

**Department for Communities and Local Government Publication**  
**Future of Local Public Audit – Consultation**  
**Briefing Document**

**Introduction**

Following on from the abolition of the Comprehensive Area Assessment framework and the consequential disbanding of the Audit Commission, Department for Communities and Local Government (DCLG) has issued a consultation document entitled Future of Local Public Audit. This publication outlines proposals for the future audit of public bodies and in order to systematically and consistently gather the views of the Public Sector provides 50 consultation questions for consideration.

This is the first phase of the consultation process which will run to 30<sup>th</sup> June 2011. This process will inform the development draft legislation which will be published in the Autumn. This will be subject to as further consultation process.

**Key Points**

There are within the consultation document a number of proposals for change and it is not possible to reflect them all within this brief. However the most important issues worthy of highlighting are set out below.

**Design Principles**

In proposing a new framework for local public audit DCLG have followed a set of design principles:

- localism and decentralisation – public bodies subject to appropriate safeguards will be free to appoint their own independent auditors from a more competitive open market;
- transparency – ensuring that results of audit work are easily accessible to the public helping local people hold public bodies to account;
- lower audit fees – achieving a reduction in the overall cost of audit; and
- high standards of auditing – through the transparent regulation of public audit and conformity to the general principles of public audit .

**Regulation of Public Audit**

Audit systems in the UK for both the public and private sector follow the International Standards on Auditing. The Government believe that having in place a sector specific regulator (the Audit Commission) for the public sector, which represents less than 10% of the overall audit market is unnecessary and costly.

It is proposed that one main regulator is appointed with overall responsibility for a consistent regulatory regime for audit which covers the private sector and the local government and health sectors. Essentially this will be done by extending the framework already in place within the Companies Act 2006 which provides the governance framework for the Regulation of audit in the private sector.

The appointed regulator (the Financial Report Council is proposed) will be responsible for authorising professional accountancy bodies to act as recognised supervisory bodies of appointed local auditors. Supervisory bodies would have roles in respect registration, monitoring and discipline of those bodies authorised to undertake public audit – this will help enable for a ‘localism’ approach to be achieved.

It would appear that the regulation framework as proposed (and currently operating within the private sector under the auspices of the Companies Act) will provide effective arrangements to ensure for the consistent regulation and maintenance of high standards of audit across both the public and private sector. However, the costs associated with this proposal and how they compare with the current costs of the current Audit Commission approach to regulation is not stated.

### **Commissioning Local Public Audit Services**

#### **Selection of an Auditor**

In support of a ‘localism’ approach, the Government has proposed that all public bodies with annual income or expenditure of over £6.5M should be under a duty to appoint an auditor. The Service will be required to appoint an external auditor via a following a tendering process. Only external auditors on the register of local public statutory auditors can be invited to tender. Joint procurement of public auditors will be encouraged and legislation will make provision for this.

It is clear that the Service will need to make arrangements to commission by way of a tendering process an external auditor to undertake an external audit. The likely costs of audit are unknown at this time and will certainly be influenced by which option for scope of works is chosen (see below). There will also be indirect costs associated with this process which the Service does not currently incur. The Audit Commission hold the view that the reduction in buying power (as a consequence of their abolition) will lead to an increase in costs as a consequence of individual organisations commissioning their own works. However, the Government is of the view that competitive market forces will contribute to keeping costs associated with appointing an external auditor and the consequential scale fee down – enabling the design principle of lower audit fees to be addressed.

#### **Role of Audit Committees and Independent Members**

The Governments consultation proposals do have the potential (should they be the preferred option) to impact upon the structure and terms of reference of the FRA Audit and Performance Management Committee (APMC)

It is proposed that the appointment of local auditors will be made by full Authority but this decision can only be made on the advices of an Audit Committee or equivalent (in the Authority's case APMC) body which will be responsible for the commissioning process.

In the interests of accountability, transparency and localism it is proposed that Audit Committees should have a number (a majority is proposed) of members who are independent of the local public body and non-elected with some elected members to enable for a balance between objectivity and informed decision making. A requirement to have knowledge of financial matters is suggested. It is suggested that the roles of Chair and Vice Chair could be undertaken by independent members of the public.

