

CONSULTATION ON THE FUTURE OF LOCAL PUBLIC AUDIT
SUMMARY OF SECTIONS 2, 3, AND 4

Section 2 – Regulation of local public audit

| Current System | Proposed System |
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| <ul style="list-style-type: none"> Standards and Codes of Practice | |
| <p>The Audit Commission sets audit standards through codes of practice for the public sector. These are based on standards issued by the Auditing Practices Board and are therefore consistent with audit standards across all sectors. However the Audit Commission codes also contain guidance on areas such as value for money.</p> | <p>Auditors of public bodies will continue to follow the auditing and ethical standards set by the Auditing Practices Board. Government believes that the National Audit Office would be best placed to produce and maintain the codes of practice which would continue to be approved by Parliament.</p> |
| <ul style="list-style-type: none"> Registration of Auditors | |
| <p>The Audit Commission Act 1988 specifies that for an individual or firm to be appointed as an auditor the person(s) conducting the audit must be a member of one of the specified professional bodies. The Audit Commission regulates the quality of work by setting the minimum qualifications a public sector auditor must have together with standards set by the professional body for membership.</p> | <p>It is proposed that an overall regulator will have responsibility for authorising professional accountancy bodies to act as recognised supervisory bodies for local public audit. The Financial Reporting Council is the regulator for private sector audit in accordance with the Companies Act 2006. It is proposed that it takes on a similar role for local public audit regulation in England. Recognised supervisory bodies for local public audit could include supervisory bodies already recognised under the Companies Act 2006 (there are currently five) and any bodies with sufficient expertise and capacity. Government proposes to set out in legislation that an auditor must be a member of a recognised supervisory body and eligible for appointment under the rules of that body.</p> |
| <ul style="list-style-type: none"> Monitoring and Enforcement | |
| <p>The Audit Commission monitors the quality of auditors' performance through its annual quality review programme.</p> | <p>It is proposed that recognised supervisory bodies for local public audit have responsibility for monitoring the quality of</p> |

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| <p>The Audit Inspection Unit of the Financial Reporting Council reviews the quality of the financial statements audits carried out by the Commission's own auditors and by private firms on behalf of the Commission.</p> | <p>audits undertaken by their members. This would include reviews of individual audit engagements, reviews of policies and procedures, reporting on the quality of audit to the registration body and investigation of disciplinary cases and complaints.</p> |
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Section 3 – Commissioning local public audit services

| Current System | Proposed System |
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| <p>• Duty to appoint an auditor</p> <p>All auditors of local public bodies are appointed by the Audit Commission. Before making appointments the Commission has a statutory duty to consult with the body.</p> | <p>It is proposed that all larger bodies (those with income / expenditure over £6.5m) will be under a duty to appoint an auditor. The auditor would need to be on the register of local public statutory auditors. It is proposed that the appointment be made by full council on the advice of an audit committee with opportunities for the electorate to have an input. The proposed legislation will allow both for joint procurement of auditors and joint audit committees.</p> <p>The government considers that, to ensure that independence is maintained in the appointment of auditors, each larger public body should have an audit committee where the majority of members are independent of that body. The legislation will set out minimum requirements for an audit committee and a possible structure is as follows:-</p> <ul style="list-style-type: none"> • The chair and vice-chair should be independent of the local public body • The elected members on the Committee should be non-executive, non cabinet members and at least one should have recent and relevant financial experience. It is |

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| | <p>recommended that a third of members have recent and relevant financial experience.</p> <ul style="list-style-type: none"> • There would be a majority of members of the committee who were independent of the local public body. <p>When selecting independent members of the committee, they can only be a member if he or she:-</p> <ul style="list-style-type: none"> • has not been a member nor an officer of the local public body within five years of the date of appointment; • is not a member nor an officer of that or any other relevant body; • is not a relative nor a close friend of a member or an officer of the body; • has applied for the appointment; • has been approved by a majority of the members of the council; • the position has been advertised in at least one newspaper distributed in the local area and in other similar publications or websites that the body considers appropriate. |
| <ul style="list-style-type: none"> • Role of the Audit Committee <p>There is currently no role for the audit committees of public bodies in the appointment of external auditors.</p> | <p>Government is likely to specify that the audit committee should have some responsibility in relation to the engagement of the external auditor and monitoring the independence and quality of external audit. However, there will still be flexibility for the audit committee to design its own role. It is proposed that the audit committee would receive all bids for external audit in order that they can make a recommendation on which to accept to full council. Full council would be required to have regard to their advice but would not need to follow it but it</p> |

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| | <p>would need to publish a statement as to why it had not followed the advice of the audit committee. The consultation contains two proposals on the role of the audit committee. One where the only mandatory duty is to provide advice on the appointment of an external auditor and a second where there is a much more detailed mandatory role including:</p> <ul style="list-style-type: none"> • providing advice on the appointment of an external auditor; • setting a policy on the provision of non-audit work by the external auditor; • overseeing issue around the resignation or removal of the auditor; • seeking assurance that action is being taken on issues identified at audit; • considering auditors' reports; • ensuring that there is an effective relationship between internal and external audit; • reviewing the financial statements, external auditor's opinions and reports to members and monitoring action in response to issues raised by external audit • providing advice to full council on the quality of service they are receiving • reporting annually to the full council on its activities for the previous year. |
| <p>• Involvement of the public in the appointment of an auditor</p> | |
| <p>There is no involvement of the public in the appointment of the external auditor.</p> | <p>Prior to any appointment, those firms showing an interest would be published on the local body's website so that the public could make representation about any of the firms. The audit committee would consider these representations when providing advice to full council. Following appointment the public would be able to make representation to the audit committee and the committee would then be able to</p> |

