



07 July 2011

Our ref: ICAEW Rep 68/11

Your ref:

Luke Scofield
The Department of Communities and Local Government
Zone 3/G6
Eland House
Bressenden Place
London SW1E 5DU

Sent via email to folia@communities.gsi.gov.uk

Dear Luke

Future of local public audit

The ICAEW is pleased to respond to your request for comments on the consultation paper *Future of local public audit*.

At this time, and subject to your impact assessment and suitable recovery of the costs, ICAEW confirms that it will be submitting an application to take on the recognised supervisory body role under this new framework.

Please do not hesitate to contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Sumita Shah
Technical Manager, Practice Risk and Public Sector Audit

T +44 (0) 207 920 8516
E sumita.shah@icaew.com



ICAEW REPRESENTATION

Future of local public audit

Memorandum of comment submitted in July 2011 by the ICAEW, in response to the Department of Communities and Local Government's consultation paper Future of local public audit published in March 2011

| Contents | Paragraph |
|--|------------------|
| Introduction | 1 |
| Who we are | 2 - 3 |
| Major points | 4 - 56 |
| Annex A – Responses to specific questions/points | |

INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Future of local public audit* published by the Department of Communities and Local Government.

WHO WE ARE

2. As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers all the firms for Companies Act audit work that are currently also carrying out work for the Audit Commission and those firms likely to carry out this work in the future. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the initiative

4. In the policy announcement in August 2010, the key objective for the abolition of the Audit Commission is to refocus audit on helping local people hold their councils and other local public bodies to account for local spending decisions. The four principles that government is working towards are:
 - Localism and decentralisation;
 - Transparency;
 - Lower audit fees; and
 - High standards of auditing.
5. ICAEW is supportive of the principles, however, we note that the proposals outlined in the consultation paper may not help to achieve these principles. For example, proposals to increase the scope of audit, the complexity of the proposed new regulatory regime and making audit firms subject to freedom of information requirements could all result in an increase in audit fees and could deter new firms entering the market.
6. ICAEW has concerns that, although the announcement was made in August 2010, there is still no clear indication of timescales for when these proposals will be put into place and indeed many of the proposals themselves lack clarity. Further delay creates uncertainty for all the bodies that may be potentially affected, including the NAO, FRC, professional bodies, audit firms, the audit practice arm of the Audit Commission and local public bodies. As the Government is proposing a departure from the established practice that public bodies should not appoint their own auditors it is all the more important that timing is of the essence. The Government should concentrate on the successful implementation of the changes it proposes quickly and efficiently to deliver the best possible value to the taxpayer.

Consistency across the public sector

7. The policy announcement in August 2010 indicated that local government, the health service, police and probation would be affected. However, the focus in this consultation is just on the audit arrangements for local government bodies. We note the comments within the consultation paper, which scope out the other bodies. It is concerning that the arrangements for local government are being developed almost in isolation of these other sectors. This has

the possible impact of creating a disjointed system for the future of local public audit. At the date of this response, we are still no clearer about the arrangements for the health service.

8. We also consider that the government should recognise that the demise of the Commission represents an opportunity to review the public audit and financial reporting regime across the wider public sector in England. There are a number of large central government bodies which have significant budgets running into billions but which are not subject to such a regime. This announcement provides an opportunity to create consistency across the wider public sector and our view is that government should consider the public sector audit arrangements in their totality.

Regulatory regime

9. Although we agree in principle with following the Companies Act 2006 approach for the regulation of local public audit, we would caution against following the approach in its entirety. There are a number of aspects of the Companies Act 2006 approach, which are designed for companies, and which, in our view, do not work for local public audit eg, the threshold at which companies are required to have a full audit is currently set at £6.5million. In our view, this is too high a threshold for local public bodies. If the Companies Act approach is followed in its entirety, the objectives outlined above (under paragraph 3) may not actually be achieved.

