

Audit Committee Meeting	Agenda Item:
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Meeting Date	25 May 2011
Report Title	Future of local public audit – consultation
Portfolio Holder	Performance and Finance
SMT Lead	Corporate Services Director
Head of Service	Head of Audit Partnership
Lead Officer	Head of Audit Partnership
Key Decision	No
Classification	Open

Recommendations	1. That the Audit Committee consider the key proposals on the Future of Local Public Audit and provide a steer to officers to allow a draft response to be prepared from the council to the consultation
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Purpose of Report and Executive Summary

1.1 The report and the attachment provide details of the consultation currently being conducted by the Department of Communities and Local Government on the future of local public audit. The Committee is being asked to consider the proposals and to provide a steer to officers to prepare a draft response from the council to the consultation.

2 Background

2.1 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 bodies to account for local spending decisions”.

2.2 The announcement 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

2.3 The Department of Communities and Local Government issued a consultation paper on 1 April 2011. The consultation paper closes on 30 June 2011.

2.4 The consultation paper sets out the proposals for the future provision of

external audit services to local government and other bodies following the decision to abolish the Audit Commission. The paper includes proposals relating to the future of audit committees. The consultation closes on 30 June 2011.

- 2.5 The Council is one of a whole range of organisations currently receiving an audit service from the Audit Commission that have been invited to respond on the proposals and the questions set out within the consultation paper.
- 2.6 There are 50 questions within the consultation paper. Some of the questions and proposals are quite technical in nature. This paper covers the more fundamental proposals of the scope of audit, the role of audit committees, and impacts for the audit of parish councils. Members are asked therefore to direct particular attention to these issues.

3 The Coalition Government's proposals

- 3.1 To require the National Audit Office to prepare Codes of audit practice, which prescribe the way in which auditors are to carry out their functions. Such Codes of practice will continue to be approved by Parliament. (This function is currently the responsibility of the Audit Commission).
- 3.2 To require the accountancy professional bodies, under the supervision of the Financial Reporting Council (FRC), to be responsible for the registration of audit firms, individual auditors able to undertake public audit and for the monitoring and enforcement of audit standards. (The FRC currently has this role for private sector audit work).
- 3.3 Principal local authorities, defined as those with annual income and expenditure over £6.5million, would appoint their own auditors with decisions made by full Council, taking into account the advice from a new independently chaired audit committee.
- 3.4 Smaller public bodies (e.g. parish councils) with annual income and expenditure below £6.5million would be subject to different audit requirements, an independent examination (typical of the audit arrangements for small charities and the like). These are set out in Section 5 of the consultation paper. Of particular note is the proposal for county councils rather than district councils (in the case of 'two-tier' areas) to maintain oversight of the appointment of independent examiners.
- 3.5 Local authority pension funds, in their own capacity, will be subject to the new local public audit framework, as opposed to being part of the external audit of the responsible authority (the county council in our case).

- 3.6 Local bodies will be able to commission additional services from their auditors, for example, value for money studies. However there will no longer be national studies in which local bodies must participate.
- 3.7 Grant certification, the National Fraud Initiative and the auditor function of the 'Whole of Government Accounts' returns will continue "in some form", but are not considered in detail in the consultation paper.

Consultation Questions

- 3.8 The consultation paper sets out fifty questions covering the range of the government's intentions for Local Public Audit. The questions are shown in full at Section 6 (page 56) of the consultation paper (Appendix 1).

Regulation of local public audit

- 3.9 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. The consultation papers discusses how other sectors regulate audit work and then makes a series of recommendations as to the future for local public audit.
- 3.10 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.
- 3.11 The Financial Reporting Council (FRC) will regulate who can undertake local public audit work through a system that is similar to the private sector, which is also regulated by the FRC. The new regulatory system will be set out in primary legislation.
- 3.12 It is proposed that there will 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. The list could be kept by the Recognised Supervisory Bodies (the main accounting bodies) or another body.
- 3.13 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

- 3.14 The consultation paper proposes that all larger local public bodies (defined as those with income/expenditure over £6.5million as in the revised Accounts and Audit Regulations) will be able to appoint its own auditor. The appointed

auditor must be on the register of local public statutory auditors.

- 3.15 The appointment will be made by Full Council, on the advice of an audit committee with opportunities for the electorate to make an input.
- 3.16 The consultation paper recognises that individual bodies might wish to cooperate on the appointment of an auditor and so it is proposed that the legislation should allow both joint procurement of audit services and joint audit committees (for the appointment).
- 3.17 To ensure that the relationship between a council and the auditor does not become too close, a system of rotation is proposed (a system of rotation is used currently). The auditor would be reappointed annually by the full council on the advice of the audit committee, but the audited body must undertake a competitive appointment process within five years. The council can, if it wishes, re-appoint the existing external auditor for a further five year period, but must appoint a different audit firm at the end of the second five year period.

