

**Report of the Director of Resources**

**Report to Corporate Governance and Audit Committee**

**Date: 23<sup>rd</sup> January 2012**

**Subject: Government Response to the Future of Local Audit Consultation**

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| Are specific electoral Wards affected?<br>If relevant, name(s) of Ward(s):   | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| Are there implications for equality and diversity and cohesion and integration?  | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| Is the decision eligible for Call-In?  | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| Does the report contain confidential or exempt information?<br>If relevant, Access to Information Procedure Rule number:<br>Appendix number: | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

**Summary of main issues**

- 1 Following the announcement of the Governments decision to abolish the Audit Commission in August 2010, the Department of Communities and Local Government (DCLG) consulted on proposals for a new local public audit framework. Those 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, 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.
- 2 The Council was firmly of the view that it had the necessary skills, experience and democratic mandate to appoint external auditors and did not support DCLG proposals to require appointment by a committee made up of a majority of independent members. However, DCLG intend to require the Council to form an Independent Audit Appointment Panel and for that panel to make a recommendation to full Council on the appointment of external auditors. Full Council do not need to act on the advice of the Independent Audit Appointment Panel but would be required to publicly set out the reason for not doing so.

On that basis, the Council does not intend to pursue the point any further with DCLG, actively influence the emerging framework and regulations and note the Government's response to the consultation.

### **Recommendations**

- 3 Members are requested to note DCLG's response to the consultation, note the proposal to actively engage with DCLG to influence the emerging framework and regulations and receive further reports on the framework as the timetable for legislative change is clarified.

## **1 Purpose of this report**

- 1.1 This purpose of this report is to inform members of the Government's response to the consultation on the future of public audit. It is acknowledged that this report can be described as lengthy. However, officers are conscious of the need to present to the Committee all relevant matters following this significant consultation exercise.

## **2 Background information**

- 2.1 On 13 August 2010, the Secretary of State for DCLG 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. Local authorities would be free to appoint their own external auditors. A new decentralised audit regime would be established and local public bodies would still be subject to robust auditing.
- 2.2 In March 2011, the Government published the Future of Local Public Audit consultation paper seeking views on proposals for the new local audit framework following the disbandment of the Audit Commission. These proposals were developed by the DCLG following discussion with a wide range of partners and bodies that would be affected by the changes. The proposals in the consultation paper built on the statutory arrangements and professional ethical and technical standards that currently apply in the companies sector with adaptations to ensure that the principles of public sector audit are maintained.
- 2.3 On 15<sup>th</sup> June 2010 the Corporate Governance and Audit Committee received a report from the Chief Officer (Audit & Risk) on the changes proposed by CLG and, subject to the additional comments made by the committee, agreed the Council's response to the consultation.

## **3 Main issues**

- 3.1 The following sections of this report deal with CLG's proposals in the consultation document in turn. The key themes are summarised as are, where appropriate, consultation comments and CLG's response.

### **3.2 Design principles**

- 3.2.1 CLG considered that the responses received to the consultation support the proposed design principles. Those design principles are
- Localism and decentralisation
  - Transparency
  - Lower audit fees and
  - High standards of auditing

The response to the consultation reaffirms CLG's view that having a single body that is regulator, commissioner and provider of local audit services provides a unique monopoly position and weak incentives to drive down costs.

That said, the response from DCLG does not address the issue; should not the consultation ask the question, is it correct to abolish the Audit Commission?

The key drivers of audit fees in the new local public audit framework (aside from commercial and market considerations) will be the scope of audit (i.e. what auditors are actually required to do) and regulation of the work of auditors.

### **3.3 Regulation and registration**

3.3.1 The Government considers that having a new and separate regulator for local public audit would be inefficient, risk duplication and have an impact on fees. Therefore, subject to Parliament's agreement, the National Audit Office (NAO) is best placed to produce the Code of Practice that auditors will be required to follow when auditing local public bodies. The NAO recognises the need for annual and in-year guidance to promote consistency in audit approach and is in principle committed to providing support to auditors which is:

- Principles-based not prescriptive;
- Addresses key themes/issues (not every query);
- Informed by technical forum of local auditors (led by the National Audit Office); and

§ Leaves discretion for an auditor to agree local audit approach based on their risk assessment.

