

**AUDIT AND GOVERNANCE COMMITTEE**

**30 June 2011**

**CONSULTATION ON LOCAL PUBLIC AUDIT**

**Report of the Executive Director of Commercial and Corporate Services**

**1. Purpose of Report**

- 1.1 To consider the draft response to the Department for Communities and Local Government's (DCLG) consultation on their vision for the future of local public audit.

**2. Background**

- 2.1 On the 13 August 2010 the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission, and refocus the audit of local public bodies on helping local people hold those bodies to account for local spending decisions.
- 2.2 The Secretary of State's aim is to replace the current, centralised audit systems managed by the Audit Commission, with a new decentralised regime, which will support local democratic accountability, and one that will also cut bureaucracy and costs, while ensuring that there continues to be robust local public audit.
- 2.3 On 30<sup>th</sup> March 2011 DCLG published a consultation document called "Future of local public audit", which set out proposals on the new audit framework where:
- audit quality is regulated within a statutory framework, overseen by the National Audit Office and the accountancy profession; and
  - local public bodies will be free to appoint their own external auditors with stringent safeguards for independence.
- 2.4 Given the size of the document a copy has not been included with this report but a copy can be viewed at:

<http://www.communities.gov.uk/publications/localgovernment/localpublicauditconsult>

This consultation runs until 30<sup>th</sup> June 2011.

2.5 The consultation does not cover the following functions, currently provided by the Audit Commission.

- Inspection and research activities will cease. The National Audit Office will be able to examine the impact of policies administered by local bodies.
- The appointed external auditor will be able to undertake value for money studies connected to audit work, with agreement of the audited body.
- Grant verification, operation of the National Fraud Initiative and the auditor function of reporting on Whole of Government Account returns.

### **3. Key Proposals**

3.1 The key proposals are:

- All local public bodies with a turnover of over £6.5m will appoint their own independent external auditor. This appointment would be made on the advice of an independent audit committee.
- External auditors would be regulated under a system which mirrors that of the audit of companies with a role for the Financial Reporting Council and the professional audit bodies. The National Audit Office will set the Code of Audit Practice which prescribes the way in which auditors are to carry out their functions.
- Principal local authorities would appoint their own external auditors, with decisions made by full council, taking into account advice from an independently chaired audit committee.

3.2 The draft response is attached for consideration and comment by the Committee before being submitted to DCLG.

3.3 At the meeting a short presentation will be made to the Committee of the substance of the proposals.

### **4. Recommendations**

4.1 Members are asked to consider and comment on the proposed response to DCLG.

### **Background Papers**

None

Question	Response
<p>Q1: Have we identified the correct design principles? If not, what other principles should be considered? Do the proposals in this document meet the design principles?</p> <p><i>Design Principles:</i></p> <ul style="list-style-type: none"> <li>• <i>Localism and decentralisation – freeing up local public bodies, subject to appropriate safeguards, to appoint their own independent external auditors from a more competitive and open market, while ensuring a proportionate approach for smaller bodies.</i></li> <li>• <i>Transparency – ensuring results of audit work are easily accessible to the public, helping local people to hold councils and other local public bodies to account for local spending decisions.</i></li> <li>• <i>Lower audit fees – achieving a reduction in the overall cost of audit.</i></li> <li>• <i>High standards of auditing – ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit.</i></li> </ul>	<p>It is considered that a number of the proposals in this document do not meet the design proposals set out. In particular:</p> <ul style="list-style-type: none"> <li>• Although many of the proposals may lead to reduced audit fees, additional costs will be borne elsewhere in relation to the potential remuneration of independent members and costs incurred by county/unitary councils if they are to take on responsibilities for administering and regulation of the audit of smaller bodies. This will result in costs not being reduced, but hidden.</li> <li>• There is some concern over whether some of the proposals could put at risk the independence that is central to public audit. The market for public sector audit will be extensive and this may have a negative influence on the judgements made by some auditors where the contract is important to their firm.</li> </ul> <p>Having considered the proposals in this document it seems that having a design principle solely around decentralisation will result in inefficiencies and a potential for variation in standards across the country. Many of the functions carried out by the Audit Commission will, by admission in this document, still need to be carried out but spreading these across a number of organisations would seem to be inefficient and potentially damaging to public confidence in the integrity of the arrangements.</p>

