
FUTURE OF LOCAL PUBLIC AUDIT

1 SUMMARY

- 1.1 Following the Secretary of State's announcement that the Audit Commission would be disbanded, this report presents a proposed response to the Communities and Local Government's consultation on the new audit framework. This response is set out in appendix 1.

2 INTRODUCTION

- 2.1 On 13 August 2010, the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission, transfer the work of the Commission's in-house practice to the private sector and put in place a new local audit framework. Local Authorities would be free to appoint their own independent external auditors. A new decentralised audit regime would be established and Councils would still be subject to robust auditing. The Secretary of State was clear that safeguards would be developed to ensure independence, competence and quality, regulated within a statutory framework.
- 2.2 The consultation is a lengthy document, so it is not attached but a copy has been placed in the Members' Library.
- 2.3 As some of the proposals in the consultation will directly affect the membership and function of this Committee, Members are asked to consider any changes they would wish to make to the draft response.

3 BACKGROUND

- 3.1 The current system for the audit of local public bodies is operated and overseen by the Audit Commission who has acted as the regulator, commissioner and provider of local audit services. As a regulator, the Commission produces statutory Codes of Practice that set the standard for audit and require the auditors to comply with the auditing and ethical standards issued by the Auditing Practices Board and monitors the quality of audit.
- 3.2 The Audit Commission appoints auditors to local public bodies, either from its in-house practice or from firms contracted to the Commission, such as PKF, who currently audits this Authority.
- 3.3 The proposed new regime would see the National Audit Office preparing the Codes of Practice. Monitoring and enforcement of audit standards would be undertaken by the accountancy professional bodies, under the supervision of the Financial Reporting Council. Principal Local Authorities would appoint their own auditors with the decision made by Full Council, taking into account independent advice from an independently chaired Audit Committee.

3.4 The consultation paper discusses the Government's proposals for how this new local audit framework could work, including some of the detailed considerations:-

- All local public bodies with a turnover of over £6.5m will appoint their own independent (external) auditor.
- This appointment would be made by Full Council, taking into account the advice of an independently chaired Audit Committee, and with an opportunity for the electorate to make an input.
- The National Audit Office would prepare audit codes of practice and prescribe the way in which auditors are to carry out their functions.
- Registration of audit firms and auditors, as well as monitoring and enforcement of audit standards, would be undertaken by the accountancy professional bodies under the supervision of the Financial Reporting Council and its operating bodies.
- It is expected that Local Authorities will wish to co-operate to ensure there is wide competition for external audit contracts and will want to work together to procure an external auditor.
- Proposals include changes to the structure of Audit Committees, with the Chairman being independent of the Local Authority. The Vice-Chairman would also be independent to allow for possible absence of the Chairman. The elected Members would be non-Executive and non-Cabinet Members, and the majority of the Members of the Committee would be independent of the Authority (in support of the increased transparency agenda).
- The Audit Committee would have responsibility for the engagement of the external auditor and also the monitoring of its independence and quality of work. The Committee would advise Full Council on the appropriate criteria for engaging an auditor and how these could be weighted. The Committee would also be involved in the evaluation of bids.
- Other proposals are made regarding failure to appoint an external auditor, rotation of audit firms, resignation / removal of auditors and auditor liability.
- The future of public interest reports / disclosures is also covered.

4 RISK IMPLICATIONS

4.1 The proposals to give Local Authorities the duty to appoint auditors will create additional work and the new responsibility to assess auditors' suitability for carrying out the audit work, particularly if new firms do enter the market, will be a new challenge for officers and Members. There is a risk around the level

of applications to join the Audit Committee as independent Members, which will need to be considered once the Government announces the final arrangements. The consultation also includes proposals around joint procurement of auditors, which is another area of risk that will need to be managed. At this stage, there is no definite timetable for when the new arrangements will be implemented. There are issues around auditor liability, which is currently indemnified by the Audit Commission and the arrangements that will need to be in place the removal or resignation of an external auditor.

5 RESOURCE IMPLICATIONS

- 5.1 External audit fees are a significant expenditure item and the additional costs of managing the procurement process and auditor relationship will need to be considered once the final arrangements have been announced. The consultation also includes proposals around public engagement with the appointment of auditors and ongoing management of the auditor relationship which will need to be adequately resourced.

6 RECOMMENDATION

- 6.1 It is proposed that the Committee **RESOLVES**

That the Council's response to the consultation on local public audit, as set out in appendix 1, be agreed.

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Background Papers:-

Future of Local Public Audit – Consultation.

