

Report to: **Audit, Best Value & Community Services Scrutiny Committee**

Date: **4 September 2012**

By: **Interim Director of Corporate Resources**

Title of report: **Draft Local Audit Bill – update and consultation response**

Purpose of report: **To provide the Committee with an update on the Government's proposals for local public audit and the Council's response to the consultation on the Draft Local Audit Bill**

RECOMMENDATION: Members are recommended to comment on the report and note the Council's response to the consultation

1. Financial Appraisal

1.1 There are no direct financial implications arising from the recommendations in this report. The recent outsourcing of the Audit Commission's in house practice has meant that the Council's core audit fee has reduced from £185,715 in 2011/12 to £111,429 in 2012/13, a reduction of 40%. The cost of core audit and inspection fees in 2009/10, the baseline year used in the CLG's impact assessment was £202,493. There will be costs associated with the establishment of an Auditor Panel and the future procurement of an external audit contract however these costs are unlikely to be incurred until 2016/17.

2. Supporting Information

2.1 In August 2010 the Government announced its intention to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice to the private sector and put in place a new local audit framework. In this framework, local bodies would be able to appoint their own auditors from an open and competitive market. A robust regulatory framework would be established, ensuring that high standards of auditing continued to be upheld. Following an extensive consultation exercise between March and June 2011 to which the Government published its response in January 2012, the Draft Local Audit Bill has now been published for consultation.

2.2 This draft Local Audit Bill abolishes the existing audit regime and sets out the proposed new audit framework for local public bodies which were previously covered by the Audit Commission regime. It sets out the process for the appointment of auditors, and the regulatory framework for local public audit. A copy of the Bill can be found at:

<http://www.communities.gov.uk/publications/localgovernment/draftlocalauditbill>

2.3 A summary of the main changes resulting from the Bill is shown at Appendix A of this report. The proposed response to the consultation on the Bill is shown at Appendix B and must be submitted by 31 August 2012.

3. Main issues

3.1 To some extent the full implications of the changes will not be known until the Bill has been through Parliament and the Secretary of State has published any supplementary regulations, however, the main issues for members to be aware are summarised below:

3.2 There is a requirement for local bodies to take into consideration the advice of an independent panel before making the appointment of their auditor. This independent 'auditor panel' must consist of a majority of independent members, and have an independent chair. To be

classified as independent, a panel member must not have been a member or officer of the body within the last five years, and must not at that time be a relative or close friend of a member or officer of the body.

3.3 The draft Bill specifies three functions of the auditor panel, but there appears to be no requirement for it to be a standing committee / panel:

- To advise on the appointment of an auditor;
- To advise the local body on the maintenance of an independent relationship with the auditor; and
- To advise on proposals for a public interest report.

3.4 Bodies will be able to delegate further functions to the panel as they see fit. The draft Bill includes a power to provide more details on these specified functions, or to confer additional functions for the panel, by regulations. It also allows for guidance to be issued on their role and practical operation. There is a risk that any such additional regulations will seek to reduce the flexibility on the formation and operation of the Auditor Panel. The actual appointment of the external auditors must be made by the County Council.

3.5 The audit outputs and scope of the audit will remain broadly the same as they currently are. The auditor must enter onto the audited body's statement of accounts a certificate that the auditor has completed the audit in accordance with statutory requirements together with the auditor's opinion on the statement. The auditor must, by examination of the accounts and otherwise, be satisfied that:

- The accounts comply with the requirements of the legislative provisions that apply to them;
- Proper practices have been observed in the preparation of the statement of accounts; and
- the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

3.6 A risk based and proportionate approach to the auditor's assessment of the authority's arrangements for securing economy, efficiency and effectiveness in its use of resources has the potential for a consequent decrease or increase in the level of audit work that some local public bodies might experience – but we would not expect this in itself to result in an overall increase in the total cost of audit

3.7 The National Audit Office will not be undertaking the full range of types of studies that the Audit Commission did. It will not have a locus to assess the performance of individual councils nor to hold them to account in the way it does central government departments.

3.8 In due course the Council will need to consider how it wishes to approach both the procurement and appointment of its own auditors in time for the audit of the 2017/18 accounts (i.e. by December 2016). This will include consideration of the form and nature of its Auditor Panel and whether the Panel and the procurement exercise could be best progressed through collaboration with other audited bodies locally, regionally or nationally.