Question	Response
	<p>Having greater public accountability is seen to be appropriate but this needs to be implemented in a way that would give a real opportunity for the public to challenge public decision making. Many of the proposals, especially in relation to smaller bodies simply remove the overall system of regulation in place and will transfer the costs to other public bodies, albeit on a reduced scale.</p> <p>The new framework needs to have a balance of a proportionate approach with efficiency and real accountability.</p>
<p>Q2: Do you agree that the audit of probation trusts should fall within the Comptroller and Auditor General's Regime?</p> <p><i>Probation services, which used to be part of Local Government's remit, have been the responsibility of central government since consolidation into the Home Office in 2000/01. The financial results of probation trusts have been consolidated into the National Offender Management Service accounts, which are audited by the Comptroller and Auditor General.</i></p>	<p>Yes</p>
<p>Q3: Do you think that the National Audit Office would be best placed to produce the Code of Audit Practice and the supporting guidance?</p> <p><i>Under the current system the Audit Commission sets audit standards through the Codes of audit practice for the local government and health sectors, which are approved by Parliament. These codes build on the ethical, auditing and other standards issued by the Auditing Practices Board. However, the codes contain additional standards to reflect the principles of public audit.</i></p>	<p>Yes</p>

Question	Response
<p><i>Standards for the audit of companies are set by the Auditing Practices Board (part of the Financial Reporting Council). The Auditing Practices Board is also responsible for setting the ethical standards for auditors in the private and public sectors.</i></p> <p><i>It is believed that the national Audit Office, given its role in providing Parliament with assurance on public spending, would be best placed to develop and maintain the audit Codes which would continue to be approved by Parliament.</i></p>	
<p>Q4: Do you agree that we should replicate the system for approving and controlling auditors under the Companies Act 2006 for statutory local public auditors?</p> <p><i>Currently, the Audit Commission regulates the quality of the work of auditors by setting minimum qualifications a public sector auditor must have in conjunction with standards set by the professional bodies for membership.</i></p> <p><i>As part of the statutory framework for the audit of companies the Professional Oversight Board (part of the Financial Reporting Council) acts as the main regulator with statutory powers for the recognition and supervision of those professional accountancy bodies responsible for supervising the work of auditors and offering an audit qualification. Recognised supervisory bodies are responsible for putting rules and arrangements in place which their members must fulfil before they can be registered auditors, both as regards eligibility for appointment as a statutory auditor and the conduct of statutory audit work..</i></p>	<p>It is not a matter of replicating a current system but ensuring that whatever system is put in place is appropriate in the public arena. It is considered that there is merit in retaining a national process for the independent appointment of auditors to local public bodies, to not only ensure independence but also to keep down the costs of procurement. This could usefully be performed by the National Audit Office working with OGC Buying Solutions.</p>
<p>Q5: Who should be responsible for maintaining and reviewing the register of statutory local public auditors?</p> <p><i>The Institute of Chartered Accountants for Scotland maintains the list of registered auditors for the whole of the UK on behalf of the recognised supervisory bodies (for the requirements of the Companies Act).</i></p>	<p>A single body should be responsible for maintaining the register.</p>

Question	Response
<p>Q6: 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?</p>	<p>All firms undertaking public sector audit need to be competent in undertaking the audits and understand the accounting requirements in the public sector. It will be for the firms in the market to demonstrate that they can fulfil this requirement during the appointment process. Firms may wish to employ auditors with the relevant experience to widen their chances of success. As the public sector now needs to comply with IFRS as in the private sector it is considered that the impact on firms will be minimal.</p>
<p>Q7: 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?</p>	<p>The most important factor is that they understand and comply with the principles of independence as set out in paragraph 1.19 of the consultation document. This will be more difficult to demonstrate, but it is essential to be incorporated.</p>
<p>Q8: 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 the local audit regulation?</p> <p><i>In the private sector some companies that are of public significance because of the nature of their business, their size, or their number of employees can be designated as 'public interests entities'. In the case of these bodies, the Professional Oversight Board has an additional role in monitoring the quality of the auditing function and the Accountancy and Actuarial Board has a role in investigating public interest disciplinary cases and imposing sanctions to those found guilty of misconduct.</i></p>	<p>All local Council, pension funds and health bodies, but not including Parish Councils, burial boards and joint committees with a threshold under the value set out below.</p> <p>The role of the Audit Inspection Unit of the Financial Reporting Council should remain in place.</p>

