

## Government Response to Future of Local Public Audit Consultation

## Annex 1

Consultation Proposal	Consultation Response	Government Proposal
<b>Regulation and Registration</b>		
<p>The National Audit Office would be responsible for developing and maintaining the audit codes of practice which set out the approach to audit that auditors must follow when auditing local public bodies. Before preparing or altering a code applicable to any accounts, the National Audit Office will be required to consult appropriate local public bodies and professional accountancy bodies.</p>	<p>93% of respondents agreed that the National Audit Office is best placed to produce the Code of Audit Practice and the supporting guidance</p>	<p>The National Audit Office is best placed to produce the Code of Practice and supporting guidance for audit of local public bodies, subject to Parliamentary approval. The National Audit Office will be required to consult key partners in developing the Code</p>
<p>The Financial Reporting Council would oversee the regulatory regime for local public audit, as it does for the statutory audit of companies under the Companies Act 2006. The Financial Reporting Council would share responsibility for registering statutory local public auditors and monitoring the quality of their audits with Recognised Supervisory Bodies</p>	<p>88% of responses were in agreement that the Companies Act 2006 should be replicated for local public audit. Some of the professional bodies responded that there would need to be some adaptation for the system to work for public bodies.</p>	<p>The Financial Reporting Council will be the overall regulator, mirroring its role under the Companies Act 2006, responsible for recognition and supervision of 'Recognised Supervisory Bodies'<sup>1</sup> and for 'Recognised Qualifying Bodies'<sup>2</sup></p> <p>Mirroring the Companies Act 2006, Recognised Supervisory Bodies will:</p> <ul style="list-style-type: none"> <li>○ have the roles of registration, monitoring and discipline</li> <li>○ put in place rules and practices covering eligibility of firms to undertake local public audit; and</li> <li>○ keep a register of firms eligible to undertake local public audit</li> </ul>

<sup>1</sup> professional accountancy bodies responsible for supervising the work of auditors, and for putting rules and arrangements in place which their members must fulfil before they can be registered auditors

<sup>2</sup> professional accountancy bodies responsible for awarding audit qualifications

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<b>Monitoring and Enforcement</b>		
<p>The appropriate professional accountancy bodies should act as Recognised Supervisory Bodies and have responsibility for monitoring the quality of audits undertaken by their members, and investigate complaints or disciplinary cases, as well as issues identified during their monitoring process. They would also be able to stop a firm being eligible for appointment as a statutory local public auditor, by removing them from the register of eligible local public auditors</p>	<p>Nearly half of respondents suggested that regulation and monitoring arrangements should be the same for audits of all local public bodies.</p> <p>The majority of respondents considered that the role of the regulator in relation to disciplinary cases should be the same for local public audit framework as it is under the Companies Act 2006.</p>	<p>As under the Companies Act 2006, Recognised Supervisory Bodies will monitor the quality of audits undertaken by their member firms, and investigate complaints, disciplinary cases and issues identified during the monitoring of firms on the register of local public auditors.</p> <p>The Accountancy and Actuarial Disciplinary Board (part of the Financial Reporting Council) investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. It is considered that the Accountancy and Actuarial Disciplinary Board should continue to have these powers for local public audit.</p> <p>There will be additional oversight and monitoring of the audits of significant local public bodies in which the Financial Reporting Council will monitor the quality of the audits, mirroring the arrangements for Public Interest Entities under the Companies Act.</p>
<b>Auditor Appointment</b>		
<p>The consultation proposed that all larger local public bodies would be under a duty to appoint an auditor. The auditor would need to be on the register of local public statutory auditors, which should help to ensure that the quality of auditors is maintained.</p> <p>Independence would be maintained in part through a new requirement for local public bodies to put in place independent audit committees</p>	<p>Generally, audited bodies, local authorities in particular, were against the idea of a majority independent audit committee.</p> <p>About a third of respondents agreed that the proposals for audit committees provided the necessary safeguards for the independence of the auditor appointment.</p>	<p>Local public bodies are already responsible for procuring large volumes of goods and services and the Government considers there to be no barriers in terms of expertise that would prevent local public bodies appointing their external auditors, subject to appropriate safeguards to ensure independence in the appointment process.</p> <p>The Government considers that requiring the appointment of an auditor to be undertaken by the full council on the advice of an independent audit committee is the most practical and effective</p>

