

**TO: GOVERNANCE AND AUDIT COMMITTEE
28 JUNE 2011**

**FUTURE OF LOCAL PUBLIC AUDIT
Borough Treasurer**

1 PURPOSE OF REPORT

- 1.1 To agree the Council's response to the consultation paper 'Future of local public audit'.

2 RECOMMENDATION(S)

- 2.1 **That the Committee agree the responses to the consultation questions set out in Annex B.**

3 REASONS FOR RECOMMENDATION(S)

- 3.1 To advise the Government of the Council's views on the proposals contained in the consultation paper 'Future of local public audit'.

4 ALTERNATIVE OPTIONS CONSIDERED

- 4.1 The alternative would be not to respond to the consultation paper, which would mean that the Council had no input into the future arrangements for external audit.

5 SUPPORTING INFORMATION

Background

- 5.1 On 13 August 2010, The Secretary of State for Communities and Local Government announced plans to disband the Audit Commission and "re-focus audit on helping local people hold their councils and other local public bodies to account for local spending decisions".
- 5.2 The Secretary of State's announcement on the 13 August contained the following overall intentions and policy aims:
- To disband the Audit Commission and transfer the work of the Audit Commission's in-house audit practice to the private sector.
 - To enable local authorities to appoint their own independent external auditors.
 - To provide a new framework for the audit of local health bodies who are also currently audited via the Audit Commission.
 - To ensure that all local public bodies would still be subject to robust auditing.
- 5.3 This consultation paper sets out the Government's vision for the future of local audit. The consultation is wide ranging and both provides details of the Government's proposals to change the audit of local councils and other local public bodies and also consults on a range of potential options where the government has yet to establish its intentions.
- 5.4 The Government's vision for local public audit is based on four principles:

- Localism: local public bodies should be free to appoint their own independent external auditors from a more competitive and open market.
- Transparency: local public bodies will become increasingly accountable for their spending decisions to the people who provide their resources.
- Lower audit fees.
- High standards of auditing: external audit should remain both robust, efficient and follow the established principles of public audit.

The Regulation of Local Public Audit

5.5 The Audit Commission is currently responsible for setting audit standards through codes of practice for local government (and health) bodies. Clearly, once the Commission has been abolished, there is a requirement for local public audit to be regulated differently.

5.6 The consultation paper proposes a regulatory system for local public audit that is similar to that for private company audit under the Companies Act 2006. The consultation proposes that:

- The National Audit Office would develop and maintain codes of audit practice and any supporting guidance. Any codes of practice will require parliamentary approval as under the current system.
- The Financial Reporting Council, the body responsible for the supervision of private sector external auditors, will regulate who can undertake local public audit work.
- There would be a list (referred to as the register of local public statutory auditors elsewhere in the consultation paper) of audit firms who are recognised as qualified to undertake public audit work. Local councils would be required to appoint their external audit from those firms on the register.

5.7 The consultation paper states that the costs of the new regulatory regime will be passed on to individual audit firms, who may wish to recover such costs as part of their audit fee.

Commissioning Local Public Audit Services

5.8 The consultation paper proposes that all larger local public bodies (defined as those with income/expenditure over £6.5million) will be able to appoint its own auditor. The appointed auditor must be on the register of local public statutory auditors.

5.9 The appointment will be made by full Council, on the advice of an audit committee with opportunities for the electorate to make an input. It is proposed that the Secretary of State should have the power to appoint an external auditor to any local public body who fails to appoint a suitable one themselves.

5.10 Auditors would be appointed annually, but with a requirement to open the role to competition at least every five years. The Council could re-appoint the incumbent audit firm for a maximum of ten years, after which a different audit firm must be used for further audit work.

5.11 The consultation paper recognises that there is more than one way of arranging such an audit committee but sets out the following possible structure:

- The audit committee chair and vice-chair would both be independent of the local public body (i.e. not elected members)
- The elected members on the audit committee should be non-executive, non-cabinet members sourced from the audited body. At least one should have recent and relevant financial experience, but with a recommendation that a third of the members have recent and relevant financial experience where possible.
- There would be a majority of members of the committee who are independent of the local public body.

