

22 MAY 2012

REPORT OF HEAD OF CENTRAL SERVICES**THE FUTURE OF LOCAL EXTERNAL AUDIT****1.0 PURPOSE OF REPORT**

- 1.1 The purpose of this report is to update the Committee on the recent Government response to the consultation on the future of local external audit and the arrangements for external audit in the future.

2.0 RECOMMENDATIONS

- 2.1 **The Committee note the update on the future of local external audit.**

3.0 KEY ISSUES

- 3.1 Following the announcement of its decision to abolish the Audit Commission in August 2010, the Government consulted on its proposals for a new local public external audit framework.

- 3.2 The Government said that the proposals were designed to deliver the Government's objective for a new local public audit framework that places responsibility firmly in the hands of local bodies (such as the Council), giving them the freedom to appoint their own auditors, with appropriate safeguards for auditor independence, from an open and competitive market for local public audit services. They were also designed with the fundamental principle of accountability in mind – providing a system of local public audit that allows local bodies to be held to account for the public money at their disposal, locally to residents and service users, and also as part of a framework of accountability that provides assurance to Parliament about the public money it votes to Government departments and which is in turn devolved to the local level.

- 3.3 Following a meeting of the Council's Overview, Scrutiny & Audit Committee (OSA) held on 14 June 2011 the Head of Central Services formally responded to the consultation proposals in accordance with a deadline of 30 June 2011 under delegated powers approved by this meeting. This was submitted to the Government's Department for Communities and Local Government (DCLG) in liaison with the Chair of OSA and incorporated comments made by OSA.

- 3.3 The Government has recently published its response to the consultation, which sets out the key themes and views raised during the consultation and what the Government now proposes for the new arrangements for audit of principal public bodies (of which the Council is one). The Government's response is attached as Appendix A and can be found on the internet using the following link:

<http://www.communities.gov.uk/documents/localgovernment/pdf/2060619.pdf>

- 3.4 The Government's design principles of the new framework for local public audit are that it should be local and transparent, achieve a reduction in the overall cost of audit, and uphold high standards of auditing - ensuring effective and transparent regulation of public audit and conformity to the principles of public audit.

- 3.5 The key elements are set out in 3.5.1 to 3.5.12 below.

Regulation

- 3.5.1 There should be a consistent regulatory regime for audit, covering the private sector and the local public bodies. The National Audit Office is considered best placed to produce the Code of Practice and supporting guidance for audit of local public bodies. The Financial Reporting Council will be the overall regulator, mirroring its role under the Companies Act 2006. It will be responsible for recognition and supervision of Recognised Supervisory Bodies (professional accountancy bodies responsible for supervising the work of auditors) and for Recognised Qualifying Bodies (professional accountancy bodies responsible for awarding audit qualifications).

Appointment of Auditors

- 3.5.2 The Full Council will appoint an external auditor from the register of local public auditors, on the advice of an Independent Auditor Appointment Panel (IAAP), and following an EU compliant competitive procurement process. This process could be undertaken by the Council on its own or as a shared procurement arrangement with other councils in Leicestershire, which at this stage is the favoured option for the Leicestershire Treasurer's Association (LTA) which includes the Fire and Police authorities. This would mirror the current arrangements the Council has with Leicestershire County Council for the administration of the pension fund one of the key elements of the annual audit of the Statement of Accounts. The auditor would usually be appointed for five years. This will be a major change for the Council, as the Audit Commission currently appoints and contracts with the auditor.
- 3.5.3 The Panel will have an independent chair and a majority of independent members. Any existing Committee that meets the independence requirement and has the necessary skills could potentially be used. The Government intends to allow local public bodies to share appointment panels (and therefore independent members) to ease administrative burdens and reduce costs.
- 3.5.4 The Council will be required to publish details of the auditor appointment, together with the Independent Audit Appointment Panel's advice. If the Council does not follow that advice, it will have to state why not.
- 3.5.5 The Council will be responsible for meeting the costs of the subsequent audits, in accordance with the contract award.
- 3.5.6 The new contracts will not take effect until April 2017.

Rotation of Audit Firms and Audit Staff

- 3.5.7 Auditors will have to comply with the standards and rules set by the regulator. Applying the current standards means the audit engagement partner will be able to undertake audit for a local public body for an initial five years and be re-appointed for a further two years. The audit manager will be able to be appointed for a maximum of ten years. After these periods, these key audit staff will not be able to work with the Council / body for a further five years, although the audit firm itself could be reappointed following the five-yearly competitive procurement process.

Scope of External Audit work

- 3.5.8 The scope of local public external audit will remain broadly similar. As now, auditors will be required to satisfy themselves that the accounts have been prepared in accordance with the necessary directions; proper practices have been observed in the compilation of the accounts; and the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

- 3.5.9 The detail of how auditors should fulfil these requirements will be set out in a code of audit practice. The value for money component should be more risk based and proportionate, with auditors basing their assessment of risk on evidence of arrangements for securing value for money provided by the Council.
- 3.5.10 The duty for auditors to undertake Public Interest Reporting will be retained, as will their ability to charge for reasonable work.
- 3.5.11 Local electors will retain the right to make formal objections to the accounts, but auditors will have greater discretion regarding whether to pursue an objection, to avoid time and cost being spent on vexatious or frivolous objections.