Question	Response
<p>Q9: There is an argument that by their very nature all 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?</p>	<p>Yes, all local Council, pension funds and health bodies, but not including Parish Councils, burial boards and joint committees with a threshold of £6.5m.</p>
<p>Q10: What role should the role of the regulator be in relation to any local bodies treated in a similar manner to the public interest entities?</p>	<p>The regulator should have a role in relation to the scope and execution of the audit provided, the public body's response to the issues raised, but in particular to the appointment process for the auditor. Given the nature of public bodies and in the interests of transparency the process for appointing the auditor and the ongoing relationship should be demonstrated as being fully independent. There should also be a maximum period of contract between the public body and the auditor.</p>
<p>Q11: Do you think the arrangements we set out are sufficiently flexible to allow Councils to co-operate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?</p> <p><i>Under the current system, all auditors of local public bodies are appointed by the Audit commission. Under the Companies Act the annual general meeting must agree a resolution on the appointment of the auditor, based on a recommendation from Directors and input from the audit committee.</i></p> <p><i>The proposed approach is, for larger public bodies, the appointment is made by full council or equivalent, on the advice of an audit committee with opportunities for the electorate to make an input. It is considered that local public bodies will wish to co-operate to ensure that there is wide competition for external audit contracts and that local public bodies will want to work together to procure an external auditor.</i></p>	<p>Although the proposed arrangements regarding appointing auditors are flexible this needs to be handled appropriately regarding compliance with the Public Procurement Regulations.</p> <p>In addition, expecting public bodies to work together to procure external auditors may lead to large contracts being let which may restrict the ability of small firms to compete for them.</p> <p>The consultation document also makes one reference to joint audit committees. It is not clear what is intended by this. It could prove difficult for audit committees working for more than one larger public body to be effective due to the different priorities and objectives of each body and</p>

Question	Response
	<p>the culture and environments operating within the bodies. It should be recognised that public sector audit committees have roles which are far wider than just considering external audit issues.</p>
<p>Q12: Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?</p> <p><b>Structure of audit committees</b>  <i>We envisage that in the new system, an audit committee could be structured in the following way:</i></p> <ul style="list-style-type: none"> <li>• <i>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.</i></li> <li>• <i>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).</i></li> <li>• <i>There would be a majority of members of the committee who were independent of the local public body.</i></li> </ul> <p><b>Independent members of the committee</b>  <i>When choosing an independent member of the committee, a person can only be considered for the position if:</i></p> <ul style="list-style-type: none"> <li>• <i>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</i></li> <li>• <i>is not a member nor an officer of that or any other relevant authority</i></li> <li>• <i>is not a relative nor a close friend of a member or an officer of the body/authority</i></li> <li>• <i>has applied for the appointment</i></li> <li>• <i>has been approved by a majority of the members of the council</i></li> <li>• <i>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.</i></li> </ul>	<ul style="list-style-type: none"> <li>• It is agreed that it is good practice for the Chair and Vice Chair to be ‘independents’</li> <li>• Apart from the requirement above re the Chair/vice Chair it is not considered necessary to mandate a majority of ‘independent’ members. This should be left to the discretion of the Authority.</li> <li>• It is recognised good practice to have one member of the Audit Committee from the Executive. This should be considered.</li> <li>• Re ‘is not a relative nor a close friend of a member or an officer of the body/authority’. This is considered to be too wide as many larger public bodies may have thousands of employees, many of which will not be in a position to impact on the decision making arrangements of the body. It is considered that any relationship with an officer or member of the body should be disclosed so that a view can be taken in individual circumstances.</li> </ul>



Question	Response
<p>Q13: 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?</p>	<p>As long as there is a reasonable level of relevant financial expertise it is not necessary to stipulate which members bring this.</p> <p>The requirements of the International Financial Reporting Standards which public bodies are now required to comply with means the accounting statements are larger and more complex. A simplified statement will therefore be necessary for presentation to members. We must be wary of restricting the pool of independent members to those with financial expertise only recognising the wider role of an Authority's Audit Committee, e.g. corporate governance, risk management.</p>
<p>Q14: Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and if so, at what level?</p>	<p>To attract interest from suitable candidates with relevant financial expertise it is considered that remuneration would be necessary.</p>
<p>Q15: 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 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?</p> <p><b>Option 1</b>  <i>We could specify only one mandatory duty for the local public body's 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.</i></p> <ul style="list-style-type: none"> <li><i>It would then be left up to the local public body and the audit committee to decide whether the audit committee should have a wider role in other issues, e.g. setting a policy on the provision of non-audit services by the statutory auditor or reviewing the relationship between the auditor and</i></li> </ul>	<p>If the appointment of the auditor is not taken on the advice of the Audit Committee then the benefit of the independent members is lost. Therefore, the arrangements in place need to be robust enough to ensure that appointment is made based on the evaluation and the procurement process, not based on subjective judgements. It is not clear how the full Council could lawfully award the contract to a firm that had not 'won' the tender following a tender process in line with the Public Procurement Regulations.</p> <p>It is considered that Option 1 is sufficient, however each</p>

