

AUDIT AND GOVERNANCE COMMITTEE

10 February 2012

**LOCAL PUBLIC AUDIT – THE GOVERNMENT’S RESPONSE TO THE
CONSULTATION**

Report of the Executive Director of Commercial and Corporate Services

1. Purpose of Report

- 1.1 To provide a summary of the Government’s response to the recent consultation regarding their proposals for the future arrangements for local public audit. The report also includes a brief Council commentary on the proposals in bold italics.

2. Background

- 2.1 Following the announcement of its decision to abolish the Audit Commission in August 2010, the Government consulted on its proposals for a new local public audit framework from 31 March to 30 June 2011.
- 2.2 The design principles of the new framework for local public audit are that it should be local and transparent, achieve a reduction in the overall cost of audit, and uphold high standards of auditing, ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit. Key elements are set out in the following sections.

3. Regulation

- 3.1 The National Audit Office is best placed to produce the Code of Practice and supporting guidance for audit of local public bodies, subject to Parliamentary approval. The National Audit Office will be required to consult key partners in developing the Code.
- 3.2 The Financial Reporting Council will be the overall regulator, mirroring its role under the Companies Act 2006. The Financial Reporting Council will be responsible for recognition and supervision of Recognised Supervisory Bodies (professional accountancy bodies responsible for supervising the work of auditors, and setting criteria which their members must fulfil before they can be registered auditors) and for Recognised Qualifying Bodies (professional accountancy bodies responsible for awarding audit qualifications).

The proposals are appropriate.

4. Auditor Registration

4.1 Mirroring the Companies Act 2006, Recognised Supervisory Bodies will:

- have the roles of registration, monitoring and discipline for local public audit,
- put in place rules and practices covering eligibility of firms to undertake local public audit; and
- keep a register of firms eligible to undertake local public audit.

The proposals are appropriate.

5. Monitoring and Enforcement

5.1 As under the Companies Act 2006, Recognised Supervisory Bodies will monitor the quality of audits undertaken by their member firms, and investigate complaints, disciplinary cases and issues identified during the monitoring of firms on the register of local public auditors.

5.2 The Accountancy and Actuarial Disciplinary Board (part of the Financial Reporting Council) investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. This arrangement is to continue.

5.3 There will be additional oversight and monitoring of the audits of significant local public bodies (referred to as “Bodies of Significant Public Interest”) - the Financial Reporting Council will monitor the quality of the audits of these bodies, mirroring the arrangements for Public Interest Entities under the Companies Act

The proposals are appropriate.

6. Commissioning Local Public Audit Services

6.1 Auditor Appointment

- Local public bodies will have a duty to appoint an auditor from the register of local public auditors, on the advice of an Independent Auditor Appointment Panel. The Independent Audit Appointment Panel will have an independent chair and a majority of independent members. Where the body already has an independent audit committee, this could be used to meet this requirement.

The proposal seems reasonable. Given that Sunderland’s Audit and Governance Committee does not have a majority of independent members this would either need to change or a separate Appointment Panel used.

- Local public bodies will be able to share appointment panels (and therefore independent members) to ease admin burdens and reduce

costs.

The potential advantages and disadvantages of a single authority or collaborative approach will require consideration.

- Local public bodies will be required to publish details of the auditor appointment on their website within 28 days of making the appointment, together with the Independent Audit Appointment Panel's advice and, if they did not follow that advice, a statement explaining why.

The proposal is reasonable.

6.2 Role of Independent Auditor Appointment Panels

- Government intends to prescribe specific functions to the Independent Audit Appointment Panel limited to the external audit, including advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports.
- The arrangements will allow local public bodies to share Independent Audit Appointment Panels, and to expand on the remit of their Panel if they wish, choosing a model which best suits their circumstances.

The proposals are reasonable.

6.3 Failure to Appoint an Auditor

Local public bodies will be required to appoint an auditor by 31 December in the year preceding the financial year to be audited, and notify the Secretary of State if they have not done so. The Secretary of State will be able to direct the local public body to appoint an auditor or make the auditor appointment directly. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.

The proposal is reasonable.

6.4 Rotation of Audit Firms and Audit Staff

- Local public bodies will be required to run a procurement competition for its audit services at least every five years.

