

TAUNTON DEANE BOROUGH COUNCIL

CORPORATE GOVERNANCE COMMITTEE 27/06/11

CONSULTATION PAPER – FUTURE OF LOCAL PUBLIC AUDIT

Report of the Strategic Director (Shirlene Adam).

This matter is the responsibility of the Leader of the Council, Cllr John Williams

Executive Summary

In preparation for the abolition of the Audit Commission, the Government has published a consultation on the future arrangements for local public audit. The consultation includes proposals relating to the role and composition of the Audit Committee. The deadline for responses is 30 June 2011.

This report summarises the main issues arising from the consultation and contains a draft response for comment.

Key issues raised in the paper relate to:

- the imposition of independent but unelected chair, vice-chair and members of the Audit Committee;
- the impact on existing arrangements for “corporate governance” in Taunton Deane;
- the potential for over-prescriptive and onerous external audit requirements;
- the proposed imposition of the role of commissioner of independent examinations and de facto regulator of smaller public bodies operating within the area of Taunton Deane.

1. Background

1.1 Since 1983, the Audit Commission has acted as regulator, commissioner and provider of external audit services.

1.2 In August 2010, the DCLG (Communities and Local Government Department of Central Government) announced plans to disband the Audit Commission and refocus audit on helping local people hold their councils and other local public bodies to account for local spending decisions. The intention was / is that this would take place during the financial year 2012/13.

- 1.3 The DCLG are currently consulting on how this can be delivered. Their consultation paper “The Future of Local Public Audit” makes it very clear that the current arrangements for “external audit” will change, and that centralised inspection and supervision through one single organisation (the Audit Commission) will not continue.
- 1.3 The consultation document contains proposals that would see all local public bodies with a turnover exceeding £6.5m appointing their own independent auditor. This appointment would be made in the light of advice given by an independent audit committee.
- 1.4 The consultation paper is a fairly lengthy document, and poses 50 questions for authorities to consider. The full consultation document is available on the DCLG website. This report pulls out the key issues for Members to consider, and includes a draft response to the consultation questions.
- 1.5 Responses must be submitted to the Department for Communities and Local Government (CLG) by 30 June.

2. The Principles

- 2.1 The document states that the Government has followed four design principles in developing the proposals for the future of local audit. These are explained in the following paragraphs.
- 2.2 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.
- 2.3 Transparency: ensuring that the 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.
- 2.4 Lower audit fees: achieving a reduction in the overall cost of audit.
- 2.5 Higher standards of auditing: ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit.
- 2.6 Reference is also made to three long-standing principles of local public audit, which were codified in 1998 by the Public Audit Forum. These are:
 - independence of public sector auditors from the organisations being audited;
 - the wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money;

- the ability of public auditors to make the results of their audits available to the public, to democratically elected representatives and other key stakeholders.

3. Regulation of local public audit

- 3.1 The second section of the consultation discusses the Code of Audit Practice, formerly the responsibility of the Audit Commission, and the need for a regulator and supervisory body for firms undertaking local public audit. Views are sought on proposals for the National Audit Office to produce the Code and supporting guidance and for the Financial Reporting Council to be the regulator.
- 3.2 The section also considers criteria for allowing firms to be included in the register of statutory local public auditors and for deciding whether a body should be classed as a public interest entity that should be subject to statutory public audit.

4. The Audit Committee

- 4.1 The Government defines larger local public bodies as those with annual income and / or expenditure over £6.5m. It proposes that all such bodies will be required to appoint an auditor and that this appointment will be made by the Full Council, on the advice of an Audit Committee, with opportunities for the electorate to make an input.
- 4.2 It also proposes co-operation between local public bodies when commissioning audit services, suggesting joint procurement and potentially joint Audit Committees.
- 4.3 The composition of the Audit Committee is given considerable coverage. There is great emphasis on a strong independent presence on the committee. There is reference to alternative arrangements and the need for authorities to have flexibility in the way they constitute and run Audit Committees, but the consultation sets out one particular model in some detail. This is shown in the table below.

Structure of audit committees

We envisage that in the new system, an Audit Committee could be structured in the following way:

- The chair and vice-chair should be independent of the local public body.
- 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

Possible alternative arrangements under consideration are set out in paragraph 3.9 of the consultation, as follows:

- a) only the chair and perhaps a minority of members are independent of the local public body
- b) a chair and a majority of members independent of the local public body, as described above
- c) as for (b), but with independent selection of the members independent of the local authorities

4.5 Views are sought on the recruitment, skills and experience of independent members. The possibility of payment to attract suitable candidates is also put forward.

