
**Cabinet
Council**

21st June 2011
28th June 2011

Name of Cabinet Member:

Cabinet Member Strategic Finance and Resources – Councillor Duggins

Director Approving Submission of the report:

Director of Finance and Legal Services

Ward(s) affected:

City Wide

Title:

Response to Consultation: Future of Local Public Audit

Is this a key decision?

No

Executive Summary:

This is a response to a government consultation on the future national arrangements for external audit and the administration of audit committees. The City Council's recommended response is included in full at Appendix 1. The key areas of concern addressed are as follows:

The consultation document identifies four design principles: localism/decentralisation, transparency, lower audit fees and high standards. The City Council's response challenges whether any of these design principles will be met by the proposed approach.

The consultation proposes that a range of duties performed previously at a national level by the Audit Commission should now be carried out at a local level. The City Council's response questions whether this is appropriate both because it is unlikely to provide for genuine independence and because the expertise to perform some of the duties does not currently exist at a local level.

There are proposals to enforce measures to introduce independent membership of the Audit Committee. The City Council's response welcomes a move to increase external representation on Audit Committees but rejects the suggested extent of such changes being enforced through legislation. The response contends that the aim of increasing the quality of membership is not necessarily aligned with securing external members. In addition, the response questions whether the proposals will work in practice and acknowledges that it will probably be necessary to offer payment in order to attract independent members, although this is not welcomed within the response.

Overall the consultation proposes a decentralisation of responsibilities from the Audit Commission to local government. It is not clear that this move will provide any genuine choice or flexibility in the provision of services to local people. Instead there is a risk that the new arrangements will involve the whole of local government in commissioning and regulatory activity that takes far more time and costs more than existing practices. This view is reflected in the response.

Much of the consultation is concerned with the composition and duties of Audit Committees. Due to the constraints of the City Council's calendar of meetings, the Audit Committee will not have had the opportunity to consider this report prior to the end of June when the consultation response is due. The Chair of Audit Committee has agreed that the Committee's members should have the opportunity to consider and comment on the report on an individual basis with any comments received being cleared by the Chair and incorporated.

Recommendations:

Cabinet is recommended to consider the consultation response in Appendix 1 and propose any changes for consideration by Council.

Council is recommended to approve the consultation response including any changes proposed by Cabinet.

List of Appendices included:

Appendix 1: Consultation Response

Other useful background papers:

Future of Local Public Audit (Available on the website of the Department for Communities and Local Government)

Has it been or will it be considered by Scrutiny?

No (but considered by members of Audit Committee)

Has it been or will it be considered by any other Council Committee, Advisory Panel or other body?

No

Will this report go to Council?

Yes – 28th June 2011

Report title:

Response to Consultation: Future of Local Public Audit

1. Context (or background)

1.1 A consultation document entitled the Future of Local Public Audit was published by the Department of Communities and Local Government on 30th March 2011 with a closing date of 30th June 2011. The document poses 50 questions in total but there are four key issues for local government:

- Whether the proposals meet the Government's stated design principles,
- What the new arrangements should be put in place for appointing external auditors after the abolition of the Audit Commission,
- Whether the proposals represent additional burdens for local authorities,
- What steps should be taken to increase independent representation on local Audit Committees.

1.2 The consultation questions and the Council's proposed response are included in full at Appendix 1. A number of the questions are not relevant to local authorities or are one step removed from issues that are likely to have a direct impact upon the City Council. This includes consideration of which body should be responsible for maintaining the list of statutory public auditors at a national level for instance. The City Council's response is restricted to those issues that are of direct relevance to the City Council. The broad thrust of the proposed responses for the remaining questions and the reasons behind these are covered in the body of this report.

2. Options considered and recommended proposal

2.1 The options for this report are to accept the proposed response in full, to suggest amendments for acceptance by Council or to not send a response. The main areas of response are summarised below.

2.2 Design Principles (Question 1)

The consultation document identifies four design principles: localism/decentralisation, transparency, lower audit fees and high standards. The City Council's response challenges whether any of these design principles will be met by the proposed approach.

