

Hampshire Fire and Rescue Authority

Governance Committee

Item: 10

30 June 2011

Future of local public audit - consultation

Report of the Treasurer

Contact: Karen Shaw, tel 01962 846194 or email karen.shaw@hants.gov.uk

1. Executive Summary

- 1.1 On 13 August 2010, the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice into the private sector and put in place a new local audit framework.
- 1.2 Local authorities would be free to appoint their own independent external auditors and there would be a new audit framework for local health bodies. The Secretary of State was clear that safeguards would be developed to ensure independence, competence and quality, regulated within a statutory framework.
- 1.3 This report provides an overview of the key aspects of the 'Future of local public audit – Consultation' paper providing a draft response on behalf of Hampshire Fire and Rescue Authority. The consultation covers four distinct areas:
 - Regulation of local public audit;
 - Commissioning local public audit services;
 - Scope of audit and work of auditors;
 - Arrangements for smaller bodies
- 1.4 The consultation incorporates 50 questions covering the key aspects of the DCLG proposals. Responses to the consultation are to be submitted by 30 June 2011. Background to the four areas is outlined below and proposed responses to the consultation questions are outlined at appendix 1. The consultation document can be found in full at <http://www.communities.gov.uk/publications/localgovernment/localpublicauditconsult>

2. Recommendations

- 2.1 That the Governance Committee agree the consultation response to the 'Future of public audit – consultation' (appendix 1) subject to comments agreed during the meeting.

3. Regulation of local public audit (consultation questions 3 – 10)

- 3.1 The Audit Commission is currently responsible for setting audit standards through codes of practice for local government (and health) bodies. Once the Commission has been abolished, there will be a requirement for local public audit to be regulated differently.
- 3.2 The consultation paper proposes a regulatory system for local public audit that is similar to that for private company audit under the Companies Act 2006. The consultation proposes that:
- The National Audit Office would develop and maintain codes of audit practice and any supporting guidance. Any codes of practice will require parliamentary approval as under the current system.
 - The Financial Reporting Council, the body responsible for the supervision of private sector external auditors, will regulate who can undertake local public audit work.
 - There would be a list (referred to as the register of local public statutory auditors elsewhere in the consultation paper) of audit firms who are recognised as qualified to undertake public audit work. Local councils would be required to appoint their external audit from those firms on the register.
 - The consultation paper states that the costs of the new regulatory regime will be passed on to individual audit firms, who may wish to recover such costs as part of their audit fee.

4. Commissioning local public audit services (consultation questions 11 – 28)

- 4.1 The consultation paper proposes that all larger local public bodies (defined as those with income/expenditure over £6.5million as in the revised Accounts and Audit Regulations recently subject to separate consultation) will be able to appoint its own auditor. The appointed auditor must be on the register of local public statutory auditors.
- 4.2 The appointment will be made by Full Authority, on the advice of an Audit (Governance) Committee with opportunities for the electorate to make an input. It is proposed that the Secretary of State should have the power to appoint an external auditor to any local public body who fails to appoint a suitable one themselves.
- 4.3 Auditors would be appointed annually, but with a requirement to open the role to competition at least every five years. The Authority could re-appoint the incumbent audit firm for a maximum of ten years, after which a different audit firm must be used for further audit work.
- 4.4 The consultation paper recognises that there is more than one way of arranging an Audit Committee but sets out the following possible structure:

- The audit committee chair and vice-chair would both be independent of the local public body (i.e. not elected members);
- The elected members on the audit committee should be non-executive, non-cabinet members sourced from the audited body. At least one should have recent and relevant financial experience, but with a recommendation that a third of the members have recent and relevant financial experience where possible; and
- There would be a majority of members of the committee who are independent of the local public body

4.5 Independent members can only be considered for a position if:

- they have not been a member or an officer of the public body within five years before the date of appointment;
- is not a member or officer of any other relevant body;
- is not a relative or close friend of a member or an officer of the body;
- has applied for the appointment;
- has been approved by a majority of the members of the authority;
and
- the position has been advertised in at least one local newspaper and in other similar publications and / or websites.

4.6 The consultation paper also seeks views on the role of the new audit committee and presents two options:

- Option One: The Audit Committee would be required to provide advice to the authority on the engagement and resignation or removal of the auditor. It would then be for the authority to decide whether or not the committee has any other function or duty.
- Option Two: There would be a much more detailed mandatory role for the Audit Committee, possibly including, providing advice on the procurement and selection of an auditor, ensuring effective relations between internal and external audit and reviewing audit reports and quality. Under this option the Audit Committee would report annually to the Full Authority on its activities during the year.

4.7 The consultation paper recognises that individual bodies might wish to collaborate on the appointment of an auditor and so the following legislation will allow both joint procurement of audit services and joint audit committees.