4.6 Consideration is then given to the mandatory duties of the Audit Committee and the guidance that it will need. It could simply have a role in making recommendations to the Full Council on the engagement of an auditor and the resignation or removal of an auditor. Other duties could be added to the committee's role at the council's discretion.

4.7 Alternatively, the mandatory duties could be much more wide ranging. Paragraph 3.24 of the consultation states:
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 council on the quality of service they are receiving
- reporting annually to the council on its activities for the previous year

4.8 The draft response, attached at appendix 1, explains how the proposals could impact on the current successful arrangements at Taunton Deane. The concern is that the minimal duties of an audit committee outlined in paragraph 4.6 would be unlikely to attract independent members of the right calibre, whereas the more extensive duties outlined in the table in paragraph 4.7 would overlap with the current duties of the Corporate Governance Committee, and so lead to duplication or fragmentation of the work.

5. Appointment of the external auditor

- 5.1 The Audit Committee will be expected to advise the Council on the engagement process for the external auditor and it will monitor the independence and quality of the external audit.
- 5.2 It is also suggested that the Audit Committee "may wish to have regard to advice from the section 151 officer" when formulating its guidance to the council on the engagement, including the criteria for selection and their weighting.
- 5.3 It is expected that the Audit Committee will receive copies of tenders for the external audit and "may, if they wish, indicate which auditor, in their view, presents the best choice."
- 5.4 It is proposed that the Full Council will need to have regard to the advice of the Audit Committee on the selection of the external auditor, but it need not follow that advice. The advice provided by the Audit Committee will be published (subject to appropriate treatment of commercially confidential material). If the Full Council does not follow the Audit Committee's recommendation, it will be required to publish on its website a statement from the Audit Committee explaining its advice and a statement from the Council explaining why it did not follow the advice.

- 5.5 Further involvement of the public is proposed by publishing in advance of the tender process a list of those firms that have expressed an interest in tendering. Members of the public could then make representations to the Audit Committee if they have any concerns. After the appointment is made, members of the public with concerns about the auditors may raise them with the Audit Committee, which will investigate them as appropriate.
- 5.6 In the event of an authority failing to appoint an auditor, reserve powers are considered for the Secretary of State either to direct the authority to make an appointment or to make an appointment himself.
- 5.7 Consideration is given to the process by which appointment of auditors will be monitored, to ensure that a failure to appoint does not go unnoticed.
- 5.8 To ensure rotation of auditors, it is proposed that the maximum duration of a firm's tenure will be two consecutive five-year periods. The firm would be formally reappointed each year, subject to satisfactory performance, and the contract would be retendered after five years.
- 5.9 Arrangements to apply to the removal or resignation of the auditor are discussed. Similar approaches are proposed, with 28 days notice of intention to remove or resign required, written submissions that will be published on the website and involvement of the Audit Committee and the audited body.
- 5.10 Finally in this section, consideration is given to the possibility of limitation of liability of auditors, recognising that a requirement for unlimited liability is likely to increase audit fees.

6. Scope of audit and the work of auditors

- 6.1 Four options for the scope of the external audit are discussed.
- 6.2 Option 1 involves reducing the scope closer to that applied to companies, with no assessment of value for money. There would be an opinion on whether the financial statements give a true and fair view of the body's financial position. Other information published with the financial statements would be reviewed and reported on as appropriate.
- 6.3 This option would give the public significantly less than is available now, with less information on how money is being spent and no view on the value for money achieved.

- 6.4 Option 2 would be broadly similar to current arrangements, including a conclusion on whether the body has proper arrangements in place to secure value for money.
- 6.5 Option 3 is intended to provide stronger assurances on the way local public bodies spend money. Opinions would be given on the financial statements, as in the options above, but in addition the auditor would provide conclusions on:
- regularity and propriety – a conclusion on compliance with relevant laws and regulations and the audited body’s governance and control regime
 - financial resilience – a conclusion about the future financial sustainability of the audited body and
 - 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
- 6.6 In practice, this work is largely being undertaken currently by the external auditors to inform their overall opinion, but it only appears in the published report as the opinion on whether or not proper arrangements are in place to secure value for money.
- 6.8 Option 4 seeks to replicate the legal requirement placed on companies to produce and publish an annual report, setting out its major activities during the year, and a business review, including risks and uncertainties.
- 6.9 Under this option, the auditor would be required to give an opinion on the financial statements, review the annual report and provide a reasonable assurance on the annual report.
- 6.10 While publication of the annual report and business review is undeniably good practice, there is a danger that setting it as a requirement to be audited will stifle innovation and prevent authorities from reporting in the ways that are most suited to local needs.
- 6.11 Public interest reports are issued by auditors when a significant matter has arisen during the audit that needs to be brought to the attention of the audited body and the public. The consultation proposes retaining this approach.
- 6.12 Views are asked about whether external auditors should be allowed to undertake audit-related work for the body or provide other services to it and, if they are, what safeguards should be put in place to ensure independence is maintained and competition promoted.
- 6.13 The consultation proposes that the role of receiving and considering public interest disclosures, formerly exercised by the Audit Commission, should be transferred to Audit Committees.