Question	Response
<p><i>the audited body.</i></p> <ul style="list-style-type: none"> <li>• <i>This option would ensure that the audit committee provided advice to the local public body at crucial moments, but would allow the local public body and the audit committee flexibility to decide on any other functions it may carry out. However, if only the minimum was followed, this may not provide an adequate check on ongoing independence through the auditor's term.</i></li> </ul> <p><b>Option 2</b></p> <p><i>We could specify a much more detailed mandatory role for the audit committee which could include, but may not be restricted to the following:</i></p> <ul style="list-style-type: none"> <li>• <i>providing advice to the full council on the procurement and selection of their external auditor</i></li> <li>• <i>setting a policy on the provision of non-audit work by the statutory auditor</i></li> <li>• <i>overseeing issues around the possible resignation or removal of the auditor</i></li> <li>• <i>seeking assurances that action is being taken on issues identified at audit</i></li> <li>• <i>considering auditors' reports</i></li> <li>• <i>ensuring that there is an effective relationship between internal and external audit</i></li> <li>• <i>reviewing the financial statements, external auditor's opinions/conclusions and reports to members and monitor management action in response to the issues raised by external audit</i></li> <li>• <i>providing advice to the full council on the quality of service they are receiving</i></li> <li>• <i>reporting annually to the full council on its activities for the previous year</i></li> </ul> <p><i>This option would provide more assurance about the independence of the relationship between the audited body and its auditor, it would also ensure that the audit committee had a wider role in reviewing the financial arrangements of the local public body</i></p>	<p>Authority should be able to determine, at its discretion, the full role of the Audit Committee in line with published good practice (e.g. CIPFA Code).</p>
<p>Q16: Which option do you consider would strike the best balance between a localist approach and a robust role for the audit committee in ensuring the independence of the auditor?</p>	<p>See answer to Q15.</p>

Question	Response
<p>Q17: Are these appropriate roles and responsibilities for the Audit Committee/To what extent should the role be specified in legislation?</p>	<p>Roles are appropriate. Responsibilities regarding the appointment, ongoing relationship and removal of the auditor should be specified in legislation or a Code of Practice.</p>
<p>Q18: 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?</p>	<p>Statutory code.</p>
<p>Q19: Is this a proportionate approach to public involvement in the selection and work of auditors?</p> <p><b>Pre - appointment</b>  <i>The audited body could ask for expressions of interest from audit firms for the audit contract one month prior to the publication of the invitation to tender. The list of those firms that have expressed an interest would then be published on the audited body's website. The public would then be able to make representations to the audited body's audit committee about any of these firms. The audit committee would consider these representations when providing advice to the full council or equivalent.</i></p> <p><b>Post - appointment</b>  <i>The public would be able to make representations at any time to the local public body's audit committee. If a representation identified a significant, or potentially significant, issue relating to the auditor, then the audit committee would be able to provide advice to the audited body on that issue and investigate as appropriate. If the issue identified was material to the ongoing work of the auditor (such as an undisclosed material conflict of interest) then the audited body would need to take such steps as appeared necessary, in accordance with the terms of the contract with the auditor, to address that issue. We may also wish to specify in legislation some statutory requirements relating to conflicts of interest.</i></p>	<p>It is not clear how the pre-appointment process would add any value to the appointment process. Any valid issues relating to the competence or suitability of the bidders would be tested as part of the procurement process. It is not clear how any representations made by a member of the public separate to the formal tender process could legally make any difference to the outcome.</p> <p>Proposed arrangements for post appointment are considered to be appropriate but it is considered that statutory requirements should be made.</p>

Question	Response
<p>Q20: How can this process be adapted for bodies without elected members?</p> <p><i>For Police and Crime Commissioners (and Mayor's Office for Policing and Crime) and Chief Constables (and Commissioner for London) we are considering whether the Police and Crime Panel should have a role similar to that of the audit committee. Arrangements for the audit of these policing bodies will be finalised once the Police Reform and Social Responsibility Bill has completed its passage.</i></p>	<p>Ensure there is an independent group which can provide advice to the decision makers of the organisation, as with companies.</p>
<p>Q21: Which option do you consider provides sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?</p> <p><i>Failure to appoint an auditor:</i></p> <p><b>Option 1</b> <i>In these circumstances we propose that the Secretary of State would be able to direct the local public body to appoint an auditor.</i></p> <p><b>Option 2</b> <i>Alternatively, where a local public body does not fulfil its duty to appoint an auditor the Secretary of State could be provided with the power to make the auditor appointment. 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.</i></p>	<p>Option 1 is considered sufficient. However, this should be a reserve power and used as a last resort.</p>
<p>Q 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?</p>	<p>Local public bodies should be required to inform a relevant body (e.g. DCLG) when they have appointed an auditor.</p>
<p>Q23: If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?</p>	<p>It is considered that one body should be specified to be notified of the appointment of auditors to ensure that there is a comprehensive and transparent approach (i.e. DCLG for LA's).</p>