3.3.2 The consultation document asked how the right balance could be 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. The majority of responses suggested that firms should be required to demonstrate their track record in public sector audit and/or their ability to source the appropriate expertise. Other responses included the need to set proper high-level criteria, including the correct skills and qualifications for firms and individuals, but in a way that would not preclude new firms entering the market.

3.3.3 The Government considers that while it is important not to preclude new entrants to the local public audit market, it is also vital that any firm able to be appointed as a local public auditor has a number of suitable individuals with the necessary qualifications and experience to undertake the work. Once enacted, legislation will provide that Recognised Supervisory Bodies (subject to the Financial Reporting Council's oversight and in line with any guidance which the Council produce) will be responsible for determining the level of expertise and experience necessary for any firm to be eligible to be appointed as a local public auditor.

### **3.4 Duty to appoint an auditor**

3.4.1 Generally, audited bodies, local authorities in particular, were against the idea of a majority independent audit committee. Those from other sectors, such as audit and

accountancy firms and the professional bodies, were generally in favour of the proposals.

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. The Government has confirmed on several occasions its commitment to maintaining auditor independence in the new local public audit framework. CLG 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 way of ensuring independence of appointment. Transparency in the appointment process will also be an important part of ensuring auditor independence.

- 3.4.2 In reaching this conclusion CLG state they have listened to the comments made by some Councils about the constitution of their existing audit committees, and that it might be difficult to find enough suitable independent members to ensure a majority of independent members. In order to distinguish between the existing traditional audit committees and the role proposed for such a committee in the appointment process, it is intended that the advice on the procurement and appointment of the auditor will be made by an independent audit appointment panel.
- 3.4.3 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. Responsibility for the final selection of the auditor and engagement of the auditor on a contractual basis will rest with the Council. 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. Where the body already has an independent audit committee, they may wish to use that committee to meet this requirement.
- 3.4.4 Some Council's have said that they are interested in undertaking joint procurement exercises and sharing Independent Audit Appointment Panels or independent members. CLG wants to ensure the arrangements that they put in place facilitate that and ease administration burdens and reduce costs. The Council will be able to choose the model that suits circumstances, and will have the flexibility to work with other public bodies to jointly procure an auditor and reduce the costs of meeting this requirement.
- 3.4.5 CLG intends to hold a series of workshops as they finalise the detail of these proposals, so they are as administratively straightforward and practical as possible. Indeed the Chair of the Corporate Governance and Audit Committee and the Chief Officer (Audit & Risk) have already accepted an invitation to such a workshop being held in Leeds on 19<sup>th</sup> January 2011. Any significant update following the workshop will be reported verbally to the committee.
- 3.4.6 To aid transparency in the appointment process the Council 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.

If the Council does 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 chose not to follow that advice.

### **3.5 Role of the independent audit appointment panel**

3.5.1 The consultation proposed options for specifying in legislation some responsibilities that the Panel should have:

- One mandatory duty for the Council's Independent Audit Appointment Panel, i.e. to provide advice on the engagement of the auditor and the resignation or removal of an auditor.
- 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 auditor, and would also ensure that the Panel had a wider role in reviewing the financial arrangements of the local public body.

3.5.2 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. However, a significant number of responses felt that a more detailed mandatory role for the Panel was preferable. The majority of respondents also 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.

3.5.3 The approach that the Government intends to take is to provide for a limited set of functions on the Independent Audit Appointment Panel in legislation, around advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports. CLG believe that such an approach will provide flexibility for Councils to mould this requirement to suit their own circumstances, and facilitate joint working and joint commissioning. They also recognise that in circumstances where a Council 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. CLG intend to work with the sector to produce guidance setting 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. This allows scope for the Council to determine how they may wish to progress these matters locally. There is scope for establishing a separate panel or, for example, for this Committee to make arrangements for the panel to be a sub-committee; using standing independent members of the committee or bringing in such independents solely for the independent panel.