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Appendix Future of Local Public Audit – Response**General Response**

The consultation is based on a number of assumptions that the local appointment of external auditors and independent Audit Committees are an improvement on the current arrangements. The consultation does not allow for any comment on the decision to abolish the Audit Commission.

This Council's view is that the transfer of functions such as appointment of auditors, monitoring external auditors, providing indemnification for auditors and ensuring auditor independence, from a centralised body such as the Audit Commission (AC) will create unnecessary duplication and additional workloads for local public bodies without realising any benefit. A reduction in audit fees could have been obtained by reducing the scope of the AC's work, which would address the criticisms of their expansion into areas outside their original remit. Against this context, the following responses are submitted. The proposals made in the consultation appear to be a bureaucratic and overly complicated way of filling the gap that will be left by the loss of the Audit Commission.

Design Principles

Question	Response
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 proposals in this document are unlikely to lead to lower audit fees and there will be a considerable amount of additional administration falling to Local Authorities to fill the gaps left by the removal of the AC that are likely to create additional costs.

Local Bodies Covered By This Consultation

Question	Response
2: Do you agree that the audit of probation trusts should fall within the Comptroller and Auditor General's regime?	No response.

Regulation of Local Public Audit

Current: The AC issues Codes of Audit, which build on the ethical, auditing and standards issued by the Auditing Practices Board (APB). The Codes contain additional standards to reflect the principles of public audit, in terms of regularity, propriety and value for money (VFM). They specify the approach to audit for areas not already covered by professional audit standards.

Proposed: Auditors would continue to follow the auditing and ethical standards set by the APB. The National Audit Office (NAO) already has a role in providing Parliament with assurance on public spending and could develop and maintain the Codes plus any supporting guidance.

Question	Response
3: Do you think that the NAO would be best placed to produce the Code of audit practice and the supporting guidance?	Yes.

Registration of Auditors

Current: The AC regulates the quality of auditors' work by setting minimum qualifications and standards.

Proposed: An overall regulator would have responsibility for authorising professional accountancy bodies to act as recognised supervisory bodies (RSBs). It would have the roles of registration, monitoring and discipline. The Financial Reporting Council (FRC), as the regulator for the private sector, takes on a similar role for local public audit. The auditor must be a member of a RSB and eligible under the rules of that body. There would be flexibility on eligibility to allow new firms to enter the market. All eligible local public auditors would be placed on a public register.

Question	Response
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?	FRC.
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?	It will be difficult for new firms to enter the market as Local Government finance is so different to the private sector. Standards should not be dropped.
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?	New firms should have auditors who are experienced in Local Government finance and/or public sector auditing.

Monitoring and Enforcement

Current: The AC carries out an annual quality review programme.

Proposed: The RSB would have responsibility for monitoring quality of audits and investigating complaints or disciplinary cases. In the private sector, some companies are designated "public interest bodies" because of their public significance and are subject to additional scrutiny by an overall regulator. The overall regulator then has a role in quality assurance and investigation. The costs of undertaking this role would be passed on and reflected in audit fees.

Question	Response
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?	Any body spending public monies is a public interest entity. However, if the overall regulator is setting the standards for the RSBs, who will then be responsible for monitoring the quality of audits as outlined in the consultation? Having the regulator carrying out a similar function would be duplication and add to the bureaucracy, which the abolition of the AC is meant to remove.
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?	The overall regulator does not need to undertake any additional regulation or monitoring. Independent audit of public bodies, subject to the monitoring and quality control of the RSBs with standards set by the overall regulator, should be more than sufficient to provide assurance about the operation and governance of 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?	No response – see previous comments.

Duty to Appoint an Auditor

Current: Appointed by the AC, following consultation with the audited bodies.

Proposed: All larger local public bodies (income/expenditure over £6.5m) will be under a duty to appoint an auditor. Appointment would be made by Full Council, on the advice of an Audit Committee with input from the electorate. The legislation will provide for joint procurement and Audit Committees. The Audit Committee would have the following proposed structure:-

- Independent Chairman and Vice-Chairman
- Non-Executive elected Members, with at least one who has recent and relevant financial experience (recommended that a third of Members have recent and relevant financial experience where possible).
- Majority of Members are independent of the local public body.

Criteria for Independent Members of the Committee

- Not been a Member/officer of the public body within 5 years.
- Not a Member/officer of that or any other relevant Authority.
- Not a relative/ close friend of a Member/officer of the body.
- Has applied for the appointment.

- Has been approved by a majority of the Members of the Council.
- The position has been properly advertised.

