

The Future of Local Public Audit

LG Group response to DCLG Consultation paper

Introduction

On 13 August 2010, Eric Pickles MP, Secretary of State for Communities and Local Government announced plans to disband the Audit Commission and to refocus audit on helping local people hold councils and local public bodies to account for local spending decisions.

In summary the Audit Commission's responsibilities for overseeing and delivering local audit and inspections will stop; the Commission's research activities will end; audit functions will be moved to the private sector; councils will be free to appoint their own independent external auditors from a more competitive and open market; and there will be a new audit framework for local health bodies.

This was followed, on 30 March 2011, by the publication of a DCLG consultation paper on the future of public audit. This paper sets out the LG Group's response to the key issues raised in the consultation paper.

The LG Group covers every part of England and Wales and includes county and district councils, metropolitan and unitary councils, London boroughs, Welsh unitary councils, fire, police, national park and passenger transport authorities.

Summary of key points:

- Future arrangements for the Audit Commission's activities need to be set within the context of the Coalition Government's approach to transparency and stronger local, rather than national, accountability.
- External audit makes an important contribution to the stewardship of public resources, but the current arrangements can be improved.
- Councillors, local people and communities should be the primary audience for audit and a simpler and more easily understandable framework for published accounts is required.
- We welcome the proposal that councils should appoint their auditors.
- We fully acknowledge the need for appropriate safeguards to preserve the independence of audit and ensure public trust in the process and outcomes is not jeopardised. But at the same time we are concerned that the new approach to audit does not become over regulated and prescribed through Government guidance
- Audit Committees - This proposal is both excessive and unnecessary. It is reminiscent of the standards committees which the government recently recognised were overly bureaucratic and runs contrary to the Government's agenda around

devolution and localism. Moreover there will still be a regulatory framework including the registration of auditors and monitoring of the quality of audits.

- Procurement: There needs to be sufficient flexibility in the arrangements for procuring audit to enable a number of organisations to work together to jointly procure audit across a local area.
- Scope of Audit: The scope of audit should in future be more tightly focussed around the accuracy of the financial statements and issues of probity (that the authority's financial activities are materially free from fraud and corruption).
- The new arrangements must deliver a competitive market. This is more likely where future arrangements do not dissuade smaller audit firms from entering the market.
- There is a need for greater clarity around the timescales for when councils will be able to appoint their own auditor.

Section 1: General comments

We support the general approach of councils leading in this area and the key design principles

- **Localism and decentralisation** – freeing up local public bodies, subject to appropriate safeguards, to appoint their own independent external auditors from a more competitive and open market, while ensuring a proportionate approach for smaller bodies;
- **Transparency** – ensuring that the results of audit work are easily accessible to the public, helping local people to hold councils and other local public bodies to account for local spending decisions;
- **Lower audit fees** - achieving a reduction in the overall cost of audit;
- **High standards for auditing** - ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit.

A careful balance will need to be struck in the way the principles are applied. Whilst we accept the need for appropriate safeguards we think that the proposed approach is unnecessarily prescriptive.

We do not think the proposals sufficiently recognise the wide range of existing safeguards and controls designed to guarantee regularity and propriety – including the requirement to set balanced budgets, to restrict borrowing to what is affordable, maintain sound systems of internal financial control, publish financial statements and secure continuous improvement. Government has recommended that councils publish details of all their expenditure over £500 – and all but one have done so.

We are particularly concerned about the proposal that councils must appoint a statutory, independent, Audit Committee (with an independent chair and majority of independent members) to advise on the appointment of auditors. This proposal ignores the traditional

stewardship role which elected councillors have performed successfully and runs counter to the first principle of localism and decentralisation.

Most councils already have some form of audit committee with the remit to challenge, review and scrutinise member and officer decisions on financial issues, often chaired by members of the opposition group. There is no reason to suggest that these arrangements could not provide a good basis for making recommendations to council about the appointment of auditors and the consultation paper provides no evidence to support the need for passing these responsibilities to unelected people.

There is a real danger that these proposals will upset current arrangements which already work well and replace them with a costly, nationally prescribed set of arrangements. There must also be a real doubt that councils will be able to find sufficient independent people to serve in the new arrangements.

Section 2: Regulation of local public audit

The Consultation paper proposes that, in future the

- National Audit Office would develop and maintain Audit Codes, which would continue to be approved by Parliament.
- The Financial Reporting Council (FRC - the regulator for Companies Act audit) would be invited to take on a similar role for the local public audit regulatory regime in England. It would have responsibility for authorising professional accountancy bodies to act as “recognised supervisory bodies” for local public audit. They would have the roles of registration, monitoring and discipline in relation to local public audit.
- The recognised supervisory bodies for local public audit would have responsibility for monitoring the quality of audits undertaken by their members, as they do in the private sector.