5. Scope of audit work and the work of the auditors (consultation questions 29 – 41)

- 5.1 Currently, public sector bodies are subject to audit with a wider scope than in the private sector, including, for example, value for money and legality issues. The consultation paper presents four possible options for the scope of the audit of authorities. These are:
- Option one: The scope of the audit would become similar to private companies with the auditor giving an opinion on the financial statements and review and report on other information published with the financial statements;
 - Option two: The scope would be similar to the current system in local government, with auditors providing an opinion of the financial statements, concluding as to whether there were proper arrangements to secure value for money and reviewing and reporting on other information including the annual governance statement;
 - Option three: New arrangements to provide stronger assurances on regularity and propriety, financial resilience and value for money; or
 - Option four: A new requirement for authorities to prepare and publish an annual report, which would be reviewed by the auditor with them providing reasonable assurance on the annual report.
- 5.2 Auditors would continue to have the power to prepare public interest reports, with the costs of such reports being recovered from the audited body. Local people would still be able to question the auditor, but the right to make formal objections to the accounts would be removed.
- 5.3 Audit firms would be able to provide non-audit services as long as they adhere to the ethical standards produced by the Auditing Practice Board and that permission is sought from the Audit Committee.

6. Arrangements for smaller bodies (consultation questions 42 – 50)

- 6.1 Different arrangements are proposed for local public bodies with income and expenditure lower than £6.5million. These are summarised in the following table:

	Number of Bodies	Income / Expenditure	Scrutiny Required
Level 1	1,200	<£1,000	<ul style="list-style-type: none"> • Existing governance and accounting arrangements • No external audit required • Annual accounts published, with positive confirmation that this has been done via the precept request, or its

			equivalent.
Level 2	Approx 6,400	£1,000 - £50,000	<ul style="list-style-type: none"> • An Independent Examiner appointed to assess the accounts • The body must publish the details of the Examiner
Level 3	Approx 1,625	£50,000 - £250,000	<ul style="list-style-type: none"> • As Level two, but • The Independent Examiner must have a professional qualification to assess accounts appointed • Existing internal audit arrangements
Level 4	Approx 675	£250,000 - £6.5m	<ul style="list-style-type: none"> • As Level 3 but, • The Independent Examiner must hold a Professional qualification and be registered as a public auditor

- 6.2 The consultation paper proposes that either the Independent Examiner could be appointed by the County or Unitary council for the smaller public body, or the smaller public body themselves appoints such a person via their own audit committee.

7. Environment and sustainability impact assessment

- 7.1 Proposals have no environmental or sustainability impacts.

8. People impact assessment

- 8.1 The proposals in this report are considered compatible with the provisions of the European Convention on Human Rights, the Human Rights 1998 and the Race Relations (Amendment) Act 2000.

9. Resource implications

- 9.1 The cost of the external audit of the Authority's annual accounts is already provided for in the Authority's budget, however, the impact of the proposals on future fee levels is unknown at this stage.

Section 100 D - Local Government Act 1972 - background documents

The following documents disclose facts or matters on which this report, or an important part of it, is based and has been relied upon to a material extent in the preparation of this report.

NB the list excludes:

Published works.

Documents which disclose exempt or confidential information as defined in the Act.

Future of local public audit – consultation, issued by the Department for Communities and Local Government in March 2011.

Proposed response to consultation questions

Regulation of local public audit (consultation questions 3 – 10)

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

Proposed response: Yes

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?

Proposed response: Yes, with the assurance that the process is independent, transparent and robustly monitored.

Whilst the introduction of a register of audit firms may restrict the choice organisations have in appointing their own external auditor, advantages are evident in that individual organisations will have an assurance regarding the quality, qualification and experience of the firm employed.

The cost benefit of such monitoring / control would need to be assessed against the potential impact of audit firms reflecting costs in their audit fees.

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

Proposed response: See Q4, potentially the Financial Reporting Council

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?

Proposed response: Quality must be the cornerstone in attaining an appropriate balance

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?

Proposed response: Any criteria should include appropriate skills, knowledge and experience of the entity being audited (including understanding of accounting and reporting requirements) and demonstrable compliance with the Code of Audit Practice

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?

Proposed response: Consideration should be proportionate to scope and magnitude, those listed in Appendix B to the consultation would appear appropriate.

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?

Proposed response: The regulator should have the ability to undertake additional regulation or monitoring, but this should be proportionate and risk assessed taking full account of current processes to meet the transparency agenda. Income / expenditure alone maybe a slightly narrow view and impact should also be considered.

10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?

Proposed response: See question 9

Commissioning local public audit services (consultation questions 11 – 28)

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?

Proposed response: Yes, however whilst the proposed value of joint procurement with other local authorities is accepted the practicalities of joint Audit Committees is questioned. Therefore in order to support opportunities for joint procurement, the mandatory terms for the Audit Committee should be limited to the appointment of external auditors which would facilitate a 'joint Audit Committee' approach to joint procurement.

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

Proposed response: These proposals significantly change the role and make up of the Audit Committee. Whilst it could be argued that proposals ensure an audit committee is totally independent, the justification for appointing individuals with no accountability to the local electorate is questioned unless the mandatory role of the Audit Committee is limited to the appointment of External Auditors.