ANDREW TRAVERS
Interim Director of Corporate Resources

Contact Officer: Duncan Savage Tel No. 01273 482330

Local Member: All

Background Documents

None

APPENDIX A

THE NEW REGIME: DESCRIPTION OF THE NEW FRAMEWORK

The creation of the new regime can be broadly summarised as:

- a) The transfer of existing functions (currently performed by the Audit Commission) to other bodies;
- b) The ceasing of certain functions.

The below table summarises broadly what is proposed in relation to the various functions.

Table 1: Changes proposed to activities previously undertaken by the Audit Commission

Function	Proposed action	Date of change
Regulation of local audit	To be transferred to Financial Reporting Council, professional accountancy bodies and National Audit Office	Following primary legislation – plan 2015/16
Commissioning local audit	To be transferred to local public bodies	Following the end of the outsourcing contracts (last financial year 2016/17)
Providing local audit	To be transferred to private sector audit firms	Already transferred under outsourcing (from Autumn 2012)
Comprehensive Area Assessment	To cease	June 2010, as assessment was a discretionary power
Routine inspection and annual assessment of local government	To cease (The Secretary of State will retain the power to intervene and call for an inspection where necessary)	June 2010, as inspection was a discretionary power
Research and value for money studies	To be reformed: the National Audit Office will continue to be able to examine the impact of Government policies administered by local bodies, and identify and report on wider issues as part of its programme of value for money studies which will complement the sector's own self improvement work.	Audit Commission reports being phased out from Summer 2010, with the National Audit Office undertaking their first reports in 2012-13
National Fraud Initiative	To be transferred	Following primary legislation – working assumption 2015/16
Co-ordination of grant certification work	To cease: certification, where it still remains, will be done	As existing grant funding streams are reformed / phased

	through a mix of self certification and free standing tri-partite arrangements	out
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Draft Local Audit Bill

Consultation response form

We are seeking your views on the following questions on the Government's draft Local Audit Bill and proposals for the audit of smaller local public bodies.

If possible, we would be grateful if you could please respond by email.

Please email: foia@communities.gsi.gov.uk

Alternatively, we would be happy to receive responses by post. Please write to:

Future of Local Audit
Department for Communities and Local Government
3/J5 Eland House
Bressenden Place
SW1E 5DU

The deadline for submissions is 5pm on 31 August 2012.

(a) About you

(i) Your details

Name:	Duncan Savage
Position:	Assistant Director - Audit and Performance
Name of organisation (if applicable):	East Sussex County Council
Address:	County Hall, St Anne's Crescent, Lewes, East Sussex, BN7 1UE
Email:	duncan.savage@eastsussex.gov.uk
Telephone number:	01273 482330

(ii) Are the views expressed on this consultation an official response from the organisation you represent or your own personal views?

Organisational response	<input checked="" type="checkbox"/>
Personal views	<input type="checkbox"/>

(iii) Please tick the *one* box which best describes you or your organisation:

Upper tier local authorities	<input checked="" type="checkbox"/>	
Lower tier local authorities	<input type="checkbox"/>	
Parish and town councils	<input type="checkbox"/>	
Audit and accountancy firms	<input type="checkbox"/>	
Professional auditing and accountancy firms	<input type="checkbox"/>	
Other audited public body (e.g. fire authority, police authority, national park authority, pension authority - please state which)	<input type="checkbox"/>	
Other (please state)	<input type="checkbox"/>	

(iv) Do your views or experiences mainly relate to a particular type of geographical location?

City	<input type="checkbox"/>	
London	<input type="checkbox"/>	
Urban	<input type="checkbox"/>	
Suburban	<input type="checkbox"/>	
Rural	<input type="checkbox"/>	
Other (please comment)	<input type="checkbox"/>	

(vi) Would you be happy for us to contact you again in relation to this consultation?

Yes	<input checked="" type="checkbox"/>
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No	<input type="checkbox"/>
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(b) Consultation questions

Draft Local Audit Bill:

Part 1 - Abolition of existing audit regime

Q1. Do you have any comments on the clauses in Part 1 or Schedule 1?

Comments (please state clearly which clause you are referring to):

No comments

Part 2 - Basic requirements and concepts

Q2. Do you have any comments on the clauses in Part 2 or Schedule 2?

Comments (please state clearly which clause you are referring to):

No comments

Part 3 - Appointment etc of auditors

Q3. Do you have any comments on the clauses in Part 3?