- 6.14 The section closes with a discussion of transparency. It concludes that the opportunities for members of the public to raise issues of concern, the access they have to information through Freedom of Information and publication of transactional data and the right to make representations to the auditor all make the local taxpayer's right to object to the accounts redundant.
- 6.15 As a further move for transparency, it is proposed that auditors will be brought within the scope of the Freedom of Information Act, to the extent that that information they hold relates to the public audit .

7. Arrangements for smaller bodies

- 7.1 The final section considers audit arrangements for smaller bodies. It is proposed that independent examination should apply, similar to the procedure in the charities sector. The rigour of the requirements and the qualifications of the independent examiner would increase depending on whether the bodies expenditure was:
- less than £1,000;
 - between £1,000 and £50,000;
 - between £50,000 and £250,000
 - between £250,000 and £6,500,000.
- 7.2 Bodies at the first level would not require an audit. Above the first level, two options for appointing independent examiners are proposed. The first would require the appointment to be made by the County or Unitary authority in which the body is located, possibly by the section 151 officer rather than the Full Council.
- 7.4 Alternatively, bodies might be required to appoint an auditor themselves, taking account the advice of an independent Audit Committee, which might be established to advise a number of other small public bodies operating in the same geographical or service area.
- 7.5 Consideration is also given to arrangements for public interest reporting, objections to accounts and the regulatory regime for smaller bodies. For the first and second of these, the proposal is that the County or Unitary authority in which the body is located should take responsibility for receiving reports or representations and, if it considers it necessary, appointing an auditor to consider the issues raised. The conclusion is then reached that this in effect makes the County or Unitary Council the regulator for this sector, whether or not it is responsible for commissioning the independent examinations.
- 7.6 The number of smaller bodies to which these arrangements would apply means that there is the potential for a significant increase in workload and diversion from core responsibilities in upper tier authorities.

8. Draft response to the consultation

- 8.1 A draft response has been prepared. It focuses on the main issues for Taunton Deane and does not attempt to respond to every question. The response must be submitted by 30 June.
- 8.2 The draft response is at Appendix 1. Members of the Corporate Governance Committee are requested to consider the draft response and put forward any amendments or additions.

3. Finance Comments

- 3.1 The Government's intention is that the new external audit arrangements will reduce costs. There is some concern that this could lead to greater risk if it impacts on audit standards.

4. Legal Comments

- 4.1 There are no legal implications from this report.

5. Links to Corporate Aims

- 5.1 No direct implications.

6. Environmental Implications

- 6.1 No direct implications.

7.0 Community Safety Implications

- 7.1 No direct implications.

8. Equalities Impact

- 8.1 This is a response to a Government consultation and does not require an Equalities Impact Assessment.

9. Risk Management

- 9.1 Any risks identified by the final proposals will be fed in to the corporate risk management process.

10. Partnership Implications

- 10.1 A significant element of assurance work is currently carried out by South West Audit Partnership on behalf of the Audit Commission each year. It is hoped that this will continue following the appointment of a new external auditor.

9. Recommendation

- 9.1 Members of the Corporate Governance Committee are requested to:-

- note the key issues emerging from the consultation paper on the Future of Local Audit, and
- comment on the draft response set out in Appendix 1.

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Taunton Deane Borough Council **DRAFT** Response

- Consultation on the Future of Local Public Audit

Taunton Deane Borough Council welcomes the opportunity to comment on the proposed future arrangements for the audit of local public bodies.

A response to some of the specific questions follows, but first we wish to give our view on the aspect of the proposals that causes the Council most concern: the composition and structure of the Audit Committee.

This Council does not recognise the presumption made in the paper that local authorities are incapable of selecting its own independent external auditors. We are deeply concerned that the DCLG proposal intends to secure the independence and transparency of external audit through the recruitment of unelected chairs and members of Audit Committees.

This Council operates a Corporate Governance Committee that has a wide remit to challenge and review decisions and actions taken by Members and Officers of the Council in discharging its functions, with particular emphasis on financial, performance and governance issues. The Committee is chaired by a non-Executive Member. This approach has served us well.