Other Duties of the Audit Commission

- 3.5.12 Following the Audit Commission's closure, Government considers that for new grants to the Council, the grant paying body should agree certification arrangements with grant recipients and auditors. The Government proposes to continue the National Fraud Initiative and intends to rationalise the number of value for money studies with a coherent and complementary programme of offerings across all providers.

Developing the Details and the Legislation

- 3.6 Further discussions will be held with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented. The Head of Central Services attended a discussion event arranged through East Midlands Councils on 24th January, at which officials from the Department for Communities and Local Government, the Audit Commission and National Audit Office were present.
- 3.7 It is apparent that many details remain to be resolved, for example:
- the minimum content of statutory regulations;
 - publication of guidance and possible standard service specifications and contract documents;
 - how the Independent Panel members could be identified, briefed and remunerated (bearing in mind that people with audit knowledge may well be employed by firms bidding for the audit work, which would preclude them from the Panel);
 - demarcation of responsibility between the Panel and the traditional audit committees;
 - how the auditor's value for money judgement will be assessed;
 - the potential impact upon councils and the audit firms of many separate procurements of audit services, particularly if they mostly become due at the same time on a five yearly cycle;
 - achieving a consistent approach across the various auditors (which is an issue in the current system);
 - ensuring that audit fees are reduced (which is an issue particularly for small rural councils like Melton) and that excessive audit work at additional cost is not undertaken, whilst maintaining a robust and quality approach to public audit; and
 - ensuring the market is not dominated by a few key players and that suitable new firms can gain business.
- 3.8 A draft Bill for pre-legislative scrutiny is planned for Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament eventually leading to a new Act of Parliament.

Audit Arrangements for the next five years

- 3.9 The Council is currently audited by PricewaterhouseCoopers LLP (PWC) as allocated by the Audit Commission and this will continue to be the arrangement until a new contract is let.

3.10 The Commission has outsourced all the District Audit work. The outsourced contracts will start from 2012/13. PWC have been re-appointed to audit the accounts for Melton for five years from 2012/13. The appointment will commence on 1 September 2012. The appointment is subject to consultation and representations to the Commission must be made by email by Friday 25 May 2012 outlining the reasons why the Council thinks the proposed appointment should not be made. No response is considered to be necessary.

3.11 District Audit staff will transfer to the firms with the new audit contracts on 31st October 2012.

3.13 Once the audits have been outsourced the Commission will be radically reduced in size. It will become a small residuary body responsible for overseeing the initial three or five year contracts and making any changes to the individual audit appointments during the life of those contracts.

4.0 POLICY & CORPORATE IMPLICATIONS

4.1 There are no further policy implications arising from this report. The final procedures to be followed could have significant policy implications that would need to be addressed once these are known.

5.0 FINANCIAL & OTHER RESOURCE IMPLICATIONS

5.1 The abolition of the Audit Commission should lead to lower audit fees. There is a need to ensure that these are not significantly taken up in the resources and costs associated with running the required procurement exercise, the costs of regulation, and the flow of this to public bodies, as well as the costs of setting up and operating such prescribed IAAP's particularly for a small organisation like Melton where this could be as significant burden.

6.0 LEGAL IMPLICATIONS/POWERS

6.1 These are included in the main body of the report.

7.0 COMMUNITY SAFETY

7.1 There are no specific community safety aspects to this report.

8.0 EQUALITIES

8.1 There are no equalities issues arising from this report.

9.0 RISKS

9.1 External Audit provides reassurance to the general public that the Council is meeting its statutory obligations. They also work with Internal Audit and the Head of Central Services in ensuring that effective internal control procedures are in place.

10.0 CLIMATE CHANGE

10.1 There are no climate change implications relating to this report.

11.0 CONSULTATION

11.1 Management Team and the Head of the Welland Internal Audit Consortium have been consulted. The Head of Central Services has also liaised with S151 officer colleagues in neighbouring authorities over the implications of the proposals.

11.2 The District Councils Network provided a response to the consultation as did this Council following a meeting of the Overview, Scrutiny & Audit Committee held on 14 June 2011.

12.0 **WARDS AFFECTED**

12.1 All wards would be indirectly affected by the proposals in the consultation response.

Contact Officer: D Cowl
Date: 19 April 2012
Appendices: Appendix A – Government Response to the Future of Local Audit Consultation, January 2012
Background Papers: OSA Committee Report and Minutes 14/6/11
Government's Consultation Document
District Council's Network Response
MBC Response to Consultation
Reference: X: Committee, Council & Sub Committees/Governance Committee/2012-13/22-5-12/DG –
The Future of Local External Audit