Clarification of roles and responsibilities

10. The Audit Commission has a number of specific statutory responsibilities, including the drafting of the Codes of Audit Practices, guidance and technical support to auditors, monitoring of audit quality, setting the grant-reporting framework, and responsibility for the national fraud initiative. All of these responsibilities are significant. The proposals bring in a number of bodies to the regulatory regime to replace the Audit Commission. There is potential for duplication of effort between the various bodies, which may serve to increase the costs of the overall process. It will be important therefore, for there to be clarification of the roles and responsibilities of each body and the relationship between each.
11. Whatever new arrangements are put in place, DCLG will need to ensure that successor bodies have:
 - Knowledge and experience of the public sector and of audit;
 - Technical competence;
 - The right infrastructure; and
 - Adequate resources and capacity.
12. As an existing RSB, ICAEW envisages that its role will be similar to that which it already carries out, including licensing and registering of audit firms for local public audit, developing the audit regulations that they would be required to follow, monitoring the quality of their work, providing audit firms with relevant technical and practical guidance (eg, we envisage that we will draft guidance, for example, around audit engagement terms, duty of care and liability in the same way as we currently do for audit firms who carry out audit and assurance engagements in other sectors).

Public Interest Entities

13. We note the questions within the consultation paper regarding public interest entities. We agree that, by their very nature, all public bodies could be categorised as public interest entities. However, it would not be practical to have such a wide definition for future of local public audit framework.
14. For the purpose of this work and the overall regulatory regime, it will be necessary for DCLG to consider the level at which a body's audit will be subject to a higher level of monitoring. In our view, it is for the DCLG to set the definition at an appropriate and significantly high level based on either income, expenditure or even the level of risk associated with that particular body

based on the services that the body provides. Whatever definition is set, it should be clearly set out in either legislation or regulation so that there is no room for misinterpretation.

15. In our view, the role of the regulator is for the DCLG to decide once it has carried out its impact assessment. The impact assessment should seek to identify the costs that would fall on the regulator if they take on this additional role and how the regulator would seek to recover those costs. The more bodies that are designated as 'public interest entities' the greater will be their costs as their audits will be subject to the full range of FRC conduct bodies including the Audit Inspection Unit and the Financial Reporting Review Panel (this is discussed further in the next few paragraphs).

Costs of a new regulatory regime

16. This transfer of responsibilities to bodies identified within the consultation may require transfer of some of the Commission's costs to the bodies that inherit the additional responsibilities. It will therefore be necessary for the DCLG to consider how these bodies will be funded to enable them to take on these responsibilities.
17. In our view, it may not be in the public interest to require a body to put into place completely new systems, procedures and processes to take on one of these roles/responsibilities as this may have a huge cost impact.
18. As discussed above, it will be necessary for DCLG to define clearly how many and which bodies will fall under the public interest entity element. It will also be necessary for DCLG to identify the potential cost of the FRC (including its conduct bodies) taking on this role for the number of entities falling under this definition and where that cost will ultimately fall.

Commissioning of audit

Outsourcing

19. We note the recent announcement on the development of options for the most effective transfer of the Audit Commission. One option will be to create an independent company, which could be sold. The second option is to outsource all the audits currently undertaken by the Audit Commission's in-house practice. It also suggests that outsourcing (if that is the option chosen) will take place for the 2012/13 audits with an effective date of 1 September 2012 (allowing time for the Audit Commission to consult with local government bodies).
20. This announcement raises a number of concerns for ICAEW:
- the tight timescales within which this will occur (which may not provide a level playing field for all firms that want to enter into the market)
 - restricts competition and choice (inconsistent with other government policy around competition and choice (ie, in recent House of Lords report stated that *The Government should make greater efforts, within EU procurement rules, to enable non-Big Four firms to win public sector work*)).
21. We believe that this policy objective provides an opportunity for new entrants to enter the public sector audit market and we urge the Government to ensure that there is sufficient choice and competition.

Audit quality and increasing market participation

22. ICAEW is in favour of increasing market participation in the public sector audit market. However, any policy objective to increase market participation should not be at the expense of audit quality and the safeguarding of public money. While potential new entrant firms to the public audit market will already have quality control systems in place for audit work in other sectors, not all audit firms will have public sector experience and building up such experience will take time.

