



## Report of the Deputy Chief Executive and Director of Resources

### Corporate Governance and Audit Committee

Date: 29<sup>th</sup> September 2010

Subject: Disbanding the Audit Commission; issues for Corporate Governance and Audit Committee

#### Electoral Wards Affected:

Ward Members consulted  
(referred to in report)

#### Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

### 1.0 Purpose Of This Report

1.1 This report provides members with emerging issues following the announcement on 13<sup>th</sup> August 2010 by the Communities and Local Government Secretary, Eric Pickles, that the Audit Commission is to be disbanded. Since the announcement, it is clear that issues are arising, on an almost daily basis and there will remain a lack of clarity for some time. This report highlights known issues at the time of writing; any developments between publication of this report and the date of the Corporate Governance and Audit Committee meeting can be presented as a verbal update.

### 2.0 Background Information

2.1 The announcement to disband the Audit Commission was a surprise and the details of future arrangements are not yet known in any detail. What is clear is that whatever form new arrangements take they will have an impact on local authority audit committees. Potential areas of impact are outlined below. It is worth thinking about these areas in advance to help prepare Corporate Governance and Audit Committee members.

### 3.0 Main Issues

3.1 The stated purpose of the decision to disband the Audit Commission is to refocus external audit on helping local people to hold council's (and other public bodies) to account for spending decisions. The intention is that the changes will pass power down to people, replace bureaucratic accountability with democratic accountability and save the taxpayer £50 million a year nationally.

3.2 The Secretary of State for Communities and Local Government (CLG) identified that the measures would radically scale back centrally imposed, bureaucratic and costly

inspection and auditing. The expertise of the Audit Commission will be moved into the private sector. Since the announcement a number of other options are emerging including partial transfer of the Audit Commission to the private sector by way of a sell – off and establishing a mutual for other parts of the business.

3.3 In summary, the announcement will have the following effects:

- The Audit Commission's responsibilities for overseeing and delivering local audit and inspections will stop
- The Audit Commission's research activities will end
- Audit functions will be moved to the private sector
- Council's will be free to appoint their own independent external auditors

3.4 The following section addresses the implications of the announcement although, at this early stage, all the implications are not clear and, in all likelihood, other issues will emerge.

### 3.5 Appointment of external auditors

The CLG press release suggests that 'councils will be able to appoint their own independent external auditors from a more competitive and open market among audit firms'. It is proposed that the new arrangements will be in place for the 2012/13 financial year.

3.6 Terms of reference for Corporate Governance and Audit Committee provide that the committee is authorized to discharge the function of considering arrangements relating to external audit requirements. If external auditors are to be in place for April 2012 then the procurement and selection process is likely to start in 2011. We shall have to see if there will be an interim step of transferring existing appointments to external auditors for the duration of the agreed period or whether everyone starts from scratch.

3.7 CLG officials will be meeting with representatives of the Local Government Association and the National Audit Office (NAO) to discuss a blueprint for a credible, devolved local government regime. This blueprint is aimed at addressing concerns that the decision to disband the Audit Commission in favour of peer-led reviews and private sector auditing policed by the NAO could lead to the development of cosy relationships between auditors and the audited body. Similar cosy relationships were identified as the key causes of accounting scandals that contributed to the collapse of corporate giants Enron and Worldcom.

3.8 Both the CLG Minister and the Audit Commission have played down fears of Enron style conflicts of interest. It has been suggested that any new system of self appointment would be policed by the NAO and subject to controls that are already in place in firms that audit and provide consultancy to corporate clients.

3.9 The current arrangement organised by the Audit Commission with KPMG is a three year appointment that started with the audit of the 2009/10 accounts i.e. is due to finish when the 2011/12 final accounts audit is completed in the summer of 2012.

### 3.10 Governance and Accountability

The CLG press release states *'For local government these changes are part of the Government's wider focus on transparency that will bring about a revolution in town hall openness and accountability. Local people will now be the audience for assurances that their council is spending money wisely, that they are well governed, their council is financially robust, achieving value for money and providing accurate information and data. These proposed changes go hand in hand with plans to create an army of armchair*

*auditors - local people able to hold local bodies to account for the way their tax pounds are spent and what that money is delivering.'*

3.11 To achieve this goal the Corporate Governance and Audit Committee will need to play a key role. The Committee already leads on governance matters and receives assurances. The Corporate Governance and Audit Committee will need to consider the adequacy of its assurance framework for achieving this goal. What does it need from its external auditor and what does it get from other sources? The Committee needs a clear view of its assurance framework before it appoints external auditors. Much work has already been done on defining the assurance framework and this will need to be looked at again in light of changes to the external audit regime.

3.12 The Committee will also need to consider how effectively it communicates with the public and its role (if any) in reviewing local concerns or questions raised by 'armchair auditors' or in response to questions raised by the publication of details of spending over £500. In doing so, any arrangements will need to ensure that the role of scrutiny committees is not duplicated.

### 3.13 Monitoring good practice

*The CLG press release states that 'The Commission's research activities would stop; ending duplication with others and strengthening the National Audit Office's role in this area.'*

The Audit Commission has been a source of good practice and comparative information that many audit committees have made use of to review the adequacy of their own arrangements. This role will now be taken up by the NAO. It is too soon to tell how this will work in practice and whether similar reports will continue to be available.

### 3.14 Counter fraud

The press release makes no mention of the National Fraud Initiative, so whether this would be picked up by the NAO or discontinued is unknown. Again, participation in and results from the NFI formed part of the assurance to the Committee about the risks of fraud. If changes to the form or extent of the NFI are introduced then the Committee will need to further consider the risks of fraud and corruption, the organisation's arrangements for counter fraud and its own assurance requirements, plus the expectations of the public.

### 3.15 Local Government Ombudsman

*The CLG press release states that 'New plans to strengthen individual citizens' rights of redress should they receive poor council services by enhancing the role of the Local Government Ombudsman through making his findings legally enforceable.'*

3.16 The Committees will need to be aware of new developments here and to make sure that where there are any rulings from the Local Government Ombudsman that have governance implications they are aware of them.

### 3.17 Value for Money

Appointed auditors still have a responsibility to give a conclusion on whether audited bodies have proper arrangements for securing VfM. From 2010/11 this conclusion will be based on the arrangements for:

- Securing financial resilience
- Challenging how we secure economy, efficiency and effectiveness

3.18 There has been a suggestion that this responsibility will pass from the Audit Commission to the NAO. It is unclear whether the intention is to pass responsibility for the overall arrangements or for each council's VfM conclusion. The VfM conclusion for Leeds is currently the responsibility for KPMG.

#### **4.0 Implications For Council Policy And Governance**

4.1 It is too early to say with any surety what the implications of disbanding the Audit Commission will be. As the implications emerge the Council and the Corporate Governance and Audit Committee will need to consider the impact on the 'Leeds Assurance Framework' as the Audit Commission appointed external auditors (in Leeds' case, KPMG) are a fundamental source of independent assurance in assessing the robustness of the Council's control environment.

#### **5.0 Legal And Resource Implications.**

5.1 Legal and resource implications will be monitored and reviewed over the coming months.

#### **6.0 Recommendations**

6.1 Corporate Governance and Audit Committee are requested to note the initial implications of the decision to disband the Audit Commission and request further updates from the Chief Officer (Audit and Risk).

6.2 As part of the further update it is recommended that the impact of disbanding the Audit Commission has on the assurance framework is assessed and reported to the committee.