Question	Response
<p>Q24: Should any firm's term of appointment be limited to a maximum of two consecutive five year periods?</p> <p><i>In the case of listed companies, the audit firm must have policies and procedures so that:</i></p> <ul style="list-style-type: none"> <li>• <i>no-one shall act as audit engagement partner for more than seven years and</i></li> <li>• <i>anyone who has acted as the audit engagement partner for a particular entity for a period of seven years, shall not subsequently participate in the audit engagement with that entity until a further period of five years has elapsed</i></li> </ul> <p><i>The audit committee of a company assesses the independence and objectivity of the external auditor annually, taking into consideration regulatory and professional requirements. This assessment involves a consideration of all relationships between the company and the audit firm (including the provision of non-audit services) and any safeguards established by the external auditor. The audit committee seeks from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners and staff.</i></p> <p><i>It is proposed that in relation to the rotation of the firm, an audit firm 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. A different firm would need to be procured after the second five year period.</i></p>	<p>It is considered that a firm being appointed for a maximum of 10 years should be the maximum, with consideration being given to a less period for rotation of lead partner within the firm (e.g. 5 years).</p> <p>Unless the firm is appointed for an annual contract it is not clear how they can then be reappointed annually without going through a procurement process. There could be a requirement for the Audit Committee to confirm to full council on an annual basis there are no issues that would mean the auditor should be dismissed. Arrangements for the dismissal of the auditor would need to be specified in the contract documentation</p>
<p>Q25: 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?</p>	<p>The above should be sufficient to ensure independence.</p>
<p>Q26: Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and the audited body to build a relationship based on trust whilst ensuring the correct degree of independence?</p>	<p>Yes (see above).</p>

Question	Response
<p>Q27: 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?</p> <p><b>Resignation</b>  <i>The audited body and the auditor should discuss and seek to resolve any concerns. If the auditor still wished to resign he should give 28 days written notice of his intention to the audit committee and the audited body, setting out his intention to resign. The audited body should then make a written response, which it should send with the auditor's written notice, to its members and the audit committee. The auditor will then be required to deposit a statement at the audited body's main office and with the audit committee, which should be published on its website. The statement would set out the circumstances connected with the resignation of the office that are relevant to the business of the audited body. The audited body would need to notify the body responsible for maintaining the register of appointed auditors, and the auditor will need to notify the appropriate regulatory supervisory body. We envisage a role for the audit committee and the regulatory supervisory body in investigating the issues that have led to the resignation and considering whether any action is required.</i></p> <p><b>Removal</b>  <i>Again, we envisage that in the first instance, the audited body and the auditor should discuss and seek to resolve any concerns. If the audited body still wished to remove its auditor, it should give 28 days written notice of its intention to the audit committee and to the auditor. The audited body should put to a public meeting, or full council meeting, a resolution to remove the auditor. The audited body would also send a copy of this notice to the auditor.</i></p> <p><i>The auditor would then have the right to make a written response, which the body would need to send to its members and the audit committee, and to speak at the meeting where the resolution is to be considered. A representative from the audit committee should also be able to speak at the meeting. The auditor would be required to deposit a statement at the audited body's main office and with the audit committee, which would need to be published on its website. This statement</i></p>	<p>It is considered that the auditors should not be removed without consideration and agreement of the Audit Committee.</p>

Question	Response
<p><i>would set out the circumstances connected with the cessation of their office that are relevant to the business of the audited body. The audited body would need to notify the appropriate regulatory supervisory body. We envisage a role for the audit committee and the regulatory supervisory body in investigating the issues that have led to the removal and considering whether any action is required.</i></p>	
<p>Q28: 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?</p> <p><i>In the companies sector, the Companies Act provides that general provisions that protect auditors from liability for negligence, default, breach of duty or breach of trust in relation to the company, or provide an indemnity against liability are void, but:</i></p> <ul style="list-style-type: none"> <li><i>• does not prevent a company from indemnifying an auditor against any costs incurred by him in defending proceedings in which judgment is given in his favour or in the granting of relief by the court in the case of honest and reasonable conduct</i></li> <li><i>• allows for a “liability limitation agreement” to be put in place if it is authorised by the members of the company, provided it complies with the content permitted in the Companies Act</i></li> </ul> <p><b>Proposals:</b>  <i>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, similar to that in the companies sector, 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.</i></p>	<p>Similar arrangements should be put in place.</p>