The proposal does not take into account the championing role in good governance and risk management that our current arrangements support. There is a danger that the prescription in the current proposals will jeopardise successful local arrangements such as this.

If the required role of the future Audit Committee is limited to the minimum activities proposed, then it is doubtful whether it will attract members of the right calibre to serve any useful purpose. However, if the role is wider, whether imposed through regulation or by local choice, it will impact on the effectiveness of the existing arrangements, either through duplication or fragmentation of the work.

Therefore the Council asks for further consideration to be given to the way that independent involvement is brought to the selection and oversight of the external auditor, so that it does not jeopardise existing arrangements for wider audit and scrutiny roles currently undertaken by members.

In respect of the specific questions, the Council would like the following views to be taken into account when the Government finalises its proposals:

- 1. Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?**

Whilst the objective of lower audit fees is commended, it is important that this does not compromise the scope or quality of the audit. Particularly at a time of austerity, it is important that audit remains robust and a focus is maintained on value for money.

3. Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?

Yes, provided that they are produced in consultation with the key professional bodies.

11. Do you think the arrangements we set out are sufficiently flexible to allow councils to cooperate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?

The arrangements need to encourage but not impose local co-operation in the appointment of external auditors. This should be left to local discretion.

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

The criteria appear to relate to the independence rather than the quality of the extra members. There appears to be unnecessary emphasis given to this independence, given that auditor appointments will only be possible from the list of those firms approved to undertake such audits. Relevant expertise and experience that will add value to the process are more important.

13. 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?

The key role of the Audit Committee in commissioning external auditors means that independent members should have some financial or business expertise to bring to the role. We also consider that the elected nature of Committee members to be an important factor in ensuring debates are representative of issues affecting our local community.

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

Yes. Unless there is a history of dissatisfaction with the financial management of an authority, it is unlikely that many volunteers will come forward. Payments would need to be quite significant to act as a

motivator for suitably qualified people, and this will work against the objective of saving money.

- 15. 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?**

The safeguards should be in the process for selection to be included on the list of approved auditors, rather than an excessive reliance on independent members of an audit committee to ensure independence.

- 16. 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?**

If there needs to be an Audit Committee with a majority of independent members in order to select an independent auditor, there is something wrong with the process for determining auditors' eligibility for the role.

- 17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?**

A minimal role and low numbers of independent members – if any – should be specified.

- 18. 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?**

Statutory guidance should be provided for the key elements of the commissioning process, particularly if the Government pursues its proposal to require a significant number of independent members of the audit committee.

- 19. Is this a proportionate approach to public involvement in the selection and work of auditors?**

It appears to be overkill to propose public involvement in the appointment process as well as independent members on the audit committee. The pre-appointment opportunity to make representations could be extremely disruptive to the appointment process and is definitely not favoured by the Council.

- 21. Which option do you consider provides a sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?**

If a body does not appoint an auditor when it should, it appears appropriate for the Secretary of State to make that appointment.

- 29. 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 provides sufficient assurance and transparency to the electorate? Are there other options?**

To provide assurance to the local taxpayer, an authority should be reporting on its performance against the headings proposed for Option 3. The scope of the external audit should be limited to Option 2, which includes the opinion on whether the authority has proper arrangements in place for securing and assessing its performance against the relevant criteria.

- 30. Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?**

Yes, all authorities should produce some form of annual report to explain key aspects of their plans and performance against them. However, it should be proportionate and in line with what the local community wants.

- 31. 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?**

No. A report of a review of financial resilience etc, whilst important, will not be of interest to the great majority of the public.

- 32. Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?**

Auditing the annual report is not favoured by the Council.

- 33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?**

No guidance is required – see response to question 30.

- 42. Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?**

The cost of audit is part of the cost of being in business. To preserve transparency and accountability, independent examination fees should be borne by the body being audited. This also means that smaller bodies should be responsible for making the appointment of their examiner. Generally this would be through a collective procurement.

- 43. Do you think the county or unitary authority should have the role of 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 advice provided by the audit committee? What additional costs could this mean for county or unitary authorities?**

This Authority does not think that the County Council should be required to commission the independent examiners. Joint procurement exercises would be sensible, but this should be at the request of the smaller bodies, not an imposition on them.

- 46. 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?**

Clearly an option would be to create a new body with responsibility for audit and regulation of smaller bodies. This would avoid many of the drawbacks of the present proposals, which are unlikely to be cost-effective and distract major authorities from their core responsibilities. Even if upper tier authorities are given responsibility for commissioning independent examinations, there will be unnecessary duplication of effort and they are unlikely to obtain as favourable terms as a body able to commission examinations on a national basis.