We agree (Qu 3) that the NAO would appear to be best placed to produce the Code of Audit practice and supporting guidance in the future but this will be new territory for the National Audit Office and appropriate steps will need to be taken to ensure NAO have proper expertise – particularly for example in the case of Fire and Rescue services. We would expect the NAO to fully engage the sector in the process of reviewing and revising the Code.

We think it is very important (Qu 6) that the right balance is struck between the requirements expected of audit firms and the ability of new firms to enter the audit market. It will be important for councils looking for increased standards and reduced costs that the new arrangements encourage a competitive market for local audit - they must not be so burdensome and restrictive that they dissuade smaller firms from entering the market. Whilst councils will have the responsibility, through their procurement process, of satisfying themselves that new or existing firms have the right levels of experience and expertise new entrants could be subject to a probationary period and /or initially restricted in the size of authority they work for.

Section 3: Commissioning of local public audit services

Currently the Audit Commission appoints Auditors to councils, following consultation. The Consultation paper proposes that councils will be under a duty to appoint an auditor with appointments to be made by full Council on the basis of advice from a statutory, independent Audit Committee with a majority of independent members and an independent Chair.

We welcome the proposals for councils to appoint their own auditors and accept the need for appropriate safeguards to preserve the independence of audit but we do not think that statutory audit committees are either necessary or practicable.

We envisage that there will be a strong interest in joint audit appointments (Qu 11) – on a locality basis across the local public sector, on a geographic basis (possibly sub regionally) or on a class basis (for example clusters of FRSA's working together). There is insufficient detail in the consultation paper to understand how joint appointments might work – but the new arrangements should be as flexible as possible so that authorities can develop innovative and effective approaches to procuring audit. We must avoid the need to synchronise multiple separate full council decisions on the one hand or to end up with an unmanageably large joint committee due to the proposal to require a majority of independent members. And we must also be careful to avoid requiring authorities to make joint appointments which could in turn trigger compliance with costly and bureaucratic EU procurement rules.

We do not agree that the proposals for statutory, independent Audit Committees are either necessary or practicable.

They are not necessary because

- Elected members already take a keen interest in ensuring high standards of financial stewardship. As Leicestershire CC note

“In its experience County Councillors take very seriously their stewardship role in ensuring that the Authority acts responsibly and has high standards in relation to its corporate governance arrangements, as well as performing effectively. Elected members’ wider role in the activities of the Authority puts them in a far better position to do this than people who would not have similar connections with the Council. Elected members on audit committees are independent of the Executive”.

- There is in practice a limited number of audit firms to choose from
- The registration process and professional standards will be sufficient to ensure the independence of auditors. As Dorset CC note

“If there needs to be an audit committee with a majority of independent members in order to select an independent auditor, there is something wrong with the process for determining auditors’ eligibility for the role”.

And we think the proposals are impractical because councils' experience demonstrates that it will be very difficult for some authorities to source appropriate (i.e. suitably knowledgeable and qualified) independent people to appoint to a committee, especially given the amount of time required to understand the complex environment within which councils operate. This is particularly likely to be the case in two tier areas if each authority decides to have a separate audit committee. And of course there will be cost implications involved in advertising, appointing, training and remunerating independent members which will reduce the potential for cost savings.

It is noteworthy that as soon as the consultation paper proposes the appointment of statutory committees it is inevitably drawn into prescribing subsequent details such as: the criteria for membership; the role of committees; the appointment process; public involvement; safeguards to ensure the appointment of auditors, etc. – all of which runs completely counter to the localism and decentralisation agenda and is at odds with recent decisions to abolish Standards Committees.

Instead we should explore the opportunity to develop a more flexible approach which builds on the strengths of existing arrangements but which responds to the need to safeguard standards by ensuring that the appointment process is open and transparent and by strengthening the role of statutory officers.

Section 4: The scope of audit:

The consultation paper outlines four potential options with regard to the scope of audit, ranging from a reduced scope more in line with companies; the status quo, increased scope; and finally an option combining audit and annual reporting.

At its heart, public audit is about providing an independent opinion on the accuracy and honesty of the accounts. But over the years the scope of audit has expanded and now includes a value for money assessment – an assessment of whether organisations have made the best use of the resources at their disposal.