Members of the Combined Hampshire Fire and Rescue Authority are appointed by the constituent authorities in proportion to the number of local government electors in their respective areas which in itself provides an element of independence. All members take very seriously their stewardship role in ensuring that the Authority acts responsibly and has high standards in relation to its corporate governance arrangements, as well as performing effectively. Elected members' wider role in the activities of the Authority puts them in a strong position to do this.

It should be recognised that for combined fire authorities, run using a committee system that there are sufficient authority members who are independent of the key decision making committees to carry out an effective audit committee role. Additional independent members of the audit committee may be difficult to recruit,

would add to the Authority's costs and provide little additional benefit for local tax payers.

If there are to be independent members it is questioned whether they should hold a majority on the Committee

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?

Proposed response: Members of the audit committee , as currently constituted, should display a clear spread of competencies to ensure there is not over reliance on any one individual. Financial expertise is clearly one of the competencies that should be considered.

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

Proposed response: It is considered that sourcing willing members may be difficult, but finding those with an appropriate skills mix may prove even harder. If the mandatory role is limited to the appointment of external auditors from a pre-determined short list there would be a question regarding the added-value particularly if it were to add a further cost burden.

It would be important for the question of remuneration to be determined locally, in accordance with the Members' Allowance Regulations, having regard to the advice of the relevant Remuneration Panel.

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?

Proposed response: The appointment of External Auditors will be from a pre-determined short list and the proposals within the consultation are to limit re-appointment, therefore it is not at all clear that mandatory changes to the current constitution of the Audit Committees will add any value nor indeed further independence.

If the desire was to enforce further independence in membership option a) *'only the chair and perhaps a minority of members are independent of the local public body'* provides greatest flexibility

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?

Proposed response: Option 1 provides a clear remit / requirement whilst allowing for greater local discretion

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

Proposed response: The role should be specified as briefly and simply as possible, in line with Option one, but with sufficient detail to allow Audit Committees to have consistent Terms of Reference in the appointment of External Auditors, which is the matter being addressed by this review.

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?

Proposed response: Good practice guidance could be supplied by the National Audit Office but would have to be appreciative of local procurement requirements / regulations

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

Proposed response: Whilst transparency is essential it is questioned the added value this will provide, however, we concur the process proposed is not overly bureaucratic.

20. How can this process be adapted for bodies without elected members?

Proposed response: N/A

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?

Proposed response: Options 1 and 2 could be combined as a two stage process with a timeframe being allocated to option 1, if a public body does not appoint an auditor within given timeframes then option 2 would be invoked.

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?

Proposed response: Only if they have failed to appoint an auditor

23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?

Proposed response: N/A

24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?

Proposed response: Yes

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?

Proposed response: Yes

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?

Proposed response: Yes

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?

Proposed response: Yes

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?

Proposed response: Yes

Scope of audit work and the work of the auditors (consultation questions 29 – 41)

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?

Proposed response: Only option 1 will reduce costs. Other options will increase or maintain costs at existing levels.

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

Proposed response: No, there is currently a host of financial and performance information transparently available to the public. An annual report would further add to the burden of reporting currently in place and indeed cost to the local taxpayer.

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?

Proposed response: See response to 30.

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

Proposed response: See response to 30.

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

Proposed response: See response to 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?

Proposed response: Yes

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?

Proposed response: Yes, subject to appropriate safeguards with regard to independence.

36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?

Proposed response: Yes

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?

Proposed response: The proposal assumes independent members in the make up of the Audit Committee. If this were not the case the designated person may have to be considered further.

38. Do you agree that we should modernise the right to object to the accounts? If not, why?

Proposed response: Yes, however, the cost benefit that auditors should be brought within the remit of the Freedom of Information Act requires careful consideration as does the potential impact on the auditor / audit body relationship

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?

Proposed response: Yes

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?

Proposed response: See response to question 38, however enquiries on the financial affairs of the audited body should still be answered by that body.

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)?

Proposed response: See response to question 38, potential of fees to increase dependent on the level of FOI requests administered.

Arrangements for smaller bodies (consultation questions 42 – 50)

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

Proposed response: N/A

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?

Proposed response: N/A

44. What guidance would be required to enable county/unitary authorities to:

- Appoint independent examiners for the smaller bodies in their areas?
- Outline the annual return requirements for independent examiners?
- Who should produce and maintain this guidance?

Proposed response: N/A

45. Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?

Proposed response: N/A

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?

Proposed response: N/A

47. Is the four-level approach for the scope of the examination too complex? If so, how would you simplify it? Should the threshold for smaller bodies be not more than £6.5m or £500,000? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?

Proposed response: N/A

48. Does this provide a proportionate, but appropriate method for addressing issues that give cause for concern in the independent examination of smaller bodies? How would this work where the county council is not the precepting authority?

Proposed response: N/A

49. Is the process set out above the most appropriate way to deal with issues raised in relation to accounts for smaller bodies? If not, what system would you propose?

Proposed response: N/A

50. Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?

Proposed response: N/A