### **3.6 Involvement of the Public in the Appointment of an Auditor**

3.6.1 The consultation said the Government was considering how local people could make representations about the specification designed by the audit committee for the procurement of an auditor. The options considered were:

- Pre-appointment - the public could make representations to the audit committee about any expressions of interest from audit firms for the audit contract; or
- Post appointment – the public would be able to make representations at any time to the audit committee about issues relating to the auditor.

3.6.2 About equal numbers of respondents agreed as disagreed that this was a proportionate approach to public involvement. The Government considers that its proposals to require the appointment to be made by a full council meeting on the advice of an independent auditor appointment panel; the requirement for that advice to be published (and any departure from it publicly justified); and the other measures proposed around transparency of the auditor appointment, secure the necessary level of transparency for the public in the appointment process.

### **3.7 Failure to appoint an Auditor**

3.7.1 The consultation proposed that the Council 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 such circumstances it was proposed that the Secretary of State would be able to direct the Council to appoint an auditor. Alternatively, where a local public body does not fulfil its duty to appoint an auditor the Secretary of State could be provided with the power to make the auditor appointment.

3.7.2 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. A small majority preferred that a local public body should only be required to inform the Secretary of State in the case where it had failed to appoint an auditor, rather than when they had made the appointment. Other responses suggested that neither scenario warranted informing the Secretary of State as this would go against the principle of localism.

3.7.3 The Government considers it important, given the range of functions and legal responsibilities of a local public auditor, that Councils are required to appoint an auditor by a specified date (31<sup>st</sup> December) in the year preceding the financial year for which that auditor is to be appointed. Any Council not appointing by that date will be required to notify the Secretary of State. The Secretary of State would then have powers to either direct the local public body to make an appointment or make that 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.

### **3.8 Rotation of Audit Firms and Audit Staff**

3.8.1 The consultation proposed that the rotation of staff within the audit firm would need to be in line with the current ethical standards, but the Council would also be required to undertake a competitive appointment process within five years. The Council would be able to re-appoint the same firm for a (maximum) second five year

period, following competition. 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 as this would be a barrier to new entrants.

3.8.2 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 Councils that would enable them to gain a thorough understanding of operations, and ensuring that those undertaking the audit maintain an appropriate degree of independence and objectivity. 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. The ethical standards provide that the engagement partner would be able to perform audit work for an initial period of five years and then can only be 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 Council until a further period of five years had elapsed. However, the Government is also convinced of the need to ensure Councils are achieving value for money in procuring audit services. It therefore intends to require a competitive procurement every five years. The Independent Audit Appointment Panel would be required to provide advice before any appointment. There would, however, be no bar on the current supplier being reappointed following competition.

### **3.9 Resignation or Removal of an Auditor**

3.9.1 The consultation envisaged that a Council might wish to remove its auditor, or an auditor might wish to resign, only in exceptional circumstances, for example, an auditor being in breach of the ethical standards, or a complete breakdown in the relationship. It recognised the importance of having stringent safeguards in place for the resignation and removal of an auditor to protect the independence of the auditor and the quality of the audit. It proposed 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. The majority of responses received agreed that these proposals provide sufficient safeguard against the removal or resignation of the auditor.

3.9.2 The Government considers that it is important that there is a fully transparent process in place to deal with issues of auditor resignation or removal. 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). If differences become irreconcilable, in the case of auditor resignation, Government intend to:

- Require the auditor to give 28 days written notice of his intention to resign to the Council and its Independent Audit Appointment Panel;
- Require the Council to make a written response to the auditor's written notice, sending it, with the auditor's written notice, to its members and the Independent Audit Appointment Panel;



- Require the auditor to then deposit a statement at the main office of the Council, and with the Independent Audit Appointment Panel, setting out the circumstances connected with the resignation of the office that are relevant to the business of the audited body;
- Require the Council to publish the auditor's statement on its website;
- Require the Independent Audit Appointment Panel to investigate the circumstances that led to the resignation and consider whether any action is required; and
- Require the auditor to notify the appropriate regulatory monitoring body of his decision.