Question	Response
<p>Q29: 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?</p> <p><b>Option 1</b>  <i>The scope of audit could be reduced to be more in line with that for companies, with no assessment of value for money. The auditor would:</i></p> <ul style="list-style-type: none"> <li>• <i>give an <b>opinion</b> on whether the financial statements give a true and fair view of the audited body's financial position and of its income and expenditure; and</i></li> <li>• <i>review, and report on as appropriate, other information published with the financial statements, including the statement on internal control/annual governance statement, the remuneration report and the whole of government accounting summarisation schedules</i></li> </ul> <p><i>This option would reduce the information available to local citizens on how local bodies are spending their money or on whether bodies are securing value for money.</i></p> <p><b>Option 2</b>  <i>As under the current system, the auditor would:</i></p> <ul style="list-style-type: none"> <li>• <i>give an <b>opinion</b> on whether the financial statements give a true and fair view of the audited body's financial position and of its income and expenditure</i></li> <li>• <i>provide a <b>conclusion</b> as to whether it has the proper arrangements in place to secure value for money (based on locally defined policy priorities) having regard to specified criteria (including financial resilience and regulatory and propriety); and</i></li> <li>• <i>review, and report on as appropriate, other information published with the financial statements, including the statement on internal control/annual governance statement, the remuneration report and the whole of government accounting summarisation schedules</i></li> </ul>	<p>It is considered that option 2 would be the most appropriate option. However, the VFM work should have a tight scope and be proportionate to the body under review, including seeking reliance upon other sources of information, e.g. performance information, satisfaction surveys, benchmarking information, work of other inspectorates and internal audit.</p>



Question	Response
<p><i>This option would maintain the current scope of audit. However, this option would not provide any additional information to local citizens on how local public bodies are spending their money or on whether bodies are securing value for money.</i></p> <p><b>Option 3</b>  <i>New arrangements could provide stronger assurances on the way local public bodies spend money. Under this option, the auditor would still give an <b>opinion</b> on the financial statements, but would provide <b>conclusions</b> on:</i></p> <ul style="list-style-type: none"> <li><i>• regularity and propriety – a conclusion on compliance with relevant laws and regulations and the audited body’s governance and control regime</i></li> <li><i>• financial resilience – a conclusion about the future financial sustainability of the audited body; and</i></li> <li><i>• value for money – in addition to proper arrangements in place to secure value for money, a conclusion about the achievement of economy, efficiency and effectiveness within the audited body</i></li> </ul> <p><i>We will need to consider carefully how a stronger value for money element to the audit would fit with other sectors, such as policing, who already have alternative systems for examining and reporting value for money publicly.</i></p> <p><b>Option 4</b>  <i>Local public spending should be transparent so that citizens can hold bodies to account. Companies are required, by law, to produce and publish an annual report, including the principal activities of the company during the year, and a business review which includes risks and uncertainties. Most public bodies also produce such a report, although local authorities are not currently required to do so.</i></p> <p><i>Under this option, all local public bodies would be required to produce an annual report and to publish this report on their website. The report would set out the arrangements the audited body</i></p>	

Question	Response
<p><i>had put in place to secure value for money, whether they had achieved economy, efficiency and effectiveness, regularity and propriety and financial resilience.</i></p> <p><i>The auditor would be required to:</i></p> <ul style="list-style-type: none"> <li><i>• give an opinion on the financial statements</i></li> <li><i>• review the audited body's annual report; and</i></li> <li><i>• provide reasonable assurance on the annual report</i></li> </ul> <p><i>The annual report could be written in an accessible way and would be published. This option could therefore substantially increase the transparency of the local public bodies, compared to options 1 and 2. Citizens' increased knowledge of the local public body's financial performance could help drive greater local accountability. We would need to consider whether producing an annual report in an appropriate format would be a new burden for local authorities that do not currently produce an annual report in an appropriate format.</i></p>	
<p>Q30: Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?</p>	<p>Yes, to demonstrate how their plans will improve the lives of local people and how this has been developed in line with the wishes of local people. To provide appropriate and proportionate measuring of how these outcomes have been achieved.</p>
<p>Q31: 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?</p>	<p>If an annual report is to be produced it is essential that it is clear and not overly complex so that it will be useful for local people. Demonstrating financial resilience, regularity and propriety and value for money may be difficult in this context and local people may be sceptical of its accuracy. It may be more appropriate for a separate statement to be published by the external auditor regarding their opinion on these matters.</p>

