would need to publish on its website a statement from the audit committee explaining its advice and a statement from the full council or equivalent setting out the reasons why the council or equivalent has taken a different position.
- 2.24 Two Options are presented:
- Option 1 - to specify only one mandatory duty for the audit committee i.e. to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.
 - Option 2 – to specify a much more detailed mandatory role for the audit committee (see para 3.24 of consultation document)
- 2.25 There are proposals to allow more public involvement in the appointment of an auditor, both pre-appointment and post appointment, allowing a member of the public to make representations at any time to the audit committee.

- 2.26 The paper also considers the amount of regulation there should be if a body fails to appoint an auditor.
- 2.27 It is proposed that auditors would be reappointed annually by the full council on the advice of the audit committee (who may want to provide advice on the quality of service received in the previous year) but the audited body could be required to undertake a competitive appointment process within five years. The audited body would be able to re-appoint the same firm for a second consecutive five year period, following competition. However to preserve independence, the audited body would need to procure a different audit firm at the end of the second five year period, to ensure that in carrying out their responsibilities auditors are not influenced by their desire to secure re-appointment.
- 2.28 Proposals for the event of resignation or removal of auditors and auditor liability are made. These are considered to be appropriate.

Section 4 – Scope of audit and the work of auditors (questions 29 -41)

- 2.29 Local authorities' auditors are currently required to; give an opinion on the financial statements; provide a value for money conclusion; review and report on other published information including the governance statement, and review and report on Whole of Government Accounts return. The consultation identifies 4 possible future options;
- Option 1 – Reduced scope to something similar to private company audits with the auditor giving an opinion on the financial statements and reviewing and reporting on other information published with the financial statements.
 - Option 2 – Similar scope to the current audit of local government with auditors providing an opinion on the financial statements as well as arriving at a conclusion on value for money arrangements and reviewing and reporting on other information included with the financial statements.
 - Option 3 – Increased scope with new requirements for the auditor to give not only an opinion on the financial statements but also a conclusion on regularity and propriety, financial resilience and value for money.
 - Option 4 – A new requirement for councils to prepare and publish an annual report. The auditor would give an opinion on the financial statements, review the annual report and provide reasonable assurance on it.
- 2.30 It is proposed that arrangements for public interest reports are retained. Auditors would continue to have the power to prepare a public interest report, with the council required to consider it within one month of receipt and to publish a summary of the meetings decision. Members of the public would retain the right to question the auditor about the accounts but the right to make formal objection to the accounts would be removed.

- 2.31 Audit firms would be able to provide non audit services as long as they adhere to the ethical standards produced by the Auditing Practices Board and that permission is sought from the Audit Committee.
- 2.32 The Government considers that the rights for local government electors to object to the accounts are both outdated and over-burdensome on auditors, local public bodies and council tax payers. Under the new local audit framework, members of the public would retain the right to make representations to the auditor, raise issues with the auditor and to ask the auditor questions about the accounts. While the right to make formal objections would be removed, the local public body would still be required to advertise that its accounts had been prepared and there will be increased publicity requirements for audited bodies. The auditor would still be open and transparent about the audit, and would consider any relevant representations from the public. The auditor would have discretion to decide whether to follow-up any issues raised by local citizens, having regard to the significance of the issue, the amounts of public money involved and the wider public interest. If the auditor decided not to consider a representation further, the decision would be amenable to judicial review, should the citizen who made the representation be dissatisfied with the decision.
- 2.33 It is being proposed that auditors should also be brought within the remit of the Freedom of Information Act to the extent that they are carrying out their functions as public office holders. There are costs associated with responding to freedom of information requests which could have an impact on audit fees, and it is recognised that this could also be detrimental to the auditor and audited body's relationship.

Section 5 – Arrangements for smaller bodies

- 2.34 Arrangements for smaller bodies are considered separately in this section of the consultation. It is not proposed to respond to this section.

OTHER CONSIDERATIONS

3. SUSTAINABLE COMMUNITY STRATEGY AND CHANGE PLANS (RELEVANCE TO):

- 3.1. External Audit supports all facets of the Sustainable Community Strategy and Change Plans.

4. RESOURCE IMPLICATIONS:

- 4.1. No immediate implications but the changes finally legislated will have cost implications for the Council.

5. RISK MANAGEMENT ISSUES

5.1. None

BACKGROUND DOCUMENTS

[Letter from Sir Bob Kerslake on the future of Local Audit, 2 June 2011](#)

[Future of local public audit: Consultation, 30 March 2011](#)

ATTACHMENTS:

Appendix 1: Consultation questions and proposed responses

Consultation questions and proposed responses

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 are appropriate.

2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?

No comments

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?

The Financial Reporting Council

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?

Ensure that the additional criteria to ensure that auditors have the right level of experience to be able to undertake a robust audit of a local public body are the minimum requirements.

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?

Able to demonstrate an understanding of the different requirements in relation to the public sector, including a detailed understanding of accounting and audit requirements for the Public sector.

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?

Similar criteria as for the private sector should be applied.

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?

There should be no requirement for additional regulation or monitoring.

10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?

There should be no requirement for additional regulation

11. 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?

Yes

12. Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?

Yes

13. 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?

There is a need for a mix of skills on the audit committee. Whilst a certain level of financial understanding would be beneficial, financial "expertise" is not considered to be a prerequisite.

14. Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?

This is unknown. It would be expected that offering remuneration would provide more options. Remuneration should be determined locally to be determined by Members on the advice of a Remuneration Panel.

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?

The proposals are overly prescriptive and bureaucratic.

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?

Option 1 – only 1 mandatory duty for the Audit Committee

17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?

Yes – the specification in legislation should be the minimum requirements to allow for local discretion and different models.

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?

Yes – it would help to have common guidance. This could be maintained by the Financial Reporting Council.

19. Is this a proportionate approach to public involvement in the selection and work of auditors?

No – it is considered to be overly prescriptive.

20. How can this process be adapted for bodies without elected members?

No Comments

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 1 – Secretary of State to direct the body to appoint an auditor

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?

Only if they have failed to appoint an auditor by the required date

23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?

The Recognised Supervisory Body

24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?

Yes – but there should maybe be provision for exceptional circumstances

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?

Yes

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

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?

Only Option 1 will reduce costs – this would not necessarily reduce the information available to local citizens on how local bodies are spending their money or securing value for money – it would reduce the audit burden.

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 – the performance monitoring information needs to be proportionate and not overly prescribed. It should be responsive to local circumstances and already exists in various forms, transparently available to the public.

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 – these matters are already covered within existing reports for example financial resilience is dealt with in the Budget report to Council.

32. Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?

Reasonable

33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?

If believed to be necessary – should be similar to that for other public bodies

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

38. Do you agree that we should modernise the right to object to the accounts? If not, why?

Yes

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

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 – could be detrimental to the relationship with the audited body, there will be cost implications and any relevant information should be already available directly from the audited body

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)?

See Q40 above

Arrangements for Smaller Bodies

Questions 42 – 50

No comments