3.9.3 In circumstances where a local public body wished to remove its auditor, the process would be similar:

- Require the Council to give 28 days written notification of its wish to terminate the contract, to the auditor and its Independent Audit Appointment Panel;
- Provide that the auditor will have the right to make a written response to the notice, that the Council will be required to send to its members and the Independent Audit Appointment Panel;
- Require the Panel to provide advice to the Council within that 28 days notice period, having regard to any written response made by the auditor;
- Require the Council to have regard to the advice of the Independent Audit Appointment Panel before making a decision whether to remove its auditor;
- Following the 28 days notice period, require the Council to put to a meeting of full council, a resolution to remove the auditor (at which both the auditor and a representative of the Independent Audit Appointment Panel could speak if they wished);
- Require that, if the Council still wished to remove its auditor, it should publish a statement of its decision on its website within 28 days of the decision of the full council. If the Council did not follow the advice of the Independent Audit Appointment Panel, it will be required to explain in its statement what that advice had been, and the reasons why it had chosen not to follow that advice, subject to considerations of commercial confidentiality; and
- Require the Council to notify the appropriate regulatory monitoring body of its decision.

### **3.10 Auditor Liability**

3.10.1 The Audit Commission currently indemnifies auditors for the costs they incur when they are engaged in litigation. In practice, calls on the indemnity are infrequent. Without a liability agreement, audit firms may increase their fees to match the increased risk they face in undertaking the work. Therefore, the Government considers that auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body.

### **3.11 Scope of Local Public Audit**

3.11.1 The consultation asked for views on four options regarding the scope of future audits. 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. The responses to the consultation were split between the options but indicated a slight preference for leaving the overall scope of audit unchanged.

3.11.2 The Government has considered the wide range of views expressed in the consultation and intends to retain the current broad scope so that auditors will continue to be required to satisfy themselves that:-

- The accounts have been prepared in accordance with the necessary directions or regulations and comply with relevant statutory requirements;
- Proper practices have been observed in the compilation of the accounts; and
- The Council has made proper arrangements for securing economy efficiency and effectiveness (value for money) in its use of resources.

3.11.3 The Government considers that the value for money component of the audit could be delivered in a more risk based and proportionate way. This has the potential for a consequent decrease or increase on the level of audit work some Councils might see as a result, but would not expect this in itself to result in an overall increase in the total costs of audit. The auditors will need to base their risk assessment on evidence of arrangements for securing value for money. Government considers that responsibility for providing the evidence rests firmly with the Council, without introducing additional burdens by requiring the production of additional reports or documents. The majority of respondents to the consultation were not in favour of local public bodies being required to set out performance and plans in an annual report. An option that remains available to the Government would be to ask Councils to build on the information they already make available on their arrangements for securing value for money - for example, through the Annual Governance Statement. Input from a range of stakeholders is still needed to develop the value for money element of audit.

### **3.12 Public Interest Reporting**

3.12.1 The consultation proposed to retain existing duties for auditors around Public Interest Reporting and asked whether the new processes for resignation and removal of auditors would mitigate the risk that the introduction of local auditor appointment would impact on the auditor's ability or willingness to publish Public Interest Reports.

The vast majority of responses agreed that the safeguards outlined in the consultation document would allow the auditor to issue a public interest report, but some had concerns that the safeguards may not work in practice.

