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## REPORT ON THE CONSULTATION BY THE DEPARTMENT FOR COMMUNITIES AND LOCAL GOVERNMENT ON THE FUTURE OF LOCAL PUBLIC AUDIT

To: **Governance and Audit Committee – 29 June 2011**

Main Portfolio Area: **Financial Services**

By: **Financial Services Manager (Deputy Section 151 Officer)**

Classification: **Unrestricted**

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Summary: **To provide Governance and Audit Committee with the consultation response to the Department of Communities and Local Government (DCLG) on the Future of Local Public Audit.**

### **For Decision**

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#### **1.0 Purpose of Report**

- 1.1 To approve the response, at Annex 1, to the DCLG consultation on the Future of Local Public Audit.
- 1.2 Members should note that the DCLG proposals will fundamentally change the composition and role of the Audit (Governance) committee.

#### **2.0 Background**

- 2.1 The Audit Commission is responsible for overseeing the audit of local authority accounts. It is the commissioner of all local authority audits, and undertakes a large proportion of the audits itself, including the audit of Thanet District Council and the other East Kent Councils, using its in-house audit service. The other audits are undertaken by commercial audit firms, paid at rates which generally reflect the levels charged by the Audit Commission.
- 2.2 The Secretary of State for Communities and Local Government has decided to abolish the Audit Commission (although it will continue to operate through 2011/12 and possibly up to 2013/14 or beyond) and is now consulting on the arrangements that should be put in place to secure the audit of local authority accounts in the future.
- 2.3 The consultation runs to 54 pages and raises 50 questions for the consultees to consider. Normally it would not be considered necessary to include the full consultation within committee papers, and Members would simply be provided with a summary, and a reference to the DCLG web site.
- 2.4 However, the questions in the consultation arise from detailed and technical discussions of the current arrangements and the DCLG proposals for change.
- 2.5 Therefore, to assist Members, the main issues are set out below, and referenced to the draft response. But, in order to ensure that Members are able to follow all of the proposed responses they are provided at Annex 1, with the full consultation paper at Annex 2.

2.6 The consultation closes on 30 June 2011. The response will be sent on behalf of the Governance and Audit Committee of Thanet District Council.

### **3.0 Summary of DCLG's Proposals**

3.1 The Secretary of State's main aims are to:

- Disband the Audit Commission and transfer the work of the Audit Commission's in-house audit service to the private sector (which may include a mutual organisation formed by former Audit Commission staff);
- Enable local authorities to appoint their own independent auditors;
- Provide new arrangements for the audit of local health bodies (not a significant issue for TDC); and
- Ensure that all local public bodies are still subject to robust auditing.

3.2 The underlying approach is to replace the current structure and approach to local public audit with a model that is much closer to the private sector approach, but adapted to meet the specific requirements of the public sector.

3.3 The consultation covers:

- **Section 1** – Introduction (Scope and Principles)
- **Section 2** – Regulation of local public audit
- **Section 3** – Commissioning local public audit services
- **Section 4** – Scope of audit and the work of the auditors
- **Section 5** – Arrangements for smaller bodies.

3.4 The main issues for each of the sections are outlined below.

### **4.0 Section 1 – Introduction (Scope and Principles)**

4.1 It is proposed that the National Audit Office will prepare the Codes of Audit practice which determines the approach taken by the auditors. Registration of audit firms and monitoring and enforcement of audit standards will be undertaken by the professional accountancy bodies under the supervision of the Financial Reporting Council.

4.2 The design principles used by the DCLG to develop the new approach are:

- 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
- 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
- lower audit fees – achieving a reduction in the overall cost of audit
- high standards of auditing – ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit

4.3 Questions 1 and 2 are raised in Section 1. Only question 1 is of relevance to TDC, and 2 alternative draft responses are provided at Annex 1 for Members to consider.

## **5.0 Section 2 – Regulation of local public audit**

5.1 Section 2 proposes that:

- the National Audit Office produces the audit Codes of Practice and supporting guidance to be used by local public auditors;
- the Financial Reporting Council acts as the regulator for local public audit
- auditors must be members of recognised supervisory bodies (RSBs - presumably the main accountancy institutes) and eligible for appointment under the rules of that body;
- RSBs will be responsible for monitoring the quality of audit work, investigating complaints and disciplining their members. They could also stop an unsatisfactory firm from being eligible for appointment.

5.2 In essence, there will be a list of audit firms recognised as being qualified to undertake public audit work.

5.3 Questions 4 to 10 are raised in Section 2. Members may regard these questions as largely uncontentious.

## **6.0 Section 3 – Commissioning local public audit services**

6.1 Sections 3 and 4 are at the heart of the proposals and Members may therefore want to read them in full at Annex 2.

6.2 It is proposed that instead of auditors being appointed by the Audit Commission, the appointment would be made by full Council, who will receive the advice of the audit committee. The electorate would have an opportunity to input to the process, although it is not clear exactly how this would happen.

6.3 Councils may choose to jointly appoint an auditor, so TDC could agree to procure audit services with East Kent partners. In the event that a council fails to appoint an auditor then the Secretary of State may either have the power to direct the council to appoint an auditor, or may have the power to appoint one himself.

6.4 Auditors could be appointed for 5 years, with one renewal, but after 10 years a new firm must be appointed. There are also safeguards in place for the dismissal or resignation of auditors.