Question	Response
<p>Q32: Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?</p>	<p>It should be "reasonable". This will be important to ensure that the audit arrangements are credible.</p>
<p>Q33: What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?</p>	<p>The guidance should include the minimum level of information to be provided and the scope.</p> <p>It should be produced by DCLG.</p>
<p>Q34: 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?</p> <p><i>We consider it is important that the duty on an auditor to consider whether to make a report in the public interest should be retained. Public interest reports are a key part of the current audit system and provide a vehicle through which the public are made aware of issues of significant interest to them. This is consistent with the design principles of localism and transparency. All other requirements to be retained.</i></p> <p><i>It has been suggested that the new direct contractual relationship between the audited bodies and their auditors could have, if unchecked, an impact on the ability or willingness of the auditor to issue a public interest report. However, we believe that if suitable safeguards are put in place for the resignation or removal of auditors, this will mitigate the risk.</i></p>	<p>As response to Q27, it is considered that the safeguards will not be sufficient to mitigate the risk of the auditor independence being compromised.</p>
<p>Q35: 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?</p> <p><i>We propose that auditors will be able to provide non-audit services to the audited body, but safeguards will be built into the system to prevent any actual or perceived threats to the auditor's independence. We recognise that by adding a number of safeguards into the system we could</i></p>	<p>Auditors should be able to provide audit related services but not other services to a local public body for which they are providing external audit services.</p>

Question	Response
<p><i>reduce the number of auditors eligible for appointment to an audited body, which would in turn affect competition.</i></p> <p><i>We propose that auditors should continue to adhere to the ethical standards produced by the Auditing Practices Board and permission should be sought from the audit committee who would provide advice to the body on whether non-audit work should be undertaken as well as continuing to monitor the relationship between the auditor and the audited body.</i></p>	
<p>Q36: Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?</p>	<p>Yes, given comments above.</p>
<p>Q37: 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?</p> <p><i>The Audit Commission is a 'prescribed person' as set out in the Schedule to the Public Interest Disclosure Act. It exercises this role by:</i></p> <ul style="list-style-type: none"> <li><i>• receiving the facts of a disclosure</i></li> <li><i>• supporting the discloser by referring them to Public Concern at Work for further advice and guidance if subjected to victimisation or harassment</i></li> <li><i>• acknowledging receipt of the disclosure and stating in general terms what the procedures are</i></li> <li><i>• forwarding information to the auditor and inform the discloser</i></li> </ul> <p><i>The current role of the appointed auditor includes:</i></p> <ul style="list-style-type: none"> <li><i>• evaluating the information provided by the Commission</i></li> <li><i>• acknowledging receipt to the discloser, and providing an indication of the likely response, with an explanation for the decision</i></li> </ul>	<p>The scope of issues that could be raised under the Public Interest Disclosure Act are wider than the role of the external auditor and audit committee and therefore we do not consider that independent members would wish to take on this role.</p> <p>It is considered that this role should be taken on by the Monitoring Officer (or equivalent) within an Authority.</p>

Question	Response
<ul style="list-style-type: none"> <li>• <i>undertaking appropriate audit work in response to the disclosure</i></li> <li>• <i>reporting the outcome of any work to the discloser and the Commission</i></li> </ul> <p><i>We propose that the Audit Commission’s role (receiving, acknowledging receipt of and forwarding the facts of disclosure) should be broadly transferred to the audit committee of the local public body. The audit committee may chose to designate one of its independent members as a point of contact. As this role is an administrative role, which involves no need to consider the issue they are transferring, we do not see this as an additional burden on audit committees.</i></p> <p><i>We envisage that the statutory auditor of the local public body would continue to be a prescribed person and would continue with his/her role with no change from the current system.</i></p>	
<p>Q38: Do you agree that we should modernise the right to object to the accounts, If not, why?</p> <p><i>Members of the public currently have rights to question the auditor of an audited body about its accounts and raise objections. Auditors have only limited discretion to refuse to investigate objections, but the costs of investigating objections, which are recovered from the local public body and, therefore, funded by council taxpayers, can be disproportionate to the sums involved in the complaint, or to the normal audit costs of the local public body.</i></p> <p><i>The public can now raise concerns through a wide variety of appropriate avenues for redress, including the Local Government Ombudsman (in relation to maladministration) and the Information Commissioner (on matters concerning the rights that individuals have under the Freedom of Information and Data Protection Acts). Publication of all expenditure over £500 also makes spending more transparent and more readily available to the public. With this in mind, we consider 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.</i></p> <p><i>While the right to make formal objections would be removed, the local public body would still be</i></p>	<p>Yes, the current arrangements are open to abuse and there are other avenues for the public/interested parties to obtain details of the Authority’s finances, e.g. FOI’s.</p>

Question	Response
<p><i>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.</i></p> <p><i>We propose 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. Therefore, only information in connection with a public audit would be within the remit of a freedom of information request. However, we recognise that there are costs associated with responding to freedom of information requests which could have an impact on audit fees. We would also need to consider whether this could be detrimental to the auditor and audited body's relationship.</i></p>	
<p>Q39: 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?</p>	<p>In the main, yes. It is not desirable to bring the external auditors work under the remit of the FOI Act, as this will lead to increased costs. The public/interested parties can obtain information through other routes, e.g. direct from the Authority.</p>
<p>Q40: 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 not?</p>	<p>See answer to Q39.</p>
<p>Q41: 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)?</p>	<p>This would create additional expense and is unnecessary.</p>
<p>Q42: Which Option provides the most proportionate approach for smaller bodies under our proposals?</p>	<p>Something that needs to be considered in relation to this issue is that the fundamental difference between</p>