Localism/decentralisation – These proposals represent a shift of duties to a local level. However, the view of officers is that this localism is unlikely to provide any discernible benefit to local residents and taxpayers. Also, whilst this shift will require new arrangements to be put in place at a local level the consultation does not indicate any new resources to pay for these arrangements.

Transparency – Existing arrangements for the inspection of accounts, Freedom of Information requests, improved local authority websites and the recently introduced transparency agenda mean that local government finances are now far more open than at any time in the past. The limiting factors to complete transparency are the amount of time that is available to individuals to look at huge amounts of detail and the amount of interest that actually exists in doing this. It is difficult to envisage how the proposed changes in the regime for appointing external auditors will have any significant impact upon transparency. Therefore, the response challenges whether transparency is likely to improve as a result of the consultation's proposals.

Lower Audit Fees – One of the premises on which the consultation is based is that the introduction of a competitive process for the appointment of external auditors will reduce the level of fees paid. However, the consultation document itself makes reference to a potential lack of competitiveness in this particular market place and potential barriers to new firms entering the market. In addition, we are aware from other work performed by the key players in this market (the "big four" accountancy firms) that charges will be driven by the cost to them of their professionally qualified staff which dictates the hourly rate at which their services are provided. Finally, if some or all of the most burdensome options set out in the consultation paper are selected, this would also have an impact on the overall cost of the audit. There is a high risk therefore that there will be no strong downward pressure on audit fees and that audit fees will either remain at similar levels to those charged currently or increase in future years.

High Standards – It is not clear from the consultation document that there are any measures being proposed to improve standards. The Government has already taken steps to reduce the burden of the local government performance assessment framework. At the same time the consultation document talks about increasing transparency and enabling local people to hold local government to account for the way that their money is spent. Putting to one side the merits or otherwise of these steps they are not ones designed to ensure or improve standards of local public audit in a consistent way.

2.3 Duties Performed at a National Level Previously (Questions 16, 17 and 37)

The consultation proposes that a range of duties performed previously at a national level by the Audit Commission should now be carried out at a local level. The City Council's response questions whether this is appropriate because: it is unlikely to provide for genuine independence; the expertise to perform some of the duties does not currently exist at a local level and; it is likely to lead to a lack of consistency between authorities. Overall the consultation proposes a decentralisation of responsibilities from the Audit Commission to local government. It is not clear that this move will provide any genuine choice or flexibility in the provision of services to local people. Instead there is a risk that the new arrangements will involve local government in commissioning and regulatory activity that takes far more time and costs more than existing practices. This view is reflected in the response. Additional duties for Audit Committees could include establishing whether extra non-audit work should be undertaken by appointed auditors, providing advice to Council on the appointment of the auditor, duties in relation to public interest disclosure and overseeing the resignation or removal of the auditor. These additional duties represent an additional burden, demand the establishment of local protocols and procedures and require a level of understanding and expertise in order for them to be performed.

2.4 Audit Committee Membership (Questions 12, 13 and 14)

The consultation seems to move the discussion around independent members on Audit Committees to a new level in that it proposes that larger local public bodies like the Council will operate an Audit Committee where the majority of its members are independent of the body. Whilst the City Council's response welcomes in principle some increase of external representation on Audit Committee it challenges:

- the extent to which this representation should go;
- the principle that this will automatically increase the quality of such membership and;
- how this will work in practice.

At the very least the Council's response acknowledges that it will probably be necessary to introduce payments in order to attract high quality independent members.

3. Results of consultation undertaken

- 3.1 There has been no specific consultation for this report. The City Council's Audit Committee are the key audience and have been involved in putting the response together. Any interested parties in the issues covered by the consultation are able to respond directly to Government.

4. Timetable for implementing this decision

- 4.1 The approved consultation response will be sent to the DCLG to meet the 30th June 2011 deadline.

5. Comments from Director of Finance and Legal Services

5.1 Financial implications

There are no specific financial implications resulting from this report.

