

## **Future of Public Audit Report of the County Treasurer**

Please note that the following recommendations are subject to confirmation by the Committee before taking effect.

### **Recommendation:** that Members

- i. Note the proposed draft Local Audit Bill 2012 and the response of Devon County Council which was submitted by the closing date of 31<sup>st</sup> August 2012

## **1. Introduction**

1.1. On 6 July 2012, the Department for Communities and Local Government published a draft Local Audit Bill and related impact assessment. The draft Bill was anticipated in this year's Queen's Speech and is the latest development in the government's policy to abolish the Audit Commission and enable councils to appoint their own external auditors.

1.2. As a draft Bill, it is presented for pre-legislative scrutiny and contains a number of consultation questions which are aimed to enable the Bill to be refined before full legislation is introduced in Parliament in due course. As yet, no firm timetable for the appointment of auditors and the abolition of the Audit Commission has been established.

1.3. The government's impact assessment estimates the savings to the public purse to be over £1bn during a ten-year period, of which £650m will be realised over the next five years. However, these estimates include the effect of the previously implemented abolition of the Comprehensive Area Assessment inspection regime, the impact of the outsourcing of the Audit Commission's in house audit practice and the associated savings from the reduction in the size of the Audit Commission. The longer term savings as a direct result of the move to local external audit are significantly more modest.

1.4. The document was issued in July 2012 as a consultation document inviting affected bodies to submit comments by 31<sup>st</sup> August 2012. Unfortunately due to there not being an Audit Committee before the closing date it was not possible to bring a response before Members prior to its submission. Officers therefore prepared a response which hopefully reflected the views of the Committee as expressed in previous discussions and previous responses to consultations that have been a precursor to this Draft Bill. This was then discussed with the Chair of the Committee before being submitted to the DCLG in line with the required timetable. For information, I have appended the DCLG consultation response form to the end of this report and the response provided by Devon County Council.

## **2. Part 1 - Abolition of existing regime**

2.1. Part 1 of the draft bill repeals the Audit Commission Act 1998 and abolishes the Audit Commission. Although it does not specify a date for the abolition, the inference is that it will cease to exist after 2015/16 with the existing audit contracts transferring to a new body.

2.2. Local bodies (including Health bodies) will be responsible for appointing their own Auditors from 2017/18 (assuming existing contracts are not extended, appointment will need to be made by 31 December 2016)

### 3. Part 2 - Basic Concepts and requirements

3.1. Part 2 of the draft bill sets out the general accounting and audit requirements for local public bodies. Smaller public bodies (annual turnover less than £6.5M) will be subject to a less onerous audit regime with those bodies with a turnover less than £25K pa not being subject to an external audit. There would however be a "new proportionate, transparency code for all smaller bodies with an annual turnover less than £200K pa" requiring the publication (probably online) of all items of expenditure and end of year accounts, Annual Governance statement, formal meeting minutes, Internal Audit report, lists of councillors or equivalent and location of any public land and building assets.

### 4. Part 3 - Appointment of Auditors

4.1. Part 3 of the draft bill sets out the appointment framework for Auditors. The audited body will have to take into consideration the advice of an **independent auditor appointment panel** before making the appointment of their auditor. The Bill makes it clear that the appointment of an auditor must be made by full council and cannot be delegated to any executive function.

4.2. The appointment must be made at least every 5 years and existing auditors may be reappointed. Appointments may be made for more than one year and there is no requirement for incumbent auditors to step down after 10 years as was contained in the original consultation document. The impact assessment notes that existing ethical standards published by the Financial Reporting Council already cover issues of long association and so there is no need to specifically require auditors to regularly step down from local public audit work.

4.3 The **Independent auditor panel** must consist of a majority of independent members and must have an independent chair. To be classified as independent, a panel member must not have been a member or officer of the body within the last five years, and must not at that time be a relative or close friend of a member or officer of that body.

4.4 Provided that the body's current Audit Committee (or equivalent) meets the independence criteria, it can fulfil the function of the auditor panel. Bodies can share independent panels should they so wish.

4.5 The auditor panel has three functions set out in legislation. These are:

- To advise on the appointment of an auditor;
- To advise the local body on the maintenance of an independent relationship with the auditor; and
- To advise on proposals for a public interest report.

4.6 Bodies will be able to delegate additional functions to the auditor panel if they so wish. The legislation also includes powers to prepare guidance to be issued on the role and practical operation of the panel.

4.7 The auditor panel must act in a transparent manner and the draft Bill requires that all appointments are publicised together with the advice given by the panel and the reasons why the local body chose not to follow the advice given where relevant.

4.8 The draft Bill includes the provision for the Secretary of State to make regulations regarding the resignation or removal of an auditor. However, it is envisaged that the auditor will be required to

make a statement explaining their reasons for their resignation to the audited body and the auditor panel, and the auditor's supervisory body. The local body would then be required to publish a response.

4.9 In the case of removal, the local body would be required to give notice to both the auditor and the auditor panel, including a statement of reasons. The auditor will be able to respond to this statement, with the response considered by the auditor panel. The decision to terminate the appointment of the auditor will also be subject to the advice of the auditor panel.