Proposals for new Audit Committees

- 3.18 There is currently no legal requirement for an Audit Committee and, therefore, no requirements of who should be part of the committee, its role and responsibilities, etc.
- 3.19 The proposals within the consultation paper would make an Audit Committee a statutory requirement. A possible, potentially statutory structure is set out. Adoption of the structure would have a radical impact on the way that the Swale Audit Committee is constituted and operated.
- 3.20 The possible structure is based on a review of audit and accountability in central government carried out in 2001. The consultation paper's preferred structure is set out below:
- Audit committee chairs and vice-chairs would both be independent of the local public body (i.e. not elected members).
 - 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 non elected to the local public body.
- 3.21 Members may wish to give particular consideration to this proposal and in particular the proposal that the chair, the vice chair and the majority of

members would not be elected members.

- 3.22 However, an important and related point concerns the future role for a new audit committee. The consultation paper contains two options:

Option One: There would be only one mandatory duty for an audit committee, which would be to provide advice to the council on the engagement and resignation or removal of the auditor. It would then be at the discretion of 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.

- 3.23 The proposals for both the constitution and role of a new audit committee may need to be considered together by members in the context of the wider arrangements for maintaining oversight of the council's governance and performance. It is also timely that this audit committee has received feedback about its role and effectiveness as part of the review carried out for the four councils in the partnership.
- 3.24 At present Option two relating to a possible mandatory role for the committee would sit well with this committee's current terms of reference, save that currently there is no requirement for the committee to prepare an annual report. Members will recall this was one change the committee recommended for consideration by the new council.
- 3.25 Option two may not have great impacts for other parts of the council's democratic process.
- 3.26 Option one above, however, may need to see a large part of this committee's work handled elsewhere if its role is restricted to recommending the appointment, or dismissal of the external auditor. If the council chose to use its discretion to restrict the role of the Audit Committee, then overseeing external and internal audit work, reviewing governance and risk would all need to be handled by other parts of the council's governance arrangements (including Overview and Scrutiny, and the Cabinet).
- 3.27 Decisions about the extent of the audit committee's future role once legislation is passed must be taken by the full council, following consideration therefore of the wider constitutional implications, including consideration of the full role of non-elected members.

Scope of external audit and the work of external auditors

3.28 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 external 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. There would be no assessment of value for money under this option.

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 review and report 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.

3.29 A reduction in the scope of external audit could mean that some of the elements (such as the value for money assessment) which currently form part of the role of the Audit Commission might need to be dealt with by others (including a greater input from scrutiny committees). This could impact on the work of Internal Audit, which at Swale is a very small team with limited opportunity to take on additional work.

3.30 Option 3 would lead to greater transparency, but would require greater input from auditors (than Options 1 or 2) and hence involve greater cost.

3.31 External auditors would continue to have the power to prepare public interest reports, with the costs of such report being recovered from the audited body.

3.32 While local people would retain the right to make representations to the auditor and question them about the accounts, the consultation paper proposes to remove the formal right for local people to raise objections to the accounts. The paper suggests that there are sufficient other routes that local people can take if they have an issue with their council, including the Local Government Ombudsman and the Information Commissioner.

Arrangements for smaller bodies

- 3.33 Different arrangements are proposed for local public bodies with income and expenditure lower than £6.5 million. Swale Borough Council is a 'Principal local authority' and not affected by these proposals.
- 3.34 However, the proposed arrangements would apply to all of the borough's parish councils. The detailed proposals are set out in the consultation paper at Appendix 1 (section 5).
- 3.35 In the case of smaller bodies the proposal is that a more limited independent examination is carried out; this is similar to the current requirement for small charities and other not-for-profit organisations. However, the proposal would place a responsibility on the county council to monitor the appointments of independent examiners to parish councils and other relevant bodies. The consultation paper makes no reference to a possible role here for district councils. This role for the county could be burdensome. Being closer to the day-to-day issues of parish councils it would be more logical for districts to play this role.

4 Alternative Options

- 4.1 The Council could choose not to respond to the consultation. However, the proposals within the consultation paper have implications on the way that public audit will be provided to the Council

5 Consultation Undertaken or Proposed

- 5.1 The report has been provided to the Audit Committee as part of the consultation on the Government proposals. Strategic Management Team and specifically the Head of Finance (as Section 151 Officer) will be among those who are also consulted.

6 Implications

Issue	Implications
Corporate Plan	none identified at this stage
Financial, Resource and Property	One of the objectives of the Governments proposals for the Future of Public Audit is a reduction in the cost of audit.
Legal and Statutory	Changes to the existing Public Audit arrangements will require primary legislation.
Crime and Disorder	none identified at this stage
Risk Management and Health and	The principal risk of not responding to the consultation paper is that the views of Swale Borough Council would not be represented and

Safety	would not therefore help to shape future public audit arrangements. The audit of public bodies plays a key role in ensuring that those responsible for handling public money are held accountable for the use of that money. Regular public audit also provides assurance on bodies arrangements for managing their finances properly, including their arrangements for value for money and to safeguard public money. It is therefore vital that effective public audit arrangements are put in place to manage the risks to these areas.
Equality and Diversity	none identified at this stage
Sustainability	none identified at this stage

7 Appendices

7.1 The following documents are to be published with this report and form part of the report

Appendix I: Future of local public audit – CLG consultation paper

8 Background Papers

8.1 None