Comments (please state clearly which clause you are referring to):

<p>The authority believes the the democratically elected members who form its existing audit committee and are directly accountable to the Council Taxpayers of East Sussex are sufficiently independent to make the decision to appoint the Council's external auditors - this is the response we made to the CLG's original consultation along with a large number of other authorities, and we are disappointed that these views have not been taken into account in the draft bill.</p>
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<p>12 (1) & (2) the clarity on what constitutes an independent member is welcome - this would facilitate a panel with an independent chair but formed of elected members from a range of local authorities, for example their audit committee chairs, advising on auditor appointment for that group of authorities.</p>

<p>12 (6) It is our view that there is no need for the Secretary of State to issue further regulation regarding the establishment and constitution of the auditor panel - any such regulation would further limit the ability of authorities to implement a local, flexible and proportionate solution.</p>
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<p>13 we welcome the clarity on the role of the auditor panel and the flexibility this provides for authorities either to make this part of an</p>

ongoing audit committee or a separate auditor panel that would meet only to advise on the auditor appointment and after that only as needed. This will serve to minimise the cost and bureacracy of these arrangements whilst maintaning independence and transparency.

Q4. Do the clauses in Part 3 strike the right balance between ensuring independence in the audit process and minimising any burden on local bodies?

Yes	<input type="checkbox"/>
No	<input checked="" type="checkbox"/>

Further comments:

See our comments above.

Q5. Does Clause 11 provide sufficient flexibility to local bodies to set up joint panel arrangements and/ or put in place other arrangements to suit local circumstances?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

see comments above

Q6. Does the draft Bill strike the right balance in terms of prescription and guidance on the role of auditor panels?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

see comments above

Q7. Do you have any comments on the proposals set out in paragraphs 26-34 of the consultation document on removal and resignation?

Comments:

Only that the process should be as transparent, robust and non bureaucratic as possible in either event.

Part 4 - Eligibility and regulation of auditors

Q8. Do you have any comments on the clauses in Part 4 or Schedules 3 and 4?

Comments (please state clearly which clauses you are referring to):

No comments

Q9. Do you agree with the proposed definition of connected entities in clause 20?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comments

Q10. Do you have any views on how major audits should be defined in regulations?

Comments:

Only that the selected option should be proportionate, risk based and not add to regulatory costs or costs of the audited bodies.

Part 5 - Conduct of audit

Q11. Do you have any comments on the clauses in Part 5?

Comments (please state clearly which clauses you are referring to):

Welcome the fact that scope and outputs of the audit will remain broadly the same as they currently are, with a risk based approach to the vfm

assessment.

55 (5) (a) would expect that the Auditor General will include audited bodies as well as any representative bodies in the consultation on the Code.

64 (3) and (5) Under ISA 265 the external auditors are required to report to those charged with governance control deficiencies identified through their audit work and these deficiencies are also included in the Annual Governance Report along with recommendations for improvement. Changes in accounting and auditing standards over recent years have meant that this often includes relatively minor control issues, often already identified by the body's own internal auditors, which would in the past have not required formal reporting. Clarity is required as to whether the inclusion of recommendations relating to control deficiencies which have not affected the auditor's overall opinion should also be sent to the Secretary as (5) (a) would seem to imply. This would not in our view be either necessary or proportionate and could result in the Secretary of State receiving a copy of the external auditor's report for every audited body - presumably not what was intended. Such recommendations should continue to be reported to those charged with governance at the body as required by the ISAs.

67 (4) Clarity is required on what is meant / intended by this clause. Reports (including any recommendations) made by the external auditor are considered by "those charged with governance" which would normally mean an audit committee or governance committee within the relevant statutory timescale (for example 30 September for the Annual Governance Report for a local authority's accounts). For other reports or recommendations from the external auditor they would normally be taken to the next planned meeting of the relevant Committee which may in some cases not be within a calendar month.

Whilst we would support the requirements of clauses 64 (5) (a) and 67 (4) in relation to public interest reports, we would question the need or value of applying these clauses to other reports or recommendations made by the external auditor, given that they are already covered by the ISA requirements and other statutory deadlines.

73 (1) (b) what is meant by an "immediate report"

76 (3) we would question whether the right to appeal to the courts against the decision of an independently appointed and independently acting external auditor, acting under the supervision of a regulatory body, is in the public interest.