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	<p>With regard to the make up of the audit committee, of those who indicated a preference, a minimum number of independent members was favoured.</p> <p>Other notable comments that arose were that the makeup of the independent audit committee should be a local decision for each audited body</p> <p>The majority of respondents agreed with the criteria to ensure the quality of independent members. However, a sizeable minority disagreed. The main cause for disagreement was that the criteria listed focussed on ensuring the independence of members rather than their quality and capability.</p> <p>About half of those who responded indicated that they thought it would be difficult to source independent members of a suitable calibre.</p> <p>Most respondents agreed that remuneration would be necessary for independent members.</p> <p>The most popular responses being that the level should be locally determined and that only 'reasonable' expenses should be paid</p>	<p>way of ensuring independence of appointment.</p> <p>In reaching this conclusion the Government listened to the comments that it might be difficult to find enough suitable independent members to ensure a majority of independent members.</p> <p>In order to distinguish between the existing traditional audit committees and the role the Government propose for such a committee in the appointment process, it is intend that the advice on the procurement and appointment of the auditor will be made by an 'Independent Audit Appointment Panel.</p> <p>The Government therefore intends to legislate for a system of local appointment under which all local public bodies with income/expenditure over a threshold (currently £6.5m) will be under a duty to appoint an auditor who must be on the register of local public auditors. Responsibility for the final selection of the auditor and engagement of the auditor on a contractual basis will rest with the local public body. However, that appointment must be made by the full council on the advice of an Independent Audit Appointment Panel, independently chaired, with a majority of independent members.</p> <p>Where the body already has an independent audit committee, they may wish to use that committee to meet this requirement.</p> <p>The Government intend to frame requirements in a way that will allow local public bodies to share appointment panels (and therefore independent members) to ease administration burdens and reduce costs. Local public bodies will be able to choose the model which suits their circumstances, and will have the flexibility to work with other bodies to jointly procure an auditor and reduce the costs of meeting this requirement.</p>

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		<p>To aid transparency in the appointment process the local public body will be required to publish details of the auditor appointment on their website within 28 days of making that appointment, alongside the advice of the Independent Audit Appointment Panel, subject to considerations of commercial confidentiality.</p> <p>If the local public body did not follow the advice of the Independent Audit Appointment Panel in making its appointment, it will be required to publish on its website a statement setting out the reasons why it had chosen not to follow that advice.</p>
<b>Role of Independent Auditor Appointment Panels</b>		
<p>The consultation proposed that the Independent Audit Appointment Panel would have a key role in the selection of the auditor engaged by the audited body, and monitoring the independence, quality and performance of the external audit. It proposed options for specifying in legislation some responsibilities that the Panel should have in relation to the engagement of an auditor, and monitoring the independence and quality of the external audit:-</p> <ul style="list-style-type: none"> <li>• Only specify one mandatory duty for the local public body's Independent Audit Appointment Panel, i.e. to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.</li> <li>• Specify a more detailed role for the Independent Audit Appointment Panel. This would provide more assurance about the independence of the relationship between the audited body and its</li> </ul>	<p>The majority of respondents indicated a preference for the appointment of the auditor as the only mandatory duty for the Independent Audit Appointment Panel, and any other roles or responsibilities would be a local decision.</p> <p>The majority of respondents felt that the process for the appointment of an auditor should not be set out in legislation. Guidance was preferable to a statutory code of practice with the National Audit Office indicated as the preferred provider.</p>	<p>Government intends to prescribe specific functions to the Independent Audit Appointment Panel limited to the external audit, including advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports</p> <p>The arrangements will allow local public bodies to share Independent Audit Appointment Panels, and to expand on the remit of their Panel if they wish, choosing a model which best suits their circumstances</p> <p>It was further recognised that in circumstances where a local public body will have both an audit committee (exercising the traditional functions of such a committee) and an Independent Audit Appointment Panel (whether shared or not) there may well be issues about the demarcation of responsibilities between both groups.</p> <p>It is intended to work with the sector to produce guidance which would set out how the responsibilities of the Independent Audit Appointment Panel could be exercised (and how those responsibilities might interface with those of a more traditional audit committee).</p>

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<p>auditor, and would also ensure that the Panel had a wider role in reviewing the financial arrangements of the local public body.</p>		
<b>Failure to Appoint an Auditor</b>		
<p>The audited body would be under a duty to appoint an auditor. However, it also recognised that there could be some instances under the new system where a body does not fulfil this duty. In these circumstances it was proposed that the Secretary of State would be able to direct the local public body to appoint an auditor.</p>	<p>The majority of the responses favoured the Secretary of State having a power to make the auditor appointment. Most groups of respondents also suggested a staged approach, i.e. where the Secretary of State would direct the public body to appoint an auditor and, should that fail, the Secretary of State would appoint the auditor.</p>	<p>Local public bodies will be required to appoint an auditor by 31 December in the year preceding the financial year to be audited, and notify the Secretary of State if they have not done so. The Secretary of State will be able to direct the local public body to appoint an auditor or make the auditor appointment directly. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.</p>
<b>Rotation of Audit Firms and Audit Staff</b>		
<p>The rotation of staff within the audit firm would need to be in line with the current ethical standards, but the audited body would also be required to undertake a competitive appointment process within five years. The audited body would be able to re-appoint the same firm for a (maximum) second five year period, following competition.</p>	<p>The majority of respondents were in favour of the proposal to limit a firm's term of appointment to ten years. However, some felt that there should be no limit on the length of a firm's appointment, e.g. it would be a barrier to new entrants.</p> <p>The vast majority of responses agreed that the current ethical standards were sufficient safeguard for rotation of audit staff.</p>	<p>The Government considers that there is a balance to be struck between providing enough incentive for audit firms to invest in medium term relationships with local public bodies which would enable them to gain a thorough understanding of that body's operations, and ensuring that those undertaking the audit maintain an appropriate degree of independence and objectivity from the body being audited.</p> <p>The Government considers that the ethical standards of the Auditing Practices Board around the rotation of key audit staff provide enough safeguards without the need for mandatory rotation of firms.</p> <p>The ethical standards provide that the audit engagement partner would be able to perform audit work in respect of a local public body for an initial period of five years and then can only be</p>

