

WYRE FOREST DISTRICT COUNCILAUDIT COMMITTEE
29th JUNE 2011CONSULTATION RESPONSE – FUTURE OF LOCAL PUBLIC AUDIT

OPEN	
SUSTAINABLE COMMUNITY STRATEGY THEME	Stronger Communities
CORPORATE PLAN PRIORITY	Delivering Together with Less
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APPENDICES	Appendix 1 - Proposed response to the "Future of Local Public Audit" Consultation Paper.

1. PURPOSE OF REPORT

- 1.1 To present for approval a draft response in relation to the Government consultation paper on the "Future of Local Public Audit".

2. RECOMMENDATIONS

- 2.1 **The Audit Committee is asked to APPROVE or amend as necessary the draft response identified at Appendix A.**

3. BACKGROUND

- 3.1 On 30 March the government released a consultation paper in relation to the future arrangements for local audits. The deadline for responses to this consultation paper is 30 June 2011. Following the consultation period the government will publish their proposals which will be subject to parliamentary approval in the usual way, it is expected that any new arrangements would be in place for 2013/14 at the earliest.
- 3.2 The primary reason for the consultation exercise relates to the governments decision to abolish as soon as possible the Audit Commission, however, the proposals within the document go far wider than simply providing local authorities the power to appoint their own auditors.
- 3.3 All of the proposals have been developed within a set a suggested design principles these being:
- **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

3.4 There are 50 specific questions which have been posed as part of the consultation exercise, the first 41 directly relate to our Council, with the rest of the questions related to smaller bodies such as parish councils. Attached at Appendix A, are the questions relevant to Wyre Forest District Council along with suggested responses.

3.5 This link <http://www.communities.gov.uk/publications/localgovernment/localpublicauditconsult> can be followed to access the full document.

3.6 The current arrangements for the appointment of auditors have remained virtually unchanged since 1974. It is current responsibility of the Audit Commission to oversee and appoint all audit arrangements within local government. The local authority is consulted upon the proposed auditors; however, the final decision rests with the Audit Commission, as does the determination of the annual fee.

3.7 In the appointment the Audit Commission mainly selects from the larger auditing firms including PwC, KPMG and Ernst & Young, but is also free to appoint its own auditors to undertake the work as is the case at Wyre Forest.

3.8 With the proposed abolition of the Audit Commission it is clear that the current arrangements would need to be amended, therefore the government have published proposals on how this could operate. However, the consultation document does go far further than proposing a new methodology for the appointment of auditors, it is a wider review that considers the design principles identified above

4. **KEY ISSUES**

4.1 The main proposals contained within the Consultation Paper include:

1. Ensuring independence within the Audit Committee

It is proposed that there would be a number of changes to the Audit Committee; the most significant would involve its membership. It is suggested that there should be an independent chair to the Council as well as the potential for a number of the committee to not be Councillors. There are various suggestions including that the majority of members are independent to the Council.

2. Appointment of Auditors

It is likely that the decision in relation to the appointment of auditors will rest with Council; however, the debate will be informed by a report from the Audit Committee which would make recommendations. Council would not be obliged to follow these recommendations however would have to be clear on the reasons for not following advice. There are various proposals in relation to the detail of the procurement process; however, it is clear that the government through the National Audit Office will effectively produce a select list of approved auditors that the Council could then involve in a procurement process.

There are also proposals to allow the public to have a say in relation to the appointment, however, these are limited to making comments to the Audit Committee upon the select list. This involvement could also produce difficulties in relation to collaborative approaches to such appointments related to this input.

3. Other Auditor Issues

Given the proposals that Local Authorities will be able to appoint its own auditors, there are also detailed proposals on what happens if the Council were in dispute. There are a number of mechanisms to avoid a complete breakdown in relations, however, the consultation paper does identify how an auditor could resign or indeed be removed by the Local Authority.

There would need to be safe guards in place to retain the independence of the auditor and so as not to compromise their position. It is proposed that the appointed Auditor will retain the power to present a public interest report to Council if they find a breakdown in governance issues within the authority.

4. Scope of Audit Work

One of the main drivers of the new Audit arrangements is to reduce the fees to local authorities. Since the new government the burden on Local Authorities has been reduced following the abolition of Comprehensive Area Assessments and the Use of Resources assessment.

The consultation paper debates how whilst still trying to reduce fees, Local Authorities can be even more transparent in their affairs with the public. To this end the paper discusses the requirement for Local Authorities to produce Annual Reports for the public. One of the proposals suggests that these reports are then reviewed by the Auditors to help ensure that they are objective, but also to demonstrate that the Local Authority is delivering value for money. There are alternative proposals on this matter; however, the underlying tone appears to suggest their inclusion in future.