Question	Response
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?	If too large a group of audited bodies procure together, the value of the work will exclude smaller firms. The legislation should therefore include provision for a joint procurement that allows a panel of audit firms to be appointed who can then be used by individual audited bodies. The appointment of independent Members should be done by a panel rather than having the whole Council involved.
12: Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?	The criteria are too onerous and will restrict the availability of good quality candidates. Independence would not be impaired by allowing recent Members or officers to sit on the Audit Committee and their recent knowledge of the Authority would probably add value. The appointment of independent Members should be done by a panel rather than having the whole Council involved.
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?	An interest in the governance and finances of the Authority is of more value than specific financial expertise.
14: Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?	We expect there to be difficulties in getting a sufficient number of interested candidates. One solution would be to share independent Members with other Local Authorities, so we would wish to see that criteria deleted. Remuneration would have to be linked to current Member allowances but would be set by each Council's independent remuneration panel so is difficult to forecast.

Role of the Audit Committee

Current: No current role for Audit Committees in the appointment of auditors.

Proposed: Advising the Full Council on the criteria and weighting for engaging an auditor and selection of the auditor after evaluating the bids. Full Council would have to publish a statement if it does not follow the advice of the Audit Committee. First option is that only one mandatory duty is specified 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. Second option is to specify a more

detailed mandatory role for the Audit Committee, as set out in the consultation.

Question	Response
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 de-centralised approach?	Option (c) “only the Chairman and perhaps a minority of Members are independent of the local public body” would be proportionate”.
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?	This Authority’s Audit Committee already carries out a number of the functions set out in option 2, so do not see any requirement to have legislation.
17: Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?	The Audit Committee should appoint the external auditor.
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. FRC.

Involvement of the Public in the Appointment of an Auditor

Current: There is no involvement of the public.

Proposed: The public would be able to make representations about any firm that had expressed an interest to tender, which would be considered by the Audit Committee, who would also consider any post-appointment representations.

Question	Response
19: Is this a proportionate approach to public involvement in the selection and work of auditors?	Unlike previous proposals in the consultation, this one is not accompanied by details of what happens in the private sector. Potential conflicts of interest with the audit firm would be addressed as part of the tender selection process or as part of the terms of the contract. It’s difficult to judge the scale of public interest.
20: How can this process be adapted for bodies without elected members?	This question relates to Police Authorities, so no response.

Failure to Appoint an Auditor

Current: Not applicable as AC is responsible for appointing the auditors.

Proposed: The audited body would be under a duty to appoint an auditor. Where a body does not, (1) the Secretary of State (SoS) directs body to appoint or (2) SoS makes the appointment with a sanction and costs imposed.

Question	Response
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.
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?	When they have failed to appoint.
23: If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?	NAO

Rotation of Audit Firms and Audit Staff

Current: Audit partners are appointed to an audited body for 5 years with possible extension up to 7 years, audit manager for 10 years.

Proposed: Same limits for partners and managers. Audit firms would be re-appointed annually by Full Council on the advice of the Audit Committee, with competitive appointment process repeated every 5 years. Same audit firm could only be appointed for 2 consecutive 5 year periods.

Question	Response
24: Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?	No. There is no limit to the time that an audit firm can be appointed in the private sector as long as a regular assessment is made of the objectivity and independence of the auditor. The amount of work conducted in an audit can be similar regardless of the size of the audited body, as evidenced by the limited range of external audit fees currently paid. There is a risk that for small audited bodies audit firms do not tender for the work and audit fees do not reduce as envisaged. Limiting the appointment to 2 consecutive 5-year periods could reduce our ability to get competitive tenders and mean we are not appointing the best candidate.
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.

Question	Response
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	The limit to two 5-year periods is excessive as the professional standards and scrutiny by the Audit Committee provide sufficient safeguards to ensure auditor independence.

Resignation or Removal of an Auditor

Current: AC rotate suppliers if the relationship breaks down.

Proposed: The auditor can resign by giving notice to the Audit Committee and audited body. The audited body would then make a written response to all Members and the Audit Committee. Where the body wishes to remove an auditor, it would give notice to the Audit Committee and the auditor, with a resolution to remove the auditor put to a public meeting or Full Council. The auditor can make a written response and speak at the meeting. In both cases, the audited body and auditor would publish statements. The Audit Committee would investigate the issues leading to the resignation or removal.

Question	Response
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. No additional safeguards required.

Auditor Liability

Current: The AC currently indemnifies auditors for the costs.

Proposal: In the absence of a central body providing indemnity to audit firms, it could be possible for audited bodies and auditors to deal with auditor liability as part of their contractual negotiations. A legislative framework could set out the process for setting and agreeing liability limitation agreements. Without a liability agreement, audit firms may increase their fees to match the increased risk they face in undertaking their work.

Question	Response
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. This is an area where Councils may have to purchase specialist legal advice as it has previously been managed by the AC.