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| | investigate any issues. |
| <ul style="list-style-type: none"> • Failure to appoint an auditor | |
| <p>Since the Audit Commission is responsible for appointing auditors to public bodies this situation does not arise.</p> | <p>The audited body would be under a duty to appoint an auditor. If they did not it is proposed that either the Secretary of State could direct the body to appoint an auditor or the Secretary of State could be provided with the power to make the appointment and the body failing to make the appointment could be subject to sanction.</p> |
| <ul style="list-style-type: none"> • Rotation of audit firms and audit staff | |
| <p>The Audit Commission appoints audit firms or its own staff for an initial period of 5 years. The audit engagement partner can be appointed for a maximum of seven years and the audit manager for a maximum of ten years.</p> | <p>An audit firm would be reappointed annually by full council with a full competitive process within five years. The local body could reappoint the same firm for another five years. At the end of the second five year term a different audit firm would need to be appointed.</p> |
| <ul style="list-style-type: none"> • Resignation or removal of an auditor | |
| <p>As firms are currently appointed by the Audit Commission the situation does not arise where the public body would need to remove the auditor or the auditor resign. In the event of any dispute the Audit Commission can rotate auditors.</p> | <p>It is envisaged that the resignation or removal of an auditor would only take place in the most serious circumstances and following discussion to resolve issues. However, if an auditor wished to resign then he should give 28 days notice to the audit committee and the audited body. The audited body would then make a response which it should send to its members and audit committee. The auditor will then be required to deposit a statement at the audited body's main office and with the audit committee that should be published on its website. The relevant supervisory bodies would need to be advised.</p> <p>In the case of removal, the audited body should give 28 days notice of its intention to the auditor and the audit committee. The audited body should put to a public meeting or full council meeting a resolution to remove the auditor. The auditor would have the right to make a written response to the audited body</p> |

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| | and its audit committee and to speak at the meeting where the resolution was heard. A representative from the audit committee should also be able to speak at the meeting. The auditor would be required to deposit a statement with the audited body and the audit committee on the circumstances of the cessation of their appointment. This statement would be published on the local body's website. |
| <ul style="list-style-type: none"> • Auditor liability | |
| The Audit Commission currently indemnifies auditors for the costs they incur where they are engaged in litigation arising from the exercise of special powers. | It could be possible for auditors and audited bodies to deal with auditor liability as part of their contractual negotiations. A legislative framework could set out the process for setting and agreeing liability limitation agreements. |

Section 4 – Scope of audit and the work of auditors

| Current System | Proposed System |
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| <ul style="list-style-type: none"> • Scope of local public audit | |
| <p>Currently the auditor is required to:</p> <ul style="list-style-type: none"> • give an opinion on the accounting statements; • give a conclusion on whether the local body has proper arrangements to secure value for money; • review and report on other information published with the accounts such as the statement of internal control; • review and report on the Whole of Government Accounts return. | <p>There are three proposed options:</p> <p>Option 1 The scope of audit could be reduced to be more in line with that for companies with no assessment for value for money. The auditor would:</p> <ul style="list-style-type: none"> • give an opinion on the accounting statements; • review and report on other information published with the accounts such as the statement of internal control and including the Whole of Government Accounts return. <p>Option 2 As under the current system the auditor would:</p> <ul style="list-style-type: none"> • give an opinion on the accounting statements; • give a conclusion on whether the local body has proper |

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| | <ul style="list-style-type: none"> • arrangements to secure value for money; • review and report on other information published with the accounts such as the statement of internal control; • review and report on the Whole of Government Accounts return. <p>Option 3 Under this option the auditor would still give an opinion on the accounts but would provide conclusions on:</p> <ul style="list-style-type: none"> • regularity and propriety – a conclusion on compliance with relevant laws and regulations and the audited body’s governance and control regime; • financial resilience – a conclusion about the future financial sustainability of the audited body; and • value for money – a conclusion about the achievement of economy, efficiency and effectiveness within the audited body. <p>A fourth option is also given whereby the local public body would be required to produce an annual report and the auditor would provide reasonable assurance on the annual report. This is seen as a way of increasing transparency to the local electorate.</p> |
| <ul style="list-style-type: none"> • Public interest reporting | |
| <p>Under the Audit Commission act, the auditor currently has powers to issue a report in the public interest on any significant matter.</p> | <p>The Government considers it important that the power for the auditor to make a report in the public interest is retained.</p> |
| <ul style="list-style-type: none"> • Provision of non-audit services | |
| <p>The auditor can undertake additional work for the local public body without approval from the Audit Commission if the additional work will not compromise his independence or the value of the additional work does not exceed a set de minimis.</p> | <p>It is proposed that auditors will be able to carry out additional work for a local public body provided that there are safeguards to prevent any actual or perceived threats to the auditor’s independence.</p> |

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| <ul style="list-style-type: none"> • Public interest disclosure | |
| <p>The Audit Commission and appointed auditors consider information they receive as a result of a disclosure and consider what action to take, if any.</p> | <p>It is proposed that the Audit Commission's role in receiving, acknowledging and forwarding disclosures should be undertaken by the audit committee of the local public body.</p> |
| <ul style="list-style-type: none"> • Transparency | |
| <p>Members of the public currently have the right to question an auditor about the accounts of a local public body and to raise objections if relevant.</p> | <p>It is proposed that the right for members of the public to object to the accounts would be removed although they would still be able to make representation to and raise issues with the auditor. It is also proposed that auditors are brought within the remit of the Freedom of Information Act although only as far as their work on public audits goes.</p> |