The proposed structure of Audit Committees including a detailed criterion for the selection of independent members is set out in the consultation publication. It is clear from the consultation document that whilst the selection criterion to ensure the quality of independent members is negotiable, the requirement for independent members to sit on Audit Committees is preferred by DCLG.

It is likely that the requirements of Audit Committees and their involvement in the engagement of auditors will be specified in legislation. However, the consultation publication does invite responses to inform the extent to which Audit Committee requirements should be determined by law and by local requirements.

Therefore, it is possible that the Service will be required to reconfigure its current APMC to meet the requirements of having an APMC which consists of a majority of independent members with independent members holding the responsibilities of Chair and Vice Chair. The current terms of reference of APMC will need to be considered and may require, redesign subject to the outcomes of this consultation and the development of draft legislation in the Autumn. Consideration will need to be given to the current terms of reference of the APMC and whether the Service would wish to change these in light of the obligation to provide an Audit Committee made up of a majority of independent members.

In determining the future role of the 'new' APMC consideration will have to be given to designating the role of 'prescribed person' as set out in the Public Interest Disclosure Act to the appointed external auditor and the APMC.

### **Scope of Audit and the Work of Auditors**

Within the consultation document four options to deliver effective public audit are proposed. The first option reflects the private sector approach to audit, which is essentially the same as the current public sector approach but there is not a requirement to undertake an assessment of value for money arrangements.

The second option reflects the current public sector audit approach based upon International Financial Reporting Standards approach towards public sector audit. Currently, auditors of larger public bodies (including this Service) are required to:

- give an opinion on accounting standards;

- provide a value for money conclusion against designated criteria;
- review and report on other financial statements and matters such a statement of internal control, annual governance report and annual audit letter.

Whilst, there maybe some costs reduction benefits associated with moving to a private sector 'Companies Act' based approach (Option 1) it should be remembered that private sector companies only, in general, have to report to shareholders. As a public funded body it is likely that the requirement to provide evidence of value for money to the tax payer, through an independent audit process, will still be required by Government.

A third option detailed in the consultation document is one that builds upon the current external audit framework. It is the Governments belief that splitting the current elements of the existing value for money conclusion into discreet areas may enable for greater assurances to the public. The additional burden created by the complexity of this workload would involve much more work for external auditors and as a consequence raise the potential for increased costs. This approach also seems to go against the principle of reducing the burden associated with audit thus enabling resources to be focussed on delivering high quality services.

In any event the consultation document champions the requirement to produce an Annual Report (Option 4). As this is something the Service already does this would not create an additional significant burden. However, subject to the outcomes of consultation the content requirements of the Annual Report may change and the external auditor will be required to provide assurance on the Annual Report, which in itself will incur a cost. It is thought that this option, whereby the current level of external audit remains the same (as per option 2) but is supported by the production of an Annual Report is the scope of works preferred by DCLG.

It is likely that the Audit Commission's role in respect of public interest reporting and provision of non audit services will be built into the new public audit framework and will be undertaken by appointed external auditors is required by the audited public body. This does not raise any issue with the Service but controls would need to be put in place to ensure that independence was maintained and conflict of interest does not arise.

### **Costs of New Audit Regime**

Although it is stated within the design principles that the new public audit framework will lower audit fees, there is no indication as to the likely costs associated with the proposals outlined within the consultation document. This does make it difficult to determine at this time whether the costs associated with the delivery of future audit will enable for this fundamental design principle met. It is likely that more will become known about the future cost of audit with the publication of an impact assessment which will be published with the draft bill when a preferred option for the future delivery of external public audit is more clearly defined. This will enable for consideration to be given as to whether any additional controls are needed to regulate the costs associated with local public audit. Public bodies are invited to offer their views on costs within this consultation.

## **Implementation Date**

The date which the new framework will come into operation has not been confirmed. A draft bill will be consulted upon in the autumn following Parliamentary scrutiny. Originally it was intended that the new framework would be operational at the start of the 2012/13 financial year.