For politically-led organisations like councils there is a real concern that value-for-money assessments begin to encroach on the legitimate role of elected politicians in determining how best to use scarce resources in the interests of their communities and that there is nobody better placed – certainly not private sector auditors - to make these sorts of judgements. Moreover, by the same token, it is local electors who should be the key judges of whether democratically-elected councillors have used public sector resources to best effect.

Neither do we believe that audit should include issues of financial resilience i.e. having proper processes in place to continue to operate for the foreseeable future and manage potential financial risks and opportunities. This is already an essential part of councils' good corporate governance arrangements which they alone are responsible for and which they would test through regular self evaluation and peer challenge.

For these reasons we believe the scope of audit (Qu 29) should in future be more tightly focussed around the accuracy of the financial statements and issues of probity (that the authority's financial activities are materially free from fraud and corruption) - but not value for money or financial resilience. This points to Option 1 in the consultation paper. Authorities would be free to "buy in" additional audit activity if they chose to do so.

Option 3 which includes an assessment of "financial resilience" and value for money will be more burdensome and appears to reintroduce elements of CAA.

It also follows that we do not agree with Option 4 or the proposal that council should be required to set out their performance plans in an annual report (Qus 30 to 33). As Runnymede note

"This would add a further burden to the reporting framework of local authorities. At a time when councils are trying to protect front line services, the additional cost of preparing and auditing a report cannot be justified. It seems unlikely that an annual report would be widely read, or meet the questions most often asked by the public".

The proposal would also appear to duplicate issues already dealt with through the annual budget reports and the Annual Governance statement.

We agree that it is important that the duty on an auditor to consider whether to make a report in the public interest should be retained (Qu 34). Whilst only a small proportion of the Public Interest reports issued since 2002 have related to principal authorities they are a key part of the current audit system and provide a vehicle through which the public can be made aware of issues of significant interest to them.

Section 5: Arrangements for smaller public bodies

We agree with the underlying approach that the income and expenditure of smaller public bodies should determine the level of audit required and that some form of proportionality should also be built into the process for appointing auditors or independent examiners.

The proposal that county or metropolitan councils appoint auditors does not seem to have met with universal support either within principal councils or amongst parish and town councils.

Moreover for those county councils with large numbers of parish councils the proposal could impose considerable new burdens. Conversely some shire districts have suggested that because they feel they have a closer affinity with parish councils they too might have a role to play in appointing independent examiners.

As a result we think there is an opportunity to work with smaller public bodies to develop a more locally owned approach.

Other issues

Grant certification: Although this is not explicitly covered in the consultation paper it notes that this work will continue in some form and that the issues involved will be covered in the forthcoming draft bill and accompanying consultation.

We believe it is time to bring to an end the expensive and unnecessary grant certification work. In addition to the annual audit process some grant paying authorities ask the Audit Commission to certify that the grants paid to local authorities are applied to the purposes for which they were intended.

The Audit Commission charged £19.6 million (2007/8), and £18.7 million (2008/09) in fees for additional certification work. We found that in 2007/08 of the 28 different types of grant claim, only in the case of one grant were the adjustments both substantial in absolute terms and in relation to the cost of the audit. There was a similar pattern the following year when certification of claims amounting to £45.6 billion in 2008/09 resulted in amendments in excess of £1 million in only eight cases.

Councils can be trusted to spend money for the purpose for which it is given, and the cost of providing this kind of detailed 'assurance' is an unnecessary luxury. We propose that all spending should be carefully audited, but should only be checked once. That audit should be the annual audit.

Links to sector self regulation and improvement: As part of our proposals on sector self regulation and improvement the sector has acknowledged the concept of collective accountability for performance – and as a result, the need to manage the risk of underperformance. We are currently exploring ways to strengthen the arrangements we already have in place to understand performance so that we are quickly able to offer improvement support.

One of the ways we can achieve this is by sharing intelligence more effectively with others. Auditors, by virtue of the time they spend in authorities, will inevitably pick up formal and informal intelligence which – if it can be shared – would help the LG Group to better understand any performance pressures.

As a result we think it would be helpful if auditors were under an explicit expectation to share intelligence, where appropriate, with the LG Group so that sector support could be offered on a proactive basis.

Timetable: Finally we believe there is a need for greater clarity about the timescales for allowing councils to appoint their own auditors.

Although the original intention was to have new arrangements in place for auditing England's local public bodies by 2012/13, this is subject to parliamentary timetables. The current consultation exercise will be followed by consultation on draft legislation which means that the parliamentary processes might not begin until 2012 at the earliest. As a consequence it

seems that the first financial year for which councils will have appointed their auditors will not be until 2015-16.

We do not believe this is well understood in the sector. DCLG should clarify the timescales and next steps as soon as possible.

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