5.2 Legal implications

There are no legal implications arising from this report

6. Other implications

6.1 How will this contribute to achievement of the Council's key objectives / corporate priorities (corporate plan/scorecard) / organisational blueprint / Local Area Agreement (or Coventry Sustainable Community Strategy)?

The arrangements for auditing the City Council's accounts are connected with achievement of the Council's objectives by helping us to review what we do to ensure value for money and by ensuring that our performance is well managed.

6.2 How is risk being managed?

Whatever the final arrangements for auditing the Council's accounts we can expect that the audit approach will always be informed by identification of the key risks.

6.3 What is the impact on the organisation?

No specific impact identified.

6.4 Equalities / EIA

No specific impact identified.

6.5 Implications for (or impact on) the environment

No specific impact identified.

6.6 Implications for partner organisations?

No specific impact identified.

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Other members				
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Chris West	Director of Finance and Legal Services	FLS	24.5.11	24.5.11
Cllr George Duggins			26.5.11	26.5.11

This report is published on the council's website:
www.coventry.gov.uk/meetings

Appendix 1 - Consultation Questions and Proposed Response

- 1. Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?**

The Council agrees with three of the four design principles identified – transparency, lower audit fees and high standards of auditing. We challenge whether the remaining principle of localism and decentralisation is appropriate or beneficial in the area of external public audit.

On the question of whether the proposals in the document meet these design principles, we offer the following response:

Localism and decentralisation – The proposals represent a clear shift of responsibility from the centre to individual bodies. However, insofar as this increases the level of local choice, it is difficult to see that this represents any discernible benefit to local stakeholders.

Transparency – There are extensive provisions already in place to allow for the transparency of public expenditure decisions. We challenge whether a complete overhaul of public sector audit arrangements is needed to further increase transparency and dispute the level of appetite for greater transparency in public sector accounts per se.

Lower audit fees – Whilst the introduction of a competitive process for public audit contracts may provide for the possibility of lower fees it cannot provide a guarantee that this will be the result. There is a very real risk that fees will increase rather than decrease over time. In addition, there will be a hidden but real cost resulting from hundreds of individual organisations becoming responsible for their own external audit procurement process. Also, if some or all of the most burdensome options set out in the consultation paper are selected, this would also have an impact on the overall cost of the audit.

High standards – There is nothing inherent within the proposals that indicates the likelihood of any change to existing standards of auditing.

- 2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?**

No comment.

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

We have no strong view on which body should produce the Codes of audit practice and associated guidance. However, if the National Audit Office is chosen, this fails to address the consultation documents observation "that there should be a consistent regulatory regime for audit covering the private sector and the local government and local health sectors".

- 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?**

No comment.

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

No comment.

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?**

No comment.

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?**

No comment.

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?**

No comment.

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?**

No comment.

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

No comment.

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?**

No comment.

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

The criteria documented for choosing independent members seems to focus primarily on avoiding conflicts of interests. The Council's view is that the effective operation of Audit Committees would be better served by focussing on the skills of Committee members. A well-informed, highly motivated and interested committee member, even if they are not 'independent' is likely to prove more effective than one who does not possess the skills, desire and time to apply to the demands of the role, however independent they are. In addition, whilst there is a need to ensure that any appointment is truly independent, the current proposal could reduce the number of potential candidates significantly if for example they cannot be a relative or close friend of a member/officer of the authority. It may be more appropriate if this limitation focused on key personnel rather than the whole Council.

- 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?**

It is imperative that any member of the Audit Committee has the appropriate skills and experience that enhances the overall performance of the Committee. Whilst accepting that training can support this process, it would be beneficial that any member had some expertise that they bring with their appointment. Such expertise should not be limited just to finance but could include areas such as performance management, risk management and audit.