In return it is suggested that the current right for members of the public to formally object to the Statement of Accounts will be removed, replaced with the requirement for the Auditors to consider any representations which are made to themselves. This is seen as a move to replace an outdated system.

5. FINANCIAL IMPLICATIONS

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

6. LEGAL AND POLICY IMPLICATIONS

6.1 Any legal issues have been addresses within the background section above

7. RISK MANAGEMENT

7.1 The consultation paper provides options for the future appointment of Auditors and it is therefore essential that these arrangements are robust and realistic. Any

concerns surrounding the proposals have been identified within the proposed response.

8. EQUALITY IMPACT NEEDS ASSESSMENT

8.1 An Equality Impact Assessment screening has been undertaken and it is considered that there are no discernable impacts on the six equality strands

9. CONCLUSIONS

9.1 It is clear that with the abolition of the Audit Commission government needs to identify new arrangements for the appointment of auditor. It appears that the National Audit Office will in the main fulfil this role.

10. CONSULTEES

10.1 Corporate Management Team

11. BACKGROUND PAPERS

11.1 Future of local public audit: Consultation Paper

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?

The Council can support the four principles which have been suggested and in the main the proposals do support these objectives.

However, there is a concern that the proposed requirement for Local Authorities to prepare an Annual report does not sit well with the Localism agenda. There are also concerns that whilst the proposals may reduce the external audit fee, any savings could be more than off set with the cost of producing such an Annual Report.

There are also concerns surrounding local choice when suggestions are being made specifically in relation to the membership of the Audit Committee. It is the Council's opinion that the final decision upon membership should be retained by Council.

2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?

The Council does not have an opinion on this matter

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

The Council recognises the need for a central body to ensure consistency in approach to audits, and given the current role of the National Audit Office can understand why this body has been proposed. The Council therefore supports this proposal.

4. Do you agree that we should replicate the system for approving and controlling statutory auditors under the Companies Act 2006 for statutory local public auditors?

The rationale for replicating the system under the Companies Act is understood, and the Council supports similar arrangements for local public auditors. However, any cost arising from such arrangements should be met by central government and not passed onto local authorities.

5. Who should be responsible for maintaining and reviewing the register of statutory local public auditors?

The Council would suggest that the National Audit Office would have the necessary skills and experience to maintain and review the register.

6. 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?

With the introduction of the International Financial Reporting Standards (IFRS) it is less essential that the firms have significant public sector experience. The rationale behind IFRS was that common accounting standards are adopted in the public and private sector. In addition so long as the Code of Audit Practice and supporting guidance is produced by the NAO this should be sufficient for firms to follow.

- 7. 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?**
The proposals already consider the adequacy of the qualifications of the potential auditors. There would need to be sufficient safeguards in place to ensure the independence of the staff undertaking the audit from the Council.
- 8. 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 local audit regulation? How should these be defined?**
The Council does not believe that there should be significant additional bureaucracy in relation to this role and believe that the tasks of:
- *reviews of individual audit engagements*
 - *reviews of the policies, procedures and internal controls of those firms licensed to carry out the public sector audits*
 - *reporting on the quality of audit to the registration body*
- Could be undertaken again by the National Audit Office, at the expense of central government.*
- 9. There is an argument that by their very nature all local 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?**
Care needs to be given to ensure that small parish councils are not caught up in the same regime as Mets, Unitary, County or Districts. The Council would suggest a threshold on expenditure of £500,000 in common with reporting requirements would make the most sense.
- 10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?**
They should provide the framework and allow local authorities to make their own decisions; however, they can act as arbiters in dispute situations.
- 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?**
There appears to be the potential for barriers to exist under the proposals to allow for the joint appointment of auditors. For instance, given that the Council will be required to consider the report from the Audit Committee there is no guarantee that this independent body will have the same objectives for minimising fees that Council may have. Also the involvement of the public in the decision to appoint the auditors is an unknown factor, objections may be raised at one authority which have no real substance but could undermine efforts to jointly procure. Obviously the overall decision will rest with Council however this would be unlike other procurement exercises where evaluation criteria are laid out in advance, again although all recommendations may point to a joint appointment, Council will have the final decision which may be at odds with recommendations.

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 issue of the skills of members of Audit Committees has been debated for some time, training has been provided to ensure that they have the requisite skills to undertake the role. In addition the Council has considered in the past whether the Audit Committee should have some co-opted Members.

The Council believes that the decision to appoint independent members to the Audit Committee should be left the Council and not imposed by central government. It is felt that this approach is directly at odds with the principle to decentralise.