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		<p>reappointed for a further two years. The audit manager can only be appointed for a maximum of ten years. After these respective periods have elapsed, these key audit staff would not be able to work with the local public body concerned until a further period of five years had elapsed.</p> <p>However, the Government is also convinced of the need to ensure local public bodies are achieving value for money in procuring audit services. It therefore intends to require that a local public body must run a procurement competition every five years for its audit services. The Independent Audit Appointment Panel would be required to provide advice before any appointment. There would, however, be no bar on the incumbent supplier being reappointed as a result of this competition.</p>
<b>Resignation or Removal of an Auditor</b>		
<p>Safeguards that would broadly mirror those in the Companies Act 2006, but would be adapted to reflect the principles of public audit. The process would be designed to ensure that auditors are not removed, or do not resign, without serious consideration and through a process transparent to the public.</p>	<p>The majority of responses received to this question agreed that these proposals provide sufficient safeguard against the removal or resignation of the auditor.</p>	<p>There will be rigorous, transparent processes for auditor resignation or removal, designed to protect auditor independence, quality of audit, and accountability to the electorate. These broadly mirror those in the Companies Act, but are adapted to reflect the principles of public audit.</p> <p>It is considered that in the first instance it is vital that auditors and audited bodies try as far as possible to resolve any difficulties or concerns (including through using the mediation and conciliation services of the professional accountancy bodies if appropriate).</p>
<b>Auditor Liability</b>		
<p>The consultation recognised that in the absence of a central body providing indemnity to audit firms, it could be possible for audited bodies and auditors</p>	<p>The majority of respondents agreed with the proposals in the consultation document.</p>	<p>Auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body</p>

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<p>to deal with auditor liability as part of their contractual negotiations. A legislative framework, similar to that in the companies sector, could set out the process for setting and agreeing liability limitation agreements.</p>		
<b>Scope of Local Public Audit and Auditors' Work</b>		
<p>The consultation asked for views on four options regarding the scope of future audits for local public bodies. The narrowest option would comprise an opinion on whether the financial statements give a true and fair view of the audited body's financial position and income and expenditure and a review of other information included with financial statements. Wider options suggested included an auditor's conclusion on regularity and propriety, financial resilience and value for money; and a further option of the auditor providing reasonable assurance on an annual report prepared by the local body setting out its arrangements for securing value for money, whether they had achieved economy, efficiency and effectiveness, regularity and propriety and financial resilience</p>	<p>The responses to the consultation were split between the options but indicated a slight preference for leaving the overall scope of audit unchanged.</p>	<p>The scope of local public audit will remain broadly similar. As now, auditors of local public bodies 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 body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources</p> <p>The detail of how auditors should fulfil these requirements will, as now, 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 the local public body's arrangements for securing value for money provided by the local public body</p> <p>Public Interest Reporting: The duty for auditors of local public bodies to undertake Public Interest Reporting will be retained, as will their ability to charge audited bodies for reasonable work. The duty on audited bodies to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting will be retained. A new duty will be placed on audited bodies to publish the Public Interest Report</p> <p>Non-audit services: Auditors will be permitted to provide non-audit services to the audited body, subject to adhering to the Auditing Practices Board's ethical standards and the Independent Auditor</p>

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		<p>Appointment Panel's approval</p> <p>Public interest disclosure: The local public auditor and the Independent Auditor Appointment Panel will be defined as designated persons under the Public Interest Disclosure Act, to enable individuals to make disclosures under the Act</p> <p>Transparency: The new framework will retain the rights of local electors to make formal objections to the accounts, but intend to legislate to provide a power to give the auditor discretion to reject vexatious, repeated or frivolous objections. We would welcome a discussion on whether guidance should be produced to help the auditor exercise that discretion</p> <p>Freedom of Information: The auditor's public office holder functions will not be brought within the remit of the Freedom of Information Act.</p>