76 (5) we would oppose the proposal that the legal costs of both the independent external auditor and the appellant resulting for an unsuccessful appeal to the courts should be charged to the audited body - this is perverse in the extreme given the decision is not that of the audited body but of its independent external auditor, and would serve only to encourage vexatious legal actions.

Q12. Do you agree that public interest reports issued on connected entities should be considered by their 'parent' local body?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comment

Part 6 - Data Matching

Q13. Do you have any comments on the clauses in Part 6?

Comments (please state clearly which clauses you are referring to):

See comments below

Q14. Do you have any views on the new owner(s) of the National Fraud Initiative?

Comments:

We are supportive of the NFI and would wish to see it continue and develop into a more flexible, risk based and proportionate model. Our preference would be for the NFI to transfer to the National Fraud Authority on the basis that this fits more closely with their core objectives and they have better existing mechanisms for engagement with the participating bodies.

Part 7 - Inspections, studies and information

Q15. Do you have any comments on the powers provided to the Comptroller and Auditor General to undertake studies and access information within clause 94?

Comments:

we welcome the clarification that the NAO will not have a locus to assess the performance of individual councils or hold them to account in the way it does central government departments.

Q16. Do you think that the National Audit Office should be able to undertake thematic value for money studies regarding all sectors whose bodies are subject to audit under this draft Bill?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further Comments:

If these studies are proportionate, add value to the sector as a whole and do not add to the cost of local public audit. Any programme of studies should be subject to consultation with audited bodies and their representative bodies before it is approved.

Q17. Do you have any comments on the other clauses in Part 7 or Schedule 5?

Comments

No comments

Impact Assessment:

Q18. Does the impact assessment identify the main drivers on fees?

Yes	<input type="checkbox"/>
No	<input checked="" type="checkbox"/>

Are there any other drivers on fees?:

There are two additional drivers on fees which should be taken into account:

- changes in international auditing standards and other regulatory changes**
- the extent to which the successful tenderers have recognised the real costs of delivery or priced the bid at an uneconomic level - whilst this is to some extent their commercial risk it has the potential to affect the**

sustainability of the current fee levels and also to encourage firms to levy additional fees for work that is deemed not to be covered within the core fees (as is our experience with our auditors under the existing Audit Commission framework.)

Q19. Are the estimates of local bodies' compliance costs realistic?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Whilst the estimates of compliance costs appear broadly reasonable, our observation is that the estimated cost of remuneration of independent panel members would only support the operation of the panel as a one- off body (similar to an Independent Remuneration Panel) that would meet only to consider the appointment of the auditor, and not a standing committee with regular meetings.

Q20. Are the estimates of the costs and benefits to businesses realistic?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comment

Proposals for Smaller Bodies

Q21. Do you agree that the threshold below which smaller local public bodies should not be subject to automatic external audit should be £25,000?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comment

Q22. Are the additional transparency requirements we have proposed for those bodies who will not be subject to external audit robust enough to ensure that they will be accountable to the electorate?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comments

Q23. Are these transparency requirements proportionate to the low levels of public money these bodies are responsible for?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

What steps will smaller bodies need to take in complying with these new requirements? :

No comment

Q24. Do you agree that our proposals for the eligibility of auditors of smaller local public bodies will ensure that they have the requisite expertise to undertake limited assurance audits?

Yes	<input checked="" type="checkbox"/>
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No	<input type="checkbox"/>
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Further comments:

No comment

Q25. Are our proposals for the regulatory framework for the audit of smaller bodies proportionate?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

No comment

Q26. Do these proposals provide a proportionate and sufficiently flexible mechanism for procuring and appointing audit services to smaller local public bodies?

Yes	<input checked="" type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

We would suggest that where the smaller body has a close relationship with a larger public body, for example where the smaller body is hosted by the larger body, or uses its financial systems and processes, that the smaller body should have the option to elect to appoint the auditor of the larger body as its own auditor. This would have the potential to reduce costs and the overall burden of public audit without affecting transparency or independence.

(c) Additional questions

Do you have any other comments you wish to make?

Explanatory notes para 22 p124 relating to Clause 12 second sentence should read "An independent panel member must not have been..." as currently worded this would mean that all panel members must be independent rather than the majority as intended.

Our view is that in the spirit of localism and decentralisation no further statutory guidance or regulation on the appointment of auditors is necessary Audited bodies are best placed to put in place arrangements that will meet the legislative requirements and the expectations of local people in the most cost effective manner.

END