23. ICAEW urges DCLG to consider carefully the processes for ensuring firms that want to be able to enter into the market have the ability to do so within the timescales set, whilst maintaining the quality of audit.

Eligibility criteria of audit firms

24. The eligibility criteria for firms wishing to conduct public audit need to ensure that competent auditors with the appropriate knowledge, skills and experience are appointed.
25. High level criteria should be specified in legislation. Care should be taken to ensure that the way in which the bill/legislation/regulations are drafted do not have unintended consequences for existing auditors nor should they be written in such a way as to prohibit new firms wishing to enter into the market.
26. There needs to be a mechanism in place to enable new firms wishing to enter the market, the opportunity to gain the appropriate knowledge, skills and experience.

Joint commissioning

27. In relation to the questions asked in the consultation about the ability of councils to cooperate and jointly appoint auditors, in our view there needs to be more explanation about how this might work in practice.
28. The consultation paper has not addressed whether it is legally possible for two councils to appoint an auditor together. DCLG will therefore need to take legal advice to establish whether this proposal is feasible. If it is found to be legally possible, there would need to be a clear agreement between the councils that were considering entering into a joint appointment eg, the following points would need to be considered:
- Would there be one contract in the joint appointment or would there still be individual contracts/engagements (between the auditor and the body)?
 - Who would lead on the appointment?
 - What are the requirements for each body in relation to the audit (this will depend on the size of the body, the risk elements etc)?
 - How would fees be negotiated (each body has individual risk factors)?
 - What would happen if one body wanted to terminate the appointment (for whatever reason) – would that invalidate the whole contract?
 - How would disputes be settled?

Audit committees

29. We agree that audit committees should have a role in the appointment of auditors (as they do in other sectors). The challenge, for the vast number of local public bodies, will be to find sufficiently independent members who have the right expertise to enable them to carry out their role robustly.
30. In our view, there needs to be further thinking around the role of audit committees. The FRC has published guidance on the role of audit committees. This guidance has been used in other parts of the public sector and therefore could be adapted for local public audit.

Public role in audit appointment

31. We do not agree that the public should have a role in the appointment of an auditor. The final decision on the appointment of the auditor will be taken by the council, which consists of democratically elected members. Additionally, the public does not have a role in other (higher value) tendering/contracts on which the council spends its money therefore it seems inappropriate for the appointment of an auditor to be singled out (the audit fees will be miniscule in comparison to the value of many other contracts!).

Ethical standards

32. We agree that the APB's ethical standards are sufficient for firms in their role as registered auditors. We do not agree that there should be additional limits placed upon a firm's appointment especially where there is likely to be a limited supply of firms carrying out this work. There are always higher costs/higher risks for audit firms when taking on new clients. There is merit in retaining an audit firm (if the local public body decides that this is the most cost-effective and efficient option) as the firm will have built up knowledge and expertise in its client.
33. If the process of appointment of the auditor is not restricted in the way suggested in the private sector or other parts of the public sector, then it does not appear to be consistent to introduce this new concept within local government.

Scope of audit

34. The consultation paper discusses the scope of audit and discusses a possible number of options.
35. We are concerned that the proposal within the consultation to amend the scope of audit goes further than the announcement (and the government policy) intended. There was no indication, when the announcement was made, that the scope of audit is flawed. Our view is that it would not be in the public interest to increase the scope of audit under the new framework.
36. With this in mind, option 2, ie the status quo would be the preferred option. DCLG should, however, bear in mind, that the status quo will not result in a reduction in audit fees.

Annual reports

37. In our view, there should first be a duty upon audited bodies themselves to report on their own arrangements on the services that they provide. One way of achieving this would be through the publication of an annual report. The corporate and banking sectors and companies already publish annual reports, therefore this would be bringing local government into line with other sectors. This would also meet and be consistent with a wider government policy on transparency and accountability and could result in a reduction in audit costs if auditors are only reporting on management's assertion.