6.5 Section 3 also sets out proposals for the composition of the audit committee. This is likely to be the most contentious element for Members.

6.6 It is proposed that audit committees should include independent, non-elected members who can only be considered 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

6.7 It is also proposed that:

- the chair and vice-chair of the authority would be independents
- elected members on the audit committee should be non-elected, non-cabinet members, with at least one (and ideally one third of all members) having recent and relevant financial experience
- there would be a majority of members on the committee who are independent

6.8 Finally, this section also considers the role of the audit committee. Two options are outlined. The first takes a narrow approach and considers the audit committee having one mandatory duty, which is to advise council on the appointment or removal of an auditor.

6.9 The second option is a wider and more detailed mandatory role covering:

- 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

6.10 Questions 11 to 28 are raised in Section 3.

## **7.0 Section 4 – Scope of audit and the work of the auditors**

7.1. Section 4 offers four options for the potential scope of audit work. They are:

Option 1 – The auditor would:

- give an opinion on whether the financial statements give a true and fair view of the audited body's financial position and of its income and expenditure 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.
- 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.

Option 2 – This option is the same as option 1, but in addition the auditor would:

- provide a conclusion 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)
- 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.

Option 3

- This option is designed to provide stronger assurances on the way local public bodies spend money. Under this option, the auditor would still give an opinion on the financial statements, but 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

Option 4

- 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 had put in place to secure value for money, whether they had achieved economy, efficiency and effectiveness, regularity and propriety and financial resilience.
  - The auditor would be required to:
    - give an opinion on the financial statements
    - review the audited body's annual report and
    - provide reasonable assurance on the annual report

7.2 Questions 29 to 41 are raised in Section 4.

## **8.0 Section 5 – Arrangements for smaller bodies**

8.1 Section 5 is likely to be relevant to the district's town and parish councils where different arrangements are proposed for local public bodies with income and expenditure of less than £6.5m per annum.

8.2 The arrangements group local public bodies into annual income/expenditure bands as follows:

- Less than £1,000
- £1,000 - £50,000
- £50,000 - £250,000
- £250,000 - £6.5m.

- 8.3 For these bodies it is proposed that KCC (the s151 officer or full council) would appoint an independent examiner (IE) for each of the Towns and Parishes. In practice the IE could be an officer of KCC.
- 8.4 District Councils are not given any role in these arrangements. KCC could have to appoint circa 300 IEs to the various town and parishes councils in Kent. Being closer to the day-to-day issues of parish councils in their districts, it would be more logical for District Councils to play this role.
- 8.5 Due to the timescales involved it will not be possible to consult with town and parish councils but Members may want this report to be copied to them so that they are able to see the Council's response to the DCLG.

## 9.0 Issues to Consider

- 9.1 The consultation is a long and complex document. To assist Members the table below has been drawn up to highlight issues that they may wish to consider.

Number	Issues Members May Wish to Consider/Debate
1	Do Members prefer response 1 or response 2 (as set out in Annex 1) as an answer to question 1 of the consultation?
2	Do Members support an approach to local public audit based on the private sector model. Do Members agree with the answer to question 4 as set out in Annex 1?
3	Do Members consider that the decision to abolish the Audit Commission and open up the market is likely to increase or reduce audit fees? See question 7, Annex 1?
4	Do Members support the proposal for an independent (ie non elected) chair and vice-chair, and a majority of independents on the audit committee?  Will it be practical to find suitable independent Members that are acceptable to Council?
5	Should the mandatory role of the Audit Committee be limited to recommendations on the appointment of an auditor, or should the mandatory role be wider as set out in Option 2, section 3 of the consultation? See question 6, Annex 1.
6	Which of the 4 options for the scope of the audit, as set out in Section 4 (paras 4.14 – 4.25) of the consultation, do Members consider most appropriate?
7	Do Members want to seek the views of town and parish councils on the proposed arrangements for them (questions 42 onwards)?

## 10.0 Options

- 10.1 That Governance and Audit Committee note the implication of the consultation proposals and approve the response at Annex 1.
- 10.2 That Governance and Audit Committee note the implication of the consultation proposals and recommend changes to the response at Annex 1.

## **11.0 Corporate Implications**

### **11.1 Financial**

11.1.1 There are no financial implications arising directly from this report.

### **11.2 Legal**

11.2.1 There are no legal implications arising directly from this report.

### **11.3 Corporate**

11.3.1 There are no corporate implications arising directly from this report.

### **11.4 Equity and Equalities**

11.4.1 There are no equity or equalities issues arising from this report.

### **11.5 Risks**

11.5.1 There are no risk implications arising directly from this report.

## **12.0 Recommendation(s)**

**12.1 It is recommended that Governance and Audit Committee note the implication of the consultation proposals and approve the response at Annex 1.**

**12.2 That Members agree to copy the response to the DCLG consultation to town and parish councils.**

## **13.0 Decision Making Process**

13.1 This recommendation does not involve the making of a key decision.

13.2 This recommendation is within the Council's Budgetary and Policy Framework and the decision may be taken by the Governance and Audit Committee.

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## **Annex List**

Annex 1	Consultation questions and proposed responses
Annex 2	DCLG full consultation paper

## **Background Papers**

<b>Title</b>	<b>Details of where to access copy</b>
Not applicable	