- 3.12.2 The Government intends to retain the duty for auditors to undertake Public Interest Reporting under the new framework. As is the case currently, audited bodies will be charged for reasonable work involved in undertaking a Public Interest Report. The new framework will also retain the duty on Councils to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting. In addition, in order to improve transparency the Government intend to introduce a new requirement for Councils to publish the Public Interest Report, as well as the existing requirement to publish a notice of and agenda for the meeting at which it will be discussed.
- 3.12.3 However, the Government recognise the concerns expressed around the need for further safeguards for Public Interest Reporting and will work with partners to finalise the details of these, in particular the role of the Independent Auditor Appointment Panel, and arrangements for protecting auditors in undertaking and receiving payment for Public Interest Reports, and how the publication of Public Interest Reports may help to increase transparency and engage local people.

### **3.13 Provision of Non-Audit Services**

- 3.13.1 The consultation proposed that auditors would be able to provide non-audit services to the audited body, with safeguards in the system to prevent any actual or perceived threats to the auditor's independence. It also proposed that auditors should continue to adhere to the ethical standards produced by the overall statutory regulator and permission should be sought from the Independent Auditor Appointment Panel who would provide advice to on whether non-audit work should be undertaken as well as continuing to monitor the relationship between the auditor and the Council. The majority of respondents favoured the auditor being able to provide non-audit services to the local public body in line with the regulator's current ethical guidelines and agreed that the correct balance between safeguarding auditor independence and increasing competition would be achieved.

### **3.14 Public Interest Disclosure**

- 3.14.1 The consultation proposed that the Audit Commission's role in receiving, acknowledging receipt of and forwarding the facts of disclosure should be broadly transferred to the Council's audit committee. It also envisaged that the statutory auditor and the audit committee would continue to be prescribed persons under the Public Interest Disclosure Act and would continue with their role with no change from the current system. The majority of responses agreed that was appropriate and the Government concludes that it makes sense for the auditor and the Independent Auditor Appointment Panel to be designated persons under that Act and intend to legislate accordingly.

### **3.15 Transparency**

3.15.1 The consultation proposed that the new framework for local audit would modernise the way in which local electors' objections would be considered. It proposed that electors would retain the right to make representations and raise issues and questions with the auditor. It also proposed to introduce discretion for the auditor to decide which representations to follow up. The overwhelming majority of respondents agreed that modernisation of the way objections to the accounts are handled is needed. However, whilst respondents accepted that the auditor should have discretion as to whether to pursue particular objections, it was also suggested that standard criteria should be developed to help an auditor determine if he should investigate an individual representation.

3.15.2 The Government's view is that the right of an elector to make an objection to accounts is a long-established and beneficial principle. However, they note that there are many more mechanisms now by which the electorate can hold local public bodies to account than when the right to object to the accounts was introduced more than 150 years ago. Also the costs of auditors investigating objections can be disproportionate to the sums involved in the complaint or to the normal audit costs. Auditors currently have little discretion to refuse to investigate objections and the costs of investigating objections are recovered from the Council. The Government therefore intend to legislate to provide a power to give the auditor discretion to reject vexatious, repeated or frivolous objections and would welcome a discussion on whether guidance should be produced to help the auditor exercise that discretion.

### **3.16 Freedom of Information**

3.16.1 The consultation proposed that Councils' auditors should be brought within the remit of the Freedom of Information Act to the extent that they are carrying out their functions as public office holders, although recognised the potential impact on audit fees and relationship between the auditor and audited body. Some respondents thought that this would be unnecessary as the information would already be available under the Freedom of Information Act from the Council. All respondents thought that audit fees would increase, and there were mixed views about the impact on working relationships.

3.16.2 The Government does not see a compelling case to bring the auditor within the remit of the Freedom of Information Act. The information held by appointed auditors currently is not subject to the Freedom of Information Act because appointed auditors are not currently 'public authorities' for the purposes of the Freedom of Information Act. They consider that the audited bodies being covered by the Freedom of Information Act and the requirements around publication of the accounts, the auditor's report and Public Interest Report, provide sufficient and transparent access to key material for the public. The inclusion of local public auditors within the remit of the Freedom of Information Act would therefore add little, and has the potential to increase audit fees.

