

Report to	Audit Committee
Date	20 June 2011
By	Director of Corporate Services
Title of Report	Future of Local Public Audit
Purpose of Report	To report the government consultation on the future of external audit arrangements

Recommendation: The Committee is recommended to:

- 1) Note the consultation paper on local public audit; and**
 - 2) Determine what response it wishes to make to the consultation paper.**
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1. Introduction

- 1.1 The Secretary of State for Communities and Local Government has announced plans to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice into the private sector and put in place a new local audit framework.
- 1.2 The Department for Communities and Local Government (DCLG) has issued a consultation paper on how a new local audit framework could work.
- 1.3 This report sets out the main areas covered in the consultation and focuses on those aspects which are of particular relevance to the South Downs National Park Authority and this Audit Committee.
- 1.4 In addition to any general points there are two particular areas – the role and membership of the future audit committees - where the Audit Committee may wish to make a response.

2. Background

- 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 Audit Commission's in-house practice into 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.
- 2.2 In March 2011 the Department for Communities and Local Government issued a consultation paper on the government's proposals on how a new local audit framework could work and to seek views.

3. Current arrangements

- 3.1 The consultation paper sets out the wide range of public bodies subject to (external) audit and the role of the Audit Commission in appointing auditors (including some 70% in-house). The government has concluded that the current arrangements, whereby a single organisation is the regulator, commissioner and provider is unnecessarily centralised, has a lack of transparency and there are potential conflicts of role.

4. Proposed arrangements

- 4.1 The consultation proposals:

- Build on the statutory arrangements and technical standards applying to companies but adapted to maintain the principles of public sector audit;
 - Involve the National Audit Office preparing codes of audit practice;
 - Provide for principal local authorities to appoint their own auditors; and
 - Involve an independently chaired audit committee.
- 4.2 The design principles for the proposals are:
- Localism and decentralism;
 - Transparency;
 - Lower audit fees; and
 - Higher standards of auditing.
- 4.3 The consultation paper poses 50 questions for consultees. In the following text only the key topics are explored. The full document is available from the DCLG website.
- 4.4 Under the proposals there is a need to identify an organisation to produce the codes of audit practice for which the Audit Commission is currently responsible. The proposal is that this should be the National Audit Office (given its role in central government auditing). There are certain similarities between the two organisations however the NAO has had a very limited role in local authority audit work in the past
- 4.5 There will be a need to register auditors for public sector work. An overall regulator (probably the Financial Reporting Council) is proposed with responsibility for authorising professional accountancy bodies who would in turn put appropriate rules in place for their members before they could become auditors. This would mirror the arrangements under the Companies Act 2006. The accountancy bodies would be expected to monitor and enforce standards.
- 4.6 In relation to commissioning audit services, bodies with a turnover above £6.5m (which would include the SDNPA) would be required to appoint an auditor from a register of appropriately qualified auditors. Interestingly this spending threshold would mean that different arrangements could apply to a number of other National Parks which have a turnover below £6.5m
- 4.7 There is a section concerning the future structure of the Audit Committee. **Appendix 1** sets out a summary of the proposals and the three related questions. The Committee may wish to focus at least part of its response to the consultation on these questions.
- 4.8 The terms of reference of the audit committee are also explored. These are set out in **Appendix 2** again with the related questions.
- 4.9 Various options are set out in terms of the scope of the audit. This would always include an opinion on the accounts but could go further in relation to reviewing other information published alongside the accounts, and drawing conclusions on propriety or securing value for money. An element of one option would be to make it a requirement for the organisation to produce an Annual Report.
- 4.10 Under the current arrangements the Auditor is required to issue a report in the public interest on a significant matter coming to his/ her attention. The consultation paper proposes that this safeguard is retained.
- 4.11 In a section on transparency the government proposes to retain the right for members of the public to make representations to the auditor, raise issues with the auditor and to ask the auditor questions about the accounts. However the current right for a member of the public to make a formal objection to the accounts would be removed.
- 4.12 Other topics covered include:
- Opportunities for the public to comment on the suitability of the auditor;
 - Actions if an organisation fails to appoint an auditor;
 - Rotation of audit firms (annually appointed, new procurement every 5 years, no appointments of more than 10 consecutive years);
 - Removal of auditors from office;

- The liability of auditors;
- Ability of auditors to undertake non-audit work (safeguards are proposed); and
- Arrangements for the audit of smaller bodies (with a turnover of up to £6.5m) usually involving the appointment of an independent examiner.

5. Other implications

- 5.1 About 70% of the existing Audit Commission work is undertaken by the in-house practice. The Government was considering a range of options to transfer this work into the private sector.
- 5.2 On 2 June 2011 the DCLG Permanent Secretary wrote to Local Authority Chief Executives giving an update on the future of local audit. The Department had been looking at how to transfer the audit work from the Commissions' s in-house practice to the private sector. After considering options, the conclusion is that it is preferable to outsource the work to the private sector and the Audit Commission has been asked to begin preparatory work for outsourcing the 2012-13 audits. . The Commission has been asked to design a procurement process that allows a range of firms to bid, including the possibility of an in-house bid which could form the basis of a new employee owned mutual. This would mean that the Commission will be radically reduced by the end of 2012, leaving a small residuary body overseeing contracts until public bodies are in a position to appoint their own auditors.

6. Next steps

- 6.1 The consultation period ends on 30 June 2011. The government will publish a response to the consultation. It will then publish draft legislation on the proposals and undertake further consultation. Legislation will then be introduced at the earliest opportunity.

7. Resources

- 7.1 The consultation suggests that future audit fees will be lower although there is no supporting explanation of this.

8. Risk management

- 8.1 The main risk may be in any discontinuity arising from a change of auditor under these arrangements.
- 8.2 There may also be a risk of not being able to attract a sufficient number of independent member for the Audit Committee.

9. Human Rights, Equalities, Health and Safety

- 9.1 There are no implications arising from this report.

10. External Consultees

- 10.1 None.

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Appendices	Appendix 1 - Structure of audit committees Appendix 2 - Role of Audit Committee

SDNPA Consultees	Chief Executive Officer, Chief Finance Officer, Deputy Chief Finance Officer, Monitoring Officer & Senior Solicitor.
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Background Documents	Department of Communities and Local Government "Future of local public audit" March 2011
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Structure of audit committees

"We envisage that in the new system, an audit committee could be structured in the following way:

- 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.
- 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).
- There would be a majority of members of the committee who were independent of the local public body.

Independent members of the committee

When choosing an independent member of the committee, a person can only be considered for the position if:

- 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
- is not a member nor an officer of that or any other relevant authority
- is not a relative nor a close friend of a member or an officer of the body/authority
- 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 newspaper distributed in the local area and in other similar publications or websites that the body/local authority considered appropriate

Q12: Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?

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?

Q14: Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?"

Role of Audit Committee

Option 1

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.

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 the audited body.

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.

Option 2

We could specify a much more detailed mandatory role for the audit committee which could include, but may not be restricted to the following:

- providing advice to the full council on the procurement and selection of their external auditor
- setting a policy on the provision of non-audit work by the statutory auditor
- overseeing issues around the possible resignation or removal of the auditor
- seeking assurances that action is being taken on issues identified at audit
- considering auditors' reports
- ensuring that there is an effective relationship between internal and external audit
- 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
- providing advice to the full council on the quality of service they are receiving
- reporting annually to the full council on its activities for the previous year

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.

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 in paragraph 3.9 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?

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 independence of the auditor?

Q17: Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?"