

Audit Committee

30 June 2011



Future of Local Public Audit Consultation

Don McLure, Corporate Director of Resources

Purpose of the Report

1. To inform Members of a consultation exercise being undertaken by the Department of Communities and Local Government (CLG) regarding the future of public audit following the announcement in August 2010 to disband the Audit Commission.

Background

2. In August 2010 the Secretary of State announced plans to disband the Audit Commission and refocus local public audit "on helping local people hold their councils and other public bodies to account for local spending decisions".
3. Since then Ministers have been examining the most cost effective options for disbanding the Audit Commission, transferring audit to the private sector and allowing local authorities to appoint their own auditors.
4. Proposals for the new audit framework are set out in the attached consultation document. These proposals build on the statutory arrangements and professional ethical and technical standards that currently apply to companies and outline how principal local authorities would appoint their own auditors, with decisions being made by full council, after taking into account advice from an independently chaired audit committee.
5. The proposals also outline significant changes to the membership of audit committees to reflect this additional responsibility.
6. Proposals are based on the principles of localism, transparency, lower fees and high standards of auditing. A response provided to the 50 consultation questions is attached at Appendix 2 and will be submitted to the CLG, subject to Committee's approval, to meet the consultation closure date of 30 June.
7. CLG plan to provide a response to the consultation exercise in the autumn, publish draft legislation and then bring forward primary legislation as soon as Parliamentary time allows.
8. CLC's have advised that although no decision has yet been made, they consider that outsourcing will be potentially the quickest and most cost

effective way of transferring audit work from the Audit Commission's in-house audit practice to the public sector and have asked the Audit Commission to begin preparatory work for outsourcing the 2012/13 audits.

Recommendations

9. It is recommended that Members:

- Note CLG's proposal for the new local external audit regime as set out in the consultation document.
- Agree our response to the 50 consultation questions
- Note the action being taken to transfer the work of the Audit Commission to the private sector for the 2012/13 accounts until such time as the Council can start to appoint its own auditors.

Contact: Avril Wallage, Manager of Internal Audit & Risk, Tel 0191 383 3537

Appendix 2

To: foia@communitites.gsi.gov.uk – Response to future of local audit consultation

Dear Sirs,

Future of Local Public Audit – Consultation Document,

Thank you for the opportunity to respond to the above document.

As Durham County Council's S151 Officer, I have provided responses to the 50 consultation questions as attached on behalf of the Authority.

Sent on behalf of:

Don McLure,
Corporate Director Resources

Draft Response to consultation questions

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?**

The design principles for a new audit framework based on localism and decentralisation, transparency, lower audit fees and high standards of auditing seem appropriate.

Some proposals could increase audit fees. Eg. Proposals made at 2.25 recognise that costs incurred by the overall regulator in relation to public interest entities would be passed on to audit firms and therefore could be reflected in fees.

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

This would seem appropriate.

3. Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?

It would seem logical for the National Audit Office to have this role to ensure some consistency between central and local government.

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?

We agree that an overall regulator should have responsibility for authorising accountancy bodies to act as recognised supervisory bodies for local public audit.

5. Who should be responsible for maintaining and reviewing the register of statutory local public auditors?

If the NAO are to produce the Code of Audit Practice and Guidance it would seem logical that they also maintain and review the register of statutory local public auditors.

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?

Suggest some form of board is needed that accredits and provides training for audit firms wishing to provide statutory local public audit. All firms providing service must be accredited.

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?

Suggest some kind of mentoring scheme with some form of quality assurance framework for individual auditors who are to be assigned as Audit Managers. Must be able to demonstrate that they personally have appropriate knowledge and experience and can be held personally accountable for the quality of the audit service provided. Audit managers as well as firms should also require some form of accreditation.

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?

We do not consider this is necessary as all local public bodies could be categorised as “public interest entities”.

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 or monitoring considered necessary to help keep fees as low as possible.

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

N/A. See above

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, we consider the proposals sufficiently flexible to allow joint procurement but question the need for joint audit committees in such cases.

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

We consider the proposed criteria for the selection of independent members is considered too restrictive; suggest the reference to being a relative or close friend of a member or an officer of the body be amended to any senior officer of the Council.

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?

Suggest the majority of independent members should have either financial or audit expertise. The balance between elected members and independently appointed members need to be maintained to ensure that collectively the committee has sufficient knowledge of the Council as well as technical expertise.

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

Yes. Some form of remuneration would be considered necessary but unable to comment at what level that should be. Fee could be based on attendance of meetings but with an additional amount for the Chair and Vice Chair to reflect commitment needed above attendance at meetings.