### **3.17 Grant certification**

- 3.17.1 The Audit Commission Act gives power to the Commission to make arrangements for the certification of grant claims and subsidies from government departments, and charge authorities the full cost of certification. Certification helps grant-paying bodies satisfy themselves that a scheme is operating as intended. It is not an audit but is designed to provide reasonable assurance to grant-paying bodies about an authority's entitlement to grant or subsidy, or about the information provided in a return. Specific instructions or 'Certification Instructions' are developed for each scheme and different levels of assurance arrangements are applied to different thresholds of grant. Grant certification was not covered by the consultation but the Government have set out their views on grant certification in their response.
- 3.17.2 In 2010-11, certification arrangements were made for 20 schemes, and this has reduced to 16 schemes in 2011-12. Government is reducing the number of ringfenced grant programmes which will lead to a further reduction in the number of grant schemes requiring certification. However, it is expected that a number of grant schemes will be live when the Audit Commission closes – so new certification arrangements are required for these and any new grant programmes.
- 3.17.3 Following the Audit Commission's closure, grant paying bodies for new grants will need to develop separate arrangements, either in the form of free-standing tripartite agreements (between the grant paying body, the payee and its auditor) or self-certification. Free-standing tripartite agreements would require the grant paying body to define the assurance requirements and certification instructions, and the Council to procure the necessary certification from its auditor. Some grant programmes may use self-certification to provide assurance: this relies on the internal governance and controls of the grant recipient and requires the Chief Executive or Section 151 Officer to certify the claim, usually through a standardised declaration. These arrangements will be supported by Treasury guidance, to ensure consistency of approach across Government grant programmes. For existing grant programmes currently certified by the Audit Commission, the Government are working with grant paying bodies to develop transitional arrangements that provide the assurance required.

### **3.18 The National Fraud Initiative (NFI)**

- 3.18.1 Similarly, the NFI was not covered by the consultation but the Government has also published its latest thinking on this initiative. The NFI is a secure, fully accredited, data matching service operated by the Audit Commission under statutory data matching powers now provided for in the Audit Commission Act 1998 with the purpose of protecting the public purse from fraud. The Commission's data matching powers mandate those bodies that are audited by the Commission to submit data for matching purposes. The Commission currently runs a data-matching exercise every two years (although it is working on proposals to develop the NFI into a real-time data matching service). The Government is committed to the continuation of the NFI and the DCLG has been considering the best way of securing that outcome.

This has included talking to other parts of Government – the Department for Work and Pensions and the National Fraud Authority that are interested in taking on operational ownership of the NFI once the Commission is disbanded. The Government will discuss these options with the organisations that submit data and use the NFI.

### **3.19 Value for money studies**

- 3.19.1 The Government have also given their views on value for money studies that were similarly not covered by the consultation. Section 33 of the Audit Commission Act 1998 gives the Audit Commission a duty to promote or undertake comparative or other studies in local authorities so that they can make recommendations to improve the economy, efficiency and effectiveness (the 3Es) and financial management. The Commission also has a duty to report on the effect of central government regulation, legislation, and directions on the ability of local authorities to achieve the 3Es. Before undertaking or promoting any value for money study, the Commission has a statutory requirement to consult with appropriate parties.
- 3.19.2 The Commission has a long history of publishing recommendations from its national studies. The research was used to provide audit guides that were applied through the appointed auditors in relevant local authorities. More recently, with local public bodies working together across sectors and with a wide range of partners in the public, private and voluntary sectors, the Audit Commission have examined how well that collaboration has delivered efficient and effective outcomes.
- 3.19.3 The Government announced in August 2010 that the Commission's research activities would stop. They consider that there is scope for rationalisation in the number of value for money studies published relating to the public sector compared to the number previously undertaken. They would like to see a coherent and complementary programme of offerings across providers including the National Audit Office, central Government and the Local Government Association. This was a view supported by the DCLG Select Committee inquiry into the audit and inspection of local authorities.