Scope of Local Public Audit

Proposal: Option 1 is limited to an opinion on the financial statements and the whole of Government accounts; option 2 would also include a VFM conclusion that proper arrangements are in place having regard to regularity, propriety and financial resilience; option 3 would add an auditor's opinion on compliance with laws and regulations governance and control regime and a conclusion about future financial sustainability and the achievement of VFM. Option 4 - all bodies would publish an annual report setting out arrangements to secure VFM, regularity, propriety and financial resilience and the auditor would review this report and provide reasonable assurance.

Question	Response
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 provide sufficient assurance and transparency to the electorate? Are there other options?	Option 2.
30: Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?	We agree there should be some annual reporting. However, it should not be prescriptive as public bodies may use a variety of means to provide the information and it should not be subject to external auditor review.
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. For Local Government, the Annual Governance Statement, included in the Financial Statements, is the Council's report on regularity and propriety. Financial resilience is covered in the Council's medium term financial strategy.
32: Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?	Do not agree that the annual report should be subject to external auditor review as this will add to the cost of the audit process.
33: What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?	It should not be prescriptive as public bodies may use a variety of means to provide the information and it may not be appropriate or cost effective to publish it all in one report.

Public Interest Reporting

Current: The auditor is currently required to consider whether to issue a report in the public interest on any significant matter coming to his or her notice and to bring it to the attention of the audited body and the public or issue a notice to the body regarding unlawful expenditure.

Proposed: The current publication requirements for public interest reports would be retained, as would the audited body's responsibilities to consider the report at a meeting within one month of receipt and to publish a summary of the meeting's decision. Retain the power of an auditor to make a recommendation requiring a public response and to issue an advisory notice regarding unlawful expenditure.

Question	Response
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.

Provision of Non-Audit Services

Current: Auditors can carry out additional work as long as it will not compromise independence and value of work does not exceed a de minimis.

Proposal: Auditors will be able to provide non-audit services. Permission would be sought from the Audit Committee beforehand.

Question	Response
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.

Public Interest Disclosure

Current: The AC and auditors are prescribed persons for disclosures relating to "the proper conduct of public business, value for money, fraud and corruption. The AC and appointed auditors consider information they receive as a result of a disclosure and determine what action, if any, to take.

Proposed: The role of receiving, acknowledging receipt or and forwarding the facts of the disclosure should be transferred to the Audit Committee, who could designate one independent member as the point of contact. The auditor would continue as a prescribed person.

Question	Response
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. The Council's whistleblowing policy already directs staff to external organisations, such as the National Fraud Line or the Public Concern at Work Service, if they do not wish to report a matter internally.

Transparency

Current: The public have the right to question the auditor and raise objections including a right of appeal to the court about auditor's decisions. The cost of investigating investigations is met by the audited body.

Proposal: The public would be able to make representations to the auditors or ask questions. The right to make formal objections would be removed. If an auditor decided not to consider a public representation, the decision could be amenable to a judicial review. The accounts and auditor's report would be published on the council's website. Auditors would be brought within the remit of the Freedom of Information Act but limited to information on a public audit.

Question	Response
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. Creates a burden on the auditors which will be transferred to public bodies in higher audit fees. Requests for information relating to public audit can be adequately dealt with by the public bodies themselves
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)?	Public bodies already have arrangements in place to deal with Fol requests. If auditors are having to respond, the cost will be passed on to the public bodies.

Arrangements for Smaller Bodies

Current: Limited assurance framework for public bodies with income or expenditure of less than £200,000 with additional testing on those where income/expenditure is between £200,000 to £500,000.

Proposal: Level of examination will be determined by annual income or expenditure between £1,000 and £6.5m, as set out in the consultation, ranging from independent examiner to full audit. The appointment of the independent examiner would be either by (1) the County or Unitary Council and could be one of their officers, or (2) the body appoints their own examiner using an Audit Committee, either jointly or the committee of a larger body.

Question	Response
42: Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?	Both options create additional work for the larger bodies, either through having to appoint the independent examiners or arranging for the appointments to be dealt with by their Audit Committees.
43: Do you think the county or unitary authority should have the role of AC 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?	Although not directly affected by the proposal, our view is that counties could potentially have hundreds of smaller bodies to deal with and the administrative cost would need to be addressed. We would not wish to see the role given to District Councils.
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?	NAO, in the same way that it will be producing the Codes of Practice.
45: Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?	No response.
46: Are there other options given the need to ensure independence in the appointment process? How would this work where the smaller body straddles more than one county/unitary authority?	In our view the whole idea of having counties appointing independent examiners will create an expensive bureaucracy.
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 £500k? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?	No response.