Non-audit services

38. Provision of non-audit services continues in other sectors and indeed the government's response to the house of lords inquiry states that: *'in many cases the auditor will be best placed to highlight risks relating to a particular institution's business or business model which it has considered during the audit. While the risk committee might often want to seek additional external advice, it might also wish to ask the auditor to provide assurance work for it outside the statutory audit, especially when this is closely linked to the audit work. **The Government would not wish to see the auditor prohibited from giving advice to the risk committee (the law already requires public disclosure of any non-audit services).***'
39. This accords with our view that auditors should be able to continue to provide non-audit services (where it does not compromise its independence) and should disclose what non-audit services it provides publicly.

Public interest reports

40. Public interest reports are unique to local authority and health audit in the English public sector. The publication of such reports inevitably brings the auditor into conflict with the audited body. Under the new regime, auditors will not have the protection of the Audit Commission (which currently reinforces the auditor's independence, meets the costs, provides the guidance and supports and indemnifies the legal costs that may arise) and therefore may be put under pressure not to report in the public interest.

41. DCLG has proposed that it will put suitable safeguards into place, which it considers will mitigate any risks. It also proposes that the audited body will bear the cost of the public interest report. It does not, however, consider what guidance and support will be provided and who will indemnify any legal costs that may arise. Therefore, this aspect of the public interest reporting framework will need to be carefully considered (ie, who will provide the necessary guidance and support to the auditor and which body will indemnify any legal costs that may arise). It is crucial that the independence of the audit firm and indeed the audit appointment is protected to enable it to provide public interest reports.
42. A possible way of providing the safeguard would be through the audit committee as it would, in theory, consist of independent members.

Inspection of accounts and freedom of Information

43. DCLG should also take this opportunity to modernise the right to object to the accounts including removing the right to object given that the public can now access information in relation to the local public body (including the accounts) through the Freedom of Information Act.
44. We do not, however think it is either sensible or cost-effective to bring auditors within the remit of the Freedom of Information Act.
45. As DCLG will be aware, the time/cost/systems and resources required to implement and deal with FOI requests is significant. An audit firm is bound by confidentiality clauses and duties and therefore would have to spend a significant amount of time reviewing each request to ensure it was not breaching this duty. We understand from public audit agencies that to implement systems to deal with FOI requests, they recruited an additional member of staff or re-allocated resources from other areas. Processes include training for all staff to deal with the impact of FOI, including assessing each request on a case by case basis against the legislation. Some requests have resulted in the local public body having to take legal advice on whether or not it is required to release the information. Putting such systems into place, would therefore result in a significant cost to the audit firm. Our understanding is that these costs are recovered at a flat rate from the local public bodies through audit fees. Where particular requests take up a large amount of time, these are charged separately to the body to which the FOI request refers.
46. Each request would therefore have an impact on the audit fee as the audit firm would need to recover the cost of FOI from somewhere. It could also be a deterrent for new firms wanting to enter into the market if they were required to set up complex and unique systems to deal with FOI requests for a small aspect of their work.
47. An alternative solution would be to route all FOI requests in relation to the audit via the local public body as most requests for information are usually about the local public body's information. These bodies are already required to have systems in place. If the request is about the audit itself, then the local public body who will have communicated with the audit firm on its audit engagement, audit scope, its findings etc, could determine whether or not it should release the information under FOI having carried out the necessary assessment and consulted with the auditor as appropriate.

Smaller bodies

48. The Audit Commission has for a number of years operated a 'light touch' audit for smaller bodies (parish councils) with the smallest bodies not paying any fees for their annual audit.
49. We note the proposals outlined in the consultation paper which include the adoption of a more proportionate approach, similar to that applied to charity audits. However, under the charities regime, the Charity Commission acts as regulator. Under the proposals outlined in this consultation paper, there appear to be no similar safeguards.