5.12 Independent members can only be considered for a position if:

- they have not been a member or an officer of the public body within five years before the date of appointment
- is not a member or officer of any other relevant body
- is not a relative or close friend of a member or an 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 advertised in at least one local newspaper and in other similar publications and / or websites.

5.13 The consultation paper also seeks views on the role of the new audit committee and presents two options:

Option One

The audit committee would be required to provide advice to the council on the engagement and resignation or removal of the auditor. It would then be for the council to decide whether or not the committee has any other function or duty.

Option Two

There would be a much more detailed mandatory role for the audit committee, possibly including providing advice on the procurement and selection of an auditor, ensuring effective relations between internal and external audit and reviewing audit reports and quality. Under this option the audit committee would report annually to the full council on its activities during the year.

5.14 The consultation paper recognises that individual bodies might wish to co-operate on the appointment of an auditor and so the following legislation will allow both joint procurement of audit services and joint audit committees.

Scope of Audit and the Work of Auditors

5.15 Currently, public sector bodies are subject to audit with a wider scope than in the private sector, including, for example, value for money and legality issues. The consultation paper presents four possible options for the scope of the audit of councils. These are:

Option one

The scope of the audit would become similar to private companies with the auditor giving an opinion on the financial statements and review and report on other information published with the financial statements.

Option two

The scope would be similar to the current system in local government, with auditors providing an opinion of the financial statements, concluding as to whether there were proper arrangements to secure value for money and reviewing and reporting on other information including the annual governance statement.

Option three

New arrangements to provide stronger assurances on regularity and propriety, financial resilience and value for money.

Option four

A new requirement for councils to prepare and publish an annual report, which would be reviewed by the auditor with them providing reasonable assurance on the annual report.

- 5.16 Auditors would continue to have the power to prepare public interest reports, with the costs of such reports being recovered from the audited body. Local people would still be able to question the auditor, but the right to make formal objections to the accounts would be removed.
- 5.17 Audit firms would be able to provide such non-audit services as long as they adhere to the ethical standards produced by the Auditing Practice Board and that permission is sought from the audit committee.
- 5.18 The consultation paper also deals with the arrangements of smaller bodies (those with income and expenditure of less than £6.5m) which do not apply to this Council. The full consultation paper is attached at Annex A.
- 5.19 The consultation paper contains 50 detailed consultation questions (41 of which are relevant to the Council) with a deadline for responses of 30 June 2011. The Council's proposed response to the consultation questions is set out in Annex B.

6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS

Borough Solicitor

- 6.1 The proposed responses are supported. Though the Council has been fortunate in recruiting independent Members of the Standards Committee there has not been any great number of expressions of interest to serve in that capacity when the position has been advertised. The Localism Bill, when enacted will remove the obligation to have a Standards Committee and it is unfortunate that the consultation paper does not postulate any possible merger of the role of Audit Committee and Standards Committee. The possible expansion of the role of external auditors mooted by options 3 and 4 in question 9 is not considered to be appropriate - the external auditors will have limited capability in relation to issues of general propriety. The function of ensuring propriety is essentially one for the Monitoring Officer. In relation to question 28 (the issue of limitation of liability for external auditors), one option

would be to provide that the external auditor should not be liable in damages to the audited authority or a third party.

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- 6.2 Nothing further to add to the report.

Equalities Impact Assessment

- 6.3 Not applicable

Strategic Risk Management Issues

- 6.4 There are no strategic risk management issues arising from the consultation paper itself. If the proposals are enacted, there is the potential risk of additional costs arising from the revised audit committee arrangements and audit fees, coupled with the risk of deterioration in audit quality.

7 CONSULTATION

Principal Groups Consulted

- 7.1 Council officers.

Method of Consultation

- 7.2 Circulation of draft report.

Representations Received

- 7.3 Incorporated in responses to consultation questions

Background Papers

Future of local public audit (Communities and Local Government Consultation)

Local Government Information Unit Policy Briefing – Future of local public audit: new consultation

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