The said other concerns exist as to whether there would be any members of the public that would firstly qualify under the criteria and secondly be willing to provide their services. It is likely that a payment would be required to independent members that provide their services and this again would increase the cost the Council, which could out weigh any savings which could be achieved in this area.

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 Council suggests that whilst desirable for the members to have financial expertise it is not essential and it should be the responsibility of the s151 officer that adequate training is provided to all members of the Audit Committee. This could be supported through the production of training materials through the NAO to ensure consistency of approach.

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

Yes, this will be difficult as was found to be the case when the Council explored the possibility of a co-opted member and will require payment. Given the suggested responsibility of Chairmanship of the Audit Committee this is likely to be around £2,000 pa, it is also likely for any other independent member this would be around £500 pa.

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?

Putting aside the Council's objections for the Audit Committee to be completely independent from the Council, then it has to be agreed that the proposals do increase independence. Of the options proposed:

- (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,*
- (c) as for (b), but with independent selection of the members independent of the local authorities*

The Council is not in a position to support any of the proposals; however, in line with the CIPFA/SOLACE guidance to ensure independence the Council is agreed that no member of the Cabinet should have a position on the Audit Committee.

- 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?**
Please see response to previous question
- 17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?**
Whilst the roles and responsibilities identified under Option 2 appear reasonable, and almost mirror the Council's own Terms of Reference. However, the Council does not support the view that legislation is required, moreover that authorities should have regard for guidance issued by CIPFA & SOLACE.
- 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?**
The Council does not have a strong opinion on whether the process should be subject to a statutory code or guidance; however, believe that the National Audit Office should have this responsibility.
- 19. Is this a proportionate approach to public involvement in the selection and work of auditors?**
The suggested role for the public appears to have been an after thought and does not provide any real input to the system. The Council would welcome dialogue with the appointed auditors and the public after Council has made the appointment, however, for the reasons provided earlier their involvement pre-appointment may jeopardise issues such as joint procurement.
- 20. How can this process be adapted for bodies without elected members?**
No comment
- 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?**
The appointment of an external auditor is unlikely to be a political issue and therefore all local public bodies should be able to fulfil this requirement. If however, there is no appointment then Option 2 would be supported.
- 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?**
Yes, it would serve as a good reference for other public bodies
- 23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?**
Again, the National Audit Office.
- 24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?**
Yes, this proposal is supported

25. **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?**
Again, the Council supports this proposal.
26. **Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and audited body to build a relationship based on trust whilst ensuring the correct degree of independence?**
The Council is satisfied with the arguments in this area.
27. **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?**
They appear to be well considered, however, will respond more fully in relation to question 34, there may be situations where an auditor is deterred from serving a public interest report due to either the threat of being removed or being not considered for a future tender process.
28. **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?**
Yes, again this proposal is supported.
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?**
The Council's view is that Option 1 is adopted. All public sector bodies are ensuring ever greater value for money following the reductions in funding available. This coupled with the publication of all transactions above £500 should provide sufficient information for local taxpayers.
- The Council would like to see the greatest reduction in external audit fees and believe that this is only possible through Option 1. Option 1 does recognise however the importance of the integrity of the Financial Statements.*
30. **Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?**
No, although the Council is committed to sharing with our taxpayers what our priorities and performance levels are this should be prescribed through an annual report. Local Authorities should be free to determine their own communication channels.
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?**
Please see response to previous question
32. **Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?**
Please see response to question 30.

- 33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?**
Please see response to question 30.
- 34. 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?**
The Council does have concerns that the appointed auditor may feel compromised on this issue to be completely impartial about such matters. It does make sense that the appointed auditor who would be closest to such a situation identifies in the first instance that there may be concerns and register these with the NAO. It may then be more appropriate for an alternative auditor to undertake any investigation which may or may not result in a public interest report.
- 35. 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?**
Yes, the Council is content with this proposal
- 36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?**
Yes, however, please note response to question 34.
- 37. 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?**
This depends upon the result of the proposals and again question 34. The proposals however would put considerable pressure upon the individual members of the Audit Committee who are likely to have an on-going role. It is the Council's opinion that arrangements similar to the current arrangements should be maintained.
- 38. Do you agree that we should modernise the right to object to the accounts? If not, why?**
Yes, the Council agrees with these proposals. In reality the appointed auditors act in this method already.
- 39. 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?**
Yes, the Council agrees with the proposed process.
- 40. 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?**
Again the Council agrees with the thinking in this area.
- 41. 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)?**

- (i) *it is not believed that this should not be a significant impact*
- (ii) *any costs arising from the FOI requests would need to be borne by the Auditor and not passed on through additional fees.*

Questions 42 to 50 relate to smaller bodies and the Council has not considered these areas.