50. We are in favour of a more proportionate approach and our suggestion is for DCLG to set a threshold for a full audit. We do not necessarily consider that using the same threshold as that applied to small companies (currently £6.5 million) is necessarily the right threshold but the principles that need to apply are similar.
51. We do not think, however, that a parish council will have the relevant skills or expertise to appoint their auditor and it may be disproportionate to place this additional burden on them would inevitably incur a cost.
52. For the smaller end of the scale, our view is that either DCLG or a separate body (such as the National Association of Local Councils) could be responsible for parish councils and take on the role of appointing auditors to parish councils. If either of these two options are not feasible, then our view is that the precepting authority (to whom the parish is accountable) could take responsibility for either the appointment of the auditor through the audit committee or for carrying out some checks of how the precept has been spent. The precepting authority could use its own internal auditors or perhaps even its own external auditors for this purpose (recognising that there would be additional cost involved in using its own external auditors as this would be done as part of a separate engagement).
53. Our view is that DCLG need to consider the financial reporting, audit and independent examination thresholds, appointment of auditors, and regulation of auditors' aspects in more detail for smaller bodies.

Grant certification

54. Local authorities currently receive more than £46 billion worth of grants and funding from government departments. The Commission currently makes arrangements for the certification of the claims and returns that local authorities are required to submit to government departments to indicate that the monies that they have received have been spent in accordance with the terms and conditions of the grant schemes. Under the current arrangements, the appointed auditor provides the assurance on these claims and returns to government departments based on certification instructions (which are agreed in advance with government departments by the Commission). Each separate assurance report on each grant claim that an auditor provides at each local authority is subject to separate fees.
55. It is disappointing that the consultation document does not provide any detail of what will happen to the grant certification arrangements and indeed it appears that this aspect of the Commission's work has not yet been considered properly.
56. ICAEW's view is that under a new framework, government departments would need to play more of a role in engaging with the auditor and the grant recipient. This, in practice, may be more difficult because of the number of grants and number of bodies that receive such funding. However, there are already similar arrangements in place when funds are allocated to private sector organisations. ICAEW has a framework document (published in March 2010) which outlines the principles of the framework. This could, in our view, be easily transferred to grants received by public sector organisations. However, it would mean that grant-paying bodies would need to review their own arrangements, take on more responsibility for identifying their requirements and be prepared to have discussions with auditors (or the auditors' accountancy bodies) to ensure that there is no expectations gap. If grant-paying bodies were able to do this, then this would be one aspect of the Commission's function that could potentially generate a saving. However, it should be borne in mind that reports on grants would be subject to separate engagement and separate fees and would not form part of the audit engagement.

Annex A : RESPONSES TO SPECIFIC QUESTIONS/POINTS

| |
|--|
| <p>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?</p> |
| <p>Design principles appear to be the right principles, however, there is danger that one or two will not be achieved with the proposals that are being considered for the new framework for local public audit – these are discussed in various parts of our response.</p> |
| <p>2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?</p> |
| <p>Yes.</p> |
| <p>3. Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?</p> |
| <p>We agree that the NAO is best placed to develop the codes of audit practice and supporting guidance if it is willing to take both these roles on. However, any development of the codes and supporting guidance should be done in consultation with the APB, professional bodies and firms to ensure that what is put into place is feasible and in line with existing practice and standards. The codes of audit practice should seek to follow existing auditing standards developed by the APB.</p> <p>It would be useful to clarify exactly what additional guidance DCLG expects the NAO to provide.</p> |
| <p>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?</p> |
| <p>Although we agree in principle with following the Companies Act 2006 approach for the regulatory of local public audit, we would caution against following the approach in its entirety. There are a number of aspects of the Companies Act 2006 approach, which are designed for companies, and which, in our view, do not work for local public audit eg, the threshold at which companies should be audited. If the Companies Act approach is followed in its entirety, the objectives outlined above (under paragraph 3) may not actually be achieved.</p> <p>Care should also be taken to ensure that the way in which the bill/legislation/regulations are drafted does not have unintended consequences for existing auditors nor should it be written in such as way as to prohibit new firms wishing to enter into the market.</p> |
| <p>5. Who should be responsible for maintaining and reviewing the register of statutory local public auditors?</p> |
| <p>This depends on a number of things. Firstly, DCLG need to be clear about what it means regarding 'review' of the register.</p> <p>In our view, there are a couple of options for maintenance of the register:</p> <ol style="list-style-type: none"> 1) each RSB that registers audit firms for local public audit would maintain its own list; or 2) a centralised list could be maintained by DCLG and DoH (as DCLG/DoH will be maintaining the overall list of public bodies) – the onus would be on the local public body to inform the relevant department when it appoints the audit firm. |