### **3.20 Implementation and next steps**

- 3.20.1 Having set out the key elements of the arrangements for principal bodies, Government plan to hold further discussions with local authorities, other public bodies and audit firms, to flesh out the detail of the framework, and how it might be implemented, including transitional arrangements.
- 3.20.2 The Government will bring forward legislation to close down the Audit Commission and to put in place a new framework as soon as Parliamentary time allows. They intend to publish a draft Bill for pre-legislative scrutiny in spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament.
- 3.20.3 The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice. The outsource contracts that the Commission will put in place will start from 2012-13 and are expected to run for three or five years giving

councils time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a small residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

## **4 Corporate Considerations**

### **4.1 Consultation and Engagement**

4.1.1 DCLG have published their response to a consultation document on the future of public audit. The Corporate Governance and Audit Committee agreed the Council's response to that consultation on 15<sup>th</sup> June 2011 and this report sets out DCLG's response.

### **4.2 Equality and Diversity / Cohesion and Integration**

4.2.1 This report does not highlight any issues regarding equality, diversity, cohesion and integration.

### **4.3 Council Policies and City Priorities**

4.3.1 The terms of reference of the Corporate Governance and Audit Committee require the Committee to consider the Council's arrangements relating to external audit requirements.

### **4.4 Resources and Value for Money**

4.4.1 One of the design principle upon which the DCLG consultation was based was 'lower audit fees'. Once the revised arrangements are in place and external auditors appointed, the Council will hopefully see a reduction in its external audit fee. However, the proposals require the Council to undertake a significant procurement exercise and appoint an Independent Audit Appointment Panel, both of which will have resource implications.

### **4.5 Legal Implications, Access to Information and Call In**

4.5.1 The report does not require a key or major decision and is therefore not subject to call-in. The Government have indicated the need for new primary legislation to abolish the Audit Commission and put in place revised arrangements. The legislative timetable is unclear at this point; the Government indicating that legislation will be brought forward when parliamentary time allows.

### **4.6 Risk Management**

4.6.1 There are no direct risk management implications of this report.

## **5 Conclusions**

5.1 Many of the conclusions reached by DCLG are in accordance with the Council's response to the consultation in June 2011. Other views expressed by DCLG merely make practical recommendations that need to be put in place following the demise of the Audit Commission.

The Council was firmly of the view that it had the necessary skills, experience and democratic mandate to appoint external auditors and did not support DCLG proposals to require appointment by a committee made up of a majority of independent members. However, DCLG intend to require the Council to form an Independent Audit Appointment Panel and for that panel to make a recommendation to full Council on the appointment of external auditors. Full Council do not need to act on the advice of the Independent Appointment Panel but would be required to publicly set out the reason for not doing so. On that basis, the Council does not intend to pursue the point any further with DCLG

- 5.2 DCLG have stated their intention of working with Councils on the developing framework. The Council will actively participate in DCLG workshops and seek to influence the emerging framework and regulations.
- 5.3 It is also worth concluding that there remains much further work to do. Specifically, the Council needs to:
- Determine whether it wishes to pursue joint Independent Appointment Panels and/or joint procurement exercise;
  - Consider the implications of the revised arrangements on the constitution, for example, Council functions and terms of reference for Corporate Governance and Audit Committee;
  - Terms of reference for the Independent Audit Appointment Panel and, for example, whether this would be a sub-committee of Corporate Governance and Audit Committee, or some other arrangement and
  - Develop a project plan for the procurement of external auditors and consider the timescales for such a project.

## **6 Recommendations**

- 6.1 Members are requested to note DCLG's response to the consultation, note the proposal to actively engage with DCLG to influence the emerging framework and regulations and receive further reports on the framework as the timetable for legislative change is clarified.

## **7 Background documents**

- 7.1 Future of local public audit, consultation, Department of Communities and Local Government, March 2011
- 7.2 Future of Local Public Audit; Consultation Response, report to Corporate Governance and Audit Committee, 15<sup>th</sup> June 2011.