Question	Response
	<p>companies and charities and public bodies of any size is that the public cannot decide whether or not to give money to the public body. There still needs to be an appropriate level of assurance of the propriety of the funds and therefore the independent examiner should be appropriately experienced to consider propriety issues.</p> <p>Option 1 would be proportionate for the smaller bodies but this could be a significant amount of work for the Unitary/County Council. Some rural Counties have over 100 Parish Councils and small bodies in their areas and this could be a significant piece of work, especially if no charges can be levied to the smaller bodies. There would be procurement costs if an outside provider was procured who would need to be paid. If an officer/s of the authority carried out this piece of work this could mean a significant amount of time required in some areas which would need to be funded by the council.</p> <p>Option 2 of small bodies coming together may be more cost effective but would still need to be managed by one of the bodies to make it work effectively.</p>
<p>Q43: Do you think the county or unitary authority should have the role of the 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 the advice provided by the audit committee? What additional costs could this mean for the county or unitary authorities?</p>	<p>See comments above</p>

Question	Response
<p>Q44: What guidance would be required to enable county/unitary authorities to:</p> <p>a) appoint independent examiners for the smaller bodies in their areas?</p> <p>b) Outline the annual return requirements for the independent examiners?</p> <p>Who should produce and maintain this guidance?</p>	<p>Guidance should include the required experience and qualifications of the independent examiner and the scope of the checks to be carried out.</p> <p>This guidance should be produced by the DCLG, with consultation with CIPFA and practitioners.</p>
<p>Q45: Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?</p>	<p>Only if carried out by an audit committee representing a number of smaller bodies.</p>
<p>Q46: 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?</p>	<p>Another option would be an independent examiner/auditor appointed by the DCLG for all small bodies for a specified period of time, or a central framework of providers, appointed independently who could be approached by each smaller body.</p>
<p>Q47: 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?</p>	<p>The four level approach is not too complex. The proposed threshold of £6.5m for smaller bodies seems reasonable.</p>
<p>Q48: 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 council is not the precepting authority?</p> <p><i>There would be no auditor to receive queries or objections from the public, and there would be no public interest reporting. However, if the examiner identified issues giving cause for concern we propose that these could be raised with the audited body, or the county or unitary authority. The county or unitary authority could be given the power to appoint an auditor to then carry out a public interest report on the matters raised with the audited body. Sanctions could include a power to make the next precept (partly or wholly) conditional on the matters raised being addressed.</i></p>	<p>Given the number of smaller bodies affected (9,900) this does not seem to be consistent with the principle of transparency. There should be an identified person or organisation who could receive representations in relation to smaller bodies.</p> <p>Could the local government ombudsman fulfil this role, where there is no lead authority?</p>



Question	Response
<p>Q49: 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?</p> <p><i>For bodies with an income or expenditure greater than £6.5 million we are proposing to modernise the system for dealing with objections to accounts. In the case of smaller bodies, we propose that the independent examiner would be able to consider whether to refer issues raised by citizens to the proper officer (possibly the s151 officer) of the county or unitary authority. That authority would be provided with powers to take action, which might include appointing an auditor to consider those issues and report in public to the examined body. The costs for dealing with the representation would fall to the smaller body.</i></p>	<p>As above. The question is how would the public know who the independent examiner is and how to contact them. Unless there is advertising of the examiner and the period of examination this would not be practical.</p> <p>Having the county or unitary authority deal with these issues would lead to additional costs being borne by the council. How would this be dealt with for bodies which straddle local authority boundaries?</p>
<p>Q50: Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?</p> <p><i>Regulatory regime for smaller bodies</i>  <i>For smaller bodies the more proportionate approach described of independent examination would not give rise to the same level of scrutiny as an external audit. However, if appointing the independent examiner to the smaller body, or if provided with powers to take action, which might include appointing an auditor to carry out a public interest report, the county or unitary council would, essentially, be the regulator for this sector.</i></p>	<p>As mentioned in previous responses, this could result in a significant workload for county/unitary councils, especially those who have many small bodies in their areas. A charge for this would need to be considered.</p> <p>If the additional work in relation to this is not recognised this could cause difficulties for the councils at a time when resources are being significantly reduced. Therefore, the ability for this regulation to be carried out effectively could be at risk.</p>