## 5. Part 4 - Eligibility and regulation of Auditors

5.1. The draft bill provides for the Secretary of State to authorise the professional accountancy bodies to act as recognised supervisory bodies for local public audit. In practice, the Secretary of State will delegate these powers to the **Financial Reporting Council**, who will be able to authorise the professional bodies to act as supervisory bodies. This effectively mirrors the arrangements under the Companies Act 2006

5.2. The role of the supervisory bodies will be to put rules and practices in place to cover:

- The eligibility of firms to be appointed as local public auditors;
- The qualifications, experience and other criteria that individuals must have before being permitted to carry out an audit of a local public body and sign off an audit report; and
- Arrangements for monitoring the quality of audit work by member firms. In particular, the Financial Reporting Council will have responsibility for monitoring the quality of "major audits", but a definition of this term has yet to be prepared.

5.4 The Secretary of State will make regulations regarding the preparation and maintenance of a register of those firms and individuals eligible to undertake local public audit work which it is expected will be held by "one or more of the recognised supervisory bodies".

5.5 The draft Bill requires an auditor to ensure that they are independent of the audited body and cannot be a member or officer of that body, or an officer or employee of an entity connected with the body (i.e. an entity whose financial transactions are consolidated within the group accounts of the local public body). There will not be a criminal offence attached to lack of independence as in the Companies Act, but the audit panel will play a key role in maintaining suitable auditor independence and will advise the audited body on the maintenance of an independent relationship with their auditors at least once a year.

## 6. Part 5 – Conduct of audit

6.1. The National Audit Office will be responsible for preparing detailed audit codes of practice. Any draft Code will be subject to consultation and laid before Parliament, where it will be passed after 40 days as long as there has been no resolutions against it. Any Code needs to be produced and agreed at least every five years.

6.2 Audit scope and outputs "will remain broadly the same as they currently are". This includes the need to be satisfied that the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Similarly "Reports in the Public Interest" and the right for local electors to be able to inspect, question, object and make copies of the statement of accounts, related records and the auditor's report remain. In the case of objections, the auditor will however have discretion to reject vexatious, repeated and frivolous objections. The right of an Auditor to apply to the court for a declaration on the lawfulness of an item of account and the right for an auditor to seek a judicial review of a decision of the audited body also remains.

6.3 The Accounts and Audit Regulations will continue to be required and published from time to time.

## **7. Part 6 – Data matching**

7.1. The Audit Commission Act 1998 requires local public bodies to provide data for the purposes of data-matching, in particular, for use as part of the National Fraud Initiative. The draft bill provides the Secretary of State with the powers to require data to be provided to the new “owner” of the National Fraud Initiative. The National Fraud Authority (an executive agency of the Home Office), the Department for Work and Pensions and the Cabinet Office have all expressed an interest in taking over responsibility for the National Fraud Initiative and discussions are on-going.

## **8. Part 7 – Inspections, studies and information**

8.1. Section 10 of the Local Government Act 1999 enables the Secretary of State to require the Audit Commission to carry out an inspection of a local authority. The draft legislation amends this so that the Secretary of State can appoint an inspector to carry out such an inspection. However, the government envisages “that this power would be rarely used, only where there are concerns about significant governance failure in a local authority”.

8.2 The Audit Commission is currently winding down its programme of national studies. Remaining studies will focus on summarising the results of audits and on the materials drawn from the support and information provided to auditors. For the future, “the Government would like to see a smaller, coherent and complimentary programme of value for money studies on local issues”. The National Audit Office currently envisages undertaking a small number (6 in 2014/15) of local studies and is committed to work in collaboration with other agencies such as the Local Government Association and the Care Quality Commission.

## **9. Impact Assessment**

9.1. The Government have produced an Impact Assessment which calculates that the new framework will provide savings of over £1Bn to the public purse over the next 10 years. Of this £650M will be realised over the next 5 years. Once the new framework is in place it is estimated that there will be annual savings of £164M pa (£140M to public bodies, £24M to Central Govt) compared to baseline year. The baseline for this assessment is 2009/10 meaning that the figures include the savings already identified from the ceasing of the CAA and inspection regime, the outsourcing of the Audit Commission’s In house audit practice and the resultant down sizing of the Commission.

9.2. The Impact assessment assumes that Audit fees will continue to reduce in line with Audit Commission forecasts over the lifetime of the recently awarded contracts and will remain around the same level or lower once public bodies are able to appoint their own Auditors. The On-going costs of the new framework include £2M pa NAO regulatory costs, £1.8M pa for NAO VFM studies, both of which should be incorporated in the NAO budget and not be passed on to local public bodies. The Regulatory costs of the Financial Reporting Council (FRC) will probably be included in Audit Fees so are not separately identified. The expected costs to local public bodies of compliance with the new regime are estimated at £4.43M pa which includes the annualised costs of procurement exercises and the costs of recruiting and remunerating the independent members of the Auditor Appointment Panels.

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Electoral Divisions: All

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Background Paper: None