The proposal is appropriate given the need to continue to secure vfm.

- Auditors will have to comply with the standards and rules set by the regulator. Applying the current standards means the audit engagement partner will be able to undertake audit for a local public body for an initial five years and be reappointed for a further two years. The audit manager will be able to be appointed for a maximum of ten years. After these periods, these key audit staff will not be able to work with the local public body for a further five years.

The proposal is reasonable.

6.5 Resignation or Removal of an Auditor

There will be rigorous, transparent processes for auditor resignation or removal, designed to protect auditor independence, quality of audit, and accountability to the electorate. These broadly mirror those in the Companies Act, but are adapted to reflect the principles of public audit.

The proposal is reasonable.

6.6 Scope of Local Public Audit and Auditors' Work

- The scope of local public audit will remain broadly similar. As now, auditors of local public bodies will be required to satisfy themselves that the accounts have been prepared in accordance with the necessary directions, proper practices have been observed in the compilation of the accounts, and the body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- The detail of how auditors should fulfil these requirements will, as now, be set out in a code of audit practice. The value for money component should be more risk based and proportionate based on evidence provided by the local body.
- The duty for auditors of local public bodies to undertake Public Interest Reporting will be retained, as will their ability to charge audited bodies for reasonable work.

- Auditors will be permitted to provide non-audit services to the audited body, subject to adhering to the Auditing Practices Board's ethical standards and the Independent Auditor Appointment Panel's approval.
- The local public auditor and the Independent Auditor Appointment Panel will be defined as designated persons under the Public Interest Disclosure Act [relates to whistleblowing], to enable individuals to make disclosures under the Act.
- The new framework will retain the rights of local electors to make formal objections to the accounts, but give auditors greater discretion regarding whether to pursue an objection.

The proposals are appropriate

6.7 Non Audit Functions of Audit Commission

- Following the Audit Commission's closure, Government considers that for new grants, the grant paying bodies should agree certification arrangements with grant recipients and auditors.

The approach is reasonable, and Government Departments should seek to rely upon certification from the LA's Director of Finance or Head of Internal Audit.

- Government proposes to continue the National Fraud Initiative, and is discussing with partners and the local public sector about how best to achieve this.

This initiative should be continued as it provides a valuable service in relation to the detection of fraud.

- The Government considers that there is scope for rationalisation in the number of these value for money studies compared to the number previously undertaken and would like to see a coherent and complementary programme of offerings across all providers.

The proposal is appropriate

7. Implementation and Next Steps

7.1 In progressing the proposals the Government intends to:

- hold further discussions with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented;

An event with the ANEC Leaders was held on 27th January 2012 to seek their views. The Executive Director of Commercial and Corporate Services attended this event and will update Members at the Committee meeting.

- publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament.

7.2 The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice. The outsource contracts will start from 2012-13 and are expected to run for three or five years giving local councils the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

8. Audit Commission's View of the Government's Response

8.1 The Audit Commission states that it has had a constructive dialogue with DCLG in developing the proposals and a lot of progress has been made, but there is still further work to do in a number of areas:

- It is still unclear how the proposed statutory Independent Audit Appointment Panels (IAAP), which may be shared with a number of other local public bodies, will operate. How they will relate to existing governance structures of individual bodies also remains to be worked out. It is considered they are not yet an adequate substitute for proper independent appointment of auditors.
- There is a potential 'accountability gap' in the proposals. A mechanism needs to be developed to ensure Departmental Accounting Officers continue to receive the assurance they have from the Commission's regime, that the billions of pounds of public money given to local public bodies have been safeguarded, accounted for properly and spent for the purposes intended.
- The proposed regulatory framework provides for three separate agencies - the National Audit Office (NAO), the Financial Reporting Council (FRC) and Recognised Supervisory Bodies - to discharge the Commission's current regulatory functions in relation to local public audits. It is not clear that this would be more effective, or cheaper, than a single, integrated regulatory body.

9. Recommendations

9.1 Members are asked to note the report.

Background Papers

Consultation on Local Public Audit – Audit and Governance Committee 30th June 2011

Government response to the future of local audit consultation (DCLG) – January 2012