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

This will in some way be dependent on the expectations of the skills that independent members must have. It is likely that the more expectations exist about skills and experience, the smaller the pot of talent is likely to be. It is also likely that if candidates with such skills are required then so will remuneration. It is difficult to suggest a remuneration level as there are a number of factors that will impact upon this. What is clear is that any move to remunerate external members will represent an additional cost to local authorities and the Council's preference would be to avoid the need for such remuneration.

- 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?**

The Council welcomes the principal of increasing independent representation on the Audit Committee to help strike a balance between objectivity and an in-depth knowledge of the issues. However, it is not convinced by the argument that an independent chair or a majority of independent members is necessary to avoid improper influence or ensure independence in the appointment of auditors. The Council's view is that any new regulation should stipulate the level of independent membership, ideally setting this at a minimum of one and certainly not trying to impose more 50% independent membership or that the chair must be independent.

- 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?**

No comment on which of these is the best option.

However, whichever option is chosen this will represent an additional range of duties and/or responsibilities required to be performed at a local level. The Council's view is that:

- the expertise to perform some of the duties does not currently exist at a local level,
- the proposals are likely to lead to a lack of consistency between authorities,
- it is not clear that this move will provide any genuine choice or flexibility in the provision of services to local people,
- the new arrangements will involve local government in regulatory activity that takes far more time and costs more than existing practices
- these additional duties represent an additional burden, on local government.

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

Yes – In the absence of an overarching national body these are appropriate roles and responsibilities. See answer to question 16. No comment in respect of legislation.

- 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?**

No comment.

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

No comment.

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

No comment.

- 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?**

No comment.

- 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?**

No comment.

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

No comment.

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

Yes – at most. See question 26.

- 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?**

No comment.

- 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?**

The proposal to allow firms to serve as auditors for up to two five year periods is at the high end of what the Council regards as a reasonable term. There is a risk that this length of

time will lead to auditors seeking to prolong their audit term at the expense of observing an appropriate degree of independence.

- 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?**

The proposed safeguards appear to be appropriate.

- 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?**

Yes.

- 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?**

Option 1 most closely meets the stated aims of decentralisation and localism, reducing the burden on public bodies and creating a consistent regulatory regime for audit covering the private sector and the local government and local health sectors.

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

Making plans and performance information publicly available throughout the year and through annual reports is good practice and widely carried out by local government. Legislating on the content and format of these would be a backward step, would re-introduce the considerable burdens formerly placed on local authorities by the requirements to produce Best Value Performance Plans and would go against the stated aims of promoting localism and decentralisation.

- 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?**

Local authorities already report on these and again and requiring this in a particular format is not helpful.

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

No comment.

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

Local authorities should not be required to produce an annual report to a prescribed format as set out in the response to question 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?**

No comment.

- 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?**

Yes.

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

The correct balance has been struck.

- 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?**

Our view is that it is appropriate for prescribed persons for the purpose of receiving Public Interest Disclosures should be entirely separate from the local public body. Therefore, we disagree with members of the audit committee becoming prescribed persons.

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

Yes.

- 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?**

It is not clear in sections 4.52 to 4.54 what changes to the current process are being proposed. The difference between raising objections to the accounts and making representations to the auditor is not sufficiently well defined to establish whether the process is the most appropriate one or not.

- 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?**

We agree that the remit of the Freedom of information Act should be inclusive not exclusive. However, we do not envisage that there will be many occasions when the Freedom of Information Act would be invoked in relation to local authority audit. Our view is that the large majority of questions will concern information available through the local authority. Our concerns in relation to Q41 outweigh any benefits that might arise from including auditors.

- 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)?**

Our primary concern is in relation to the likelihood that any Freedom of Information Act costs would be reflected inevitably in higher costs charged to local authorities.

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

No comment.

- 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?**

No comment.

- 44. What guidance would be required to enable county/unitary authorities to:**
a.) Appoint independent examiners for the smaller bodies in their areas?
b.) Outline the annual return requirements for independent examiners?
Who should produce and maintain this guidance?

No comment.

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

No comment.

- 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?**

No comment.

- 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?**

No comment.

- 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?**

No comment.

- 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?**

No comment.

- 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?**

No comment.