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?

Yes. Option 1.

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

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

We do not consider it would be appropriate for the Audit Committee to set a policy on the provision of non-audit work. Policy should be set by the Cabinet. The engagement or resignation/removal of auditor and responsibility for reviewing the financial statements and associated external auditors opinions/conclusions should be the only role specified in legislation.

The role and responsibilities of the S151 in relation to the framework should also be clearly defined to ensure a suitable balance of responsibilities between that of the S151 and the audit committee.

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 same body as specified at Q3. i.e the NAO

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

It is not uncommon for audit issues to attract obsessive or vexatious enquiries. The involvement of the public in the appointment of auditors is not therefore considered appropriate.

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

Independent appointed audit panel?

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, Direction by the Secretary of State

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.

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

Secretary of State

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

This would seem an appropriate time period.

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. We consider the ethical standards provide sufficient safeguards.

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?

The proposals appear reasonable in principle but would question whether 28 days notice is adequate.

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?

Option 2. Option 3 & 4 would increase audit fees and would contravene the principle of lower fees on which the new framework is based. Option 1 would provide no assessment of VFM.

30. Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?

Yes. Plans and performance targets already set out in the Council Plan. An annual report would provide details of performance outturn, although these are currently already reported through quarterly performance reporting which are in the public domain.

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?

Not considered necessary that this information is already made available to the public under current publication requirements relating to the financial statements. Additional audit fees would be incurred.

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?

Guidance would be required as to expected format and content, approval and publication processes together with expected timescales. It is suggested the CLG should produce and maintain the guidance.

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?

Grant certification work is currently carried out by Audit Commission and therefore it would make sense for this work to continue. Any additional audit related or other services to that body may compromise their independence and would therefore need to be carefully considered in terms of the value added from them doing the work.

36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?

If auditors were to be permitted to provide non-audit services, they may have access to internal information that may give them a competitive advantage. The audit committee would effectively be a part of the procurement process which will increase bureaucracy as the committee would be required to report to Council with a recommendation as to whether or not the work should be undertaken. This will slow down the overall procurement process.

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?

We agree that the audit committee should have a role in reviewing whistle-blowing arrangements to ensure that they are proportionate and allow for independence investigation of such matters and for appropriate follow-up action. We do not agree that a member of the audit committee should be a point of contact for receiving whistle blowing referrals as this would be difficult on a practical level and would involve the committee unnecessarily in the process. The continuance of the statutory auditor as a prescribed person to receive whistle blowing disclosure is supported, although we would always encourage such disclosure to be reported through the many internal channels first as this allows the issues to be directed to the appropriate person more quickly.

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?

It is understood that this relates only to information in connection with a public audit eg external audit reports, working papers, notes of meetings etc. These are currently excluded from FOI, although reports produced will be in the public domain. The accounts and the information that support them however belong to the Council not the auditors. The Council is responsible for preparing the accounts, arranging the audit, responding to issues raised by the Auditor, approving them and publishing them. The Council should therefore be responsible for responding to FOI requests relating to public audit not the auditor, even though this may include records held by the external auditor and the Council may therefore need to consult with the auditor prior to providing a response.

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)?

There is the potential for mistrust arising between the auditor and the audited body if the Auditor was in a position to respond to a FOI request without the knowledge of the audited body. The potential impact on audit fees can not be assessed.

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 is considered the most proportionate. The fees would be recharged direct to the smaller body.

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, this should be the responsibility of the section 151 officer. Any costs are considered minimal as the expected independent examiner is

likely to be either the internal audit service of the unitary or the unitary external auditor Any costs would be recharged to the smaller body.

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?

*The guidance should outline the independent examination requirements and include details of how to appoint, remove, the maximum term, scope of audit and reporting requirements etc.
The guidance should be maintained by the NAO.*

45. Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?

Yes

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?

None suggested.

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?

The 4 level approach is not considered too complex but we would suggest the levels reflect those used in the Charity Sector i.e

*Suggest level 1 should go up to £10,000
Suggest level 2 should go up to £100,000
Suggest level 3 should go up to £500,000
Suggest level 4 should go up to £6.5m*

The scope of the audit should be proportionate to the complexity of expected income and expenditure.

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. A fixed financial penalty could be imposed where the body concerned is not the precepting authority.

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.

Appendix 1: Implications

Finance

None

Staffing

None

Equality and Diversity

None

Accommodation

None

Crime and disorder

None

Human rights

None

Consultation

None

Procurement

None

Disability

None

Legal Implications