| |
|---|
| <p>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?</p> |
| <p>If the legislation/regulation is too specific/prohibitive, it could have an impact on new firms entering the market.</p> <p>In the private sector, there is no legislative requirement for a specific type of experience, just a mention about 'relevant experience'. Indeed, in other parts of the public sector eg, in central government, audit of foundation trusts, higher education, there is no specific legislative requirement for firms to have specific experience.</p> <p>If the wording within the legislation stated 'relevant experience' then the onus is put upon the audit firm to demonstrate that it has the relevant experience, skills and knowledge, competent staff etc (which it is already required to do under ISQC 1) before taking on an engagement. Therefore, self-evaluation by the firm.</p> <p>Public bodies are unlikely to appoint an audit firm that does not have the relevant experience. This could be part of the role of the audit committee, to ensure that, through the tendering process, the firm can demonstrate the relevant experience.</p> |
| <p>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?</p> |
| <p>Firms should be able to demonstrate that they have lead engagement staff and teams with the necessary qualification, and sufficient experience and knowledge of the sector. As mentioned, they are already required to do this under existing standards.</p> |
| <p>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?</p> |
| <p>This is for DCLG to decide. Public interest entities need to be carefully defined so that it is clear which regime they fall into.</p> |
| <p>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?</p> |
| <p>Agreed but it would be impractical to categorise all local public bodies as public interest entities for the purpose of local public audit. It is for DCLG to decide what the definition is.</p> <p>There is a risk of over-regulation at the higher end of the scale, which would result in increased costs which would inevitably fall to the public body and therefore the local taxpayer. This would perhaps go against the grain of other government policies and would certainly not result in savings.</p> <p>Some central government departments' expenditure is comparable to (and in one or two cases may be higher than) the total of local authority expenditure in England. It would therefore seem disproportionate to have increased levels of scrutiny and regulation in this part of the public sector but not to have something similar for other parts of the public sector.</p> |

| |
|--|
| 10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities? |
| It is for the DCLG to determine what the role of the regulator should be after it has carried out an impact assessment and determined the level of costs that will be incurred and where those costs will fall. |
| 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? |
| <p>The consultation paper has not addressed whether it is legally possible for two councils to appoint an auditor together. DCLG will therefore need to take legal advice to establish whether this proposal is feasible. If it is found to be legally possible, there would need to be a clear agreement between the councils that were considering entering into a joint appointment eg, the following points would need to be considered:</p> <ul style="list-style-type: none"> • Would there be one contract in the joint appointment or would there still be individual contracts/engagements (between the auditor and the body)? • Who would lead on the appointment? • What are the requirements of each body are in relation to the audit (this will depend on the size of the body, the risk elements etc)? • How would fees be negotiated? • What would happen if one body wanted to terminate the appointment (for whatever reason) – would that invalidate the whole contract? |
| 12. Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest? |
| DCLG should follow best practice in this area. The FRC has a publication <i>Guidance on Audit Committees</i> which is widely followed. |
| 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 would be helpful if at least one independent member of the audit committee had financial expertise but some knowledge by all audit committee members would be useful. |
| 14. Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level? |
| Yes, with the number of local public bodies and the need for members to be independent, sourcing of suitable independent members is likely to be difficult. In other parts of the public sector, it has been necessary to remunerate audit committee members, the amount of which will need to be comparable/benchmarked with others carrying out similar roles in other sectors. |
| 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? |
| It will depend on the number of independent members that are appointed. |

| |
|--|
| <p>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?</p> |
| <p>Option 2 is of course the sensible option as it will be essential to have a properly constituted audit committee.</p> |
| <p>17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?</p> |
| <p>Although there is value in specifying the requirement, what happens if a LA is unable to find suitable members to sit on the audit committee? What sanctions follow?</p> <p>It would therefore be sensible to require local authorities to follow established guidance (such as the FRC guidance on audit committees).</p> |
| <p>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?</p> |
| <p>The process for appointment of an auditor should be set out in legislation (as it currently is now under the Audit Commission Act 1998), perhaps expanded to cover the Audit Committee role. There may be some reference to the appointment within the Audit Code of Practice and related guidance (to be developed by the NAO in consultation with appropriate stakeholders).</p> <p>It would then be down to the RSB through its regulatory/monitoring role to monitor this. The RSB will provide guidance for firms if it feels that this is necessary.</p> |
| <p>19. Is this a proportionate approach to public involvement in the selection and work of auditors?</p> |
| <p>No. We do not agree that there should be public involvement in the selection and work of auditors. In our view, this would add another layer of cost to the local authority without adding any value to the process.</p> <p>There is no similar public involvement in the procurement of other services that the council buys in. The public elect local councillors through a democratic process to take these and similar decisions. As the council will be asked for final approval of the auditors, it seems unnecessary to add in another (costly) mechanism such as this when there is no similar mechanism for the procurement of other (more expensive) services.</p> |
| <p>20. How can this process be adapted for bodies without elected members?</p> |
| <p>Why do these bodies need to have the public involved in the procurement of the external auditors? Is the public involved in the procurement of other services?</p> |
| <p>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?</p> |
| <p>If it was a legislative requirement, then would a local public body knowingly not appoint an auditor?</p> <p>Under the Companies Act, the Secretary of State has the powers to direct a company to appoint an auditor. Therefore, If the local authority failed to comply, the Secretary of</p> |

| |
|--|
| State could intervene and appoint an auditor. |
| In the private sector, there is no example of where the Secretary of State has had to use this power. |
| 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? |
| Yes, local bodies should be under a duty to inform a body when an auditor has been appointed. However, the consultation does not identify which body this will be. |
| 23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor? |
| In the absence of the Commission, local authorities could inform DCLG, NHS bodies could inform the DoH, police and probation bodies could inform the home office. |
| 24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods? |
| No, as this could be a barrier to competition especially in more remote areas where there are not enough firms to carry out the work. Again, this does not happen in other sectors or indeed other parts of the public sector therefore it is not sensible or consistent to introduce this requirement for local public bodies. |
| 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? |
| Yes they do, however if a threshold is set for smaller bodies, DCLG will need to specify which provisions apply to these bodies (eg, under the Companies Act, there are different provisions for those companies that are listed and those that are not). |
| 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? |
| As stated under question 24, restricting any firm's term of appointment could be a barrier to competition. This does not happen in other sectors and indeed, for the audit of central government bodies, there is effectively only one auditor, therefore it seems inconsistent to include this requirement for local public audits. |
| Ethical standards, which auditors are already required to follow, provide the necessary safeguards and we do not think that there need to be additional requirements beyond the ethical standards. |
| 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? |
| Yes, we think that the proposed process provides sufficient safeguards. |
| 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? |

| |
|---|
| The new framework should enable audited bodies and auditors to negotiate liability limits. |
| 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? |
| <p>Option 2 is close to the status quo. Our view is that DCLG should not seek to increase the scope of audit at this stage, as this was not identified within the announcement as a problem.</p> <p>It should however be borne in mind, that this option will not lead to a reduction in audit fees.</p> |
| 30. Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why? |
| Yes, our view is that all local public bodies should report on their own performance through an annual report. This would meet the wider government objective of transparency and accountability and would provide local people with information about the local body's performance. |
| 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? |
| As in question 31. |
| 32. Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'? |
| <p>If local bodies published an annual report, then auditors would have a duty, under auditing standards, to review the annual report to ensure that any financial information that is published in the annual report is consistent with that published in the financial statements.</p> <p>The auditor's role in relation to the annual report should remain consistent to what auditors are required to do for other sectors.</p> |
| 33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance? |
| <p>We agree that there should be guidance for local authorities on how and what to publish in an annual report. CIPFA already provides local authorities with financial reporting guidance therefore, it would be best placed to provide this guidance for local authorities.</p> <p>For health bodies, we envisage that the new Commission Board would take on this role.</p> |
| 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? |
| We do not consider that sufficient safeguards have been put into place to provide audit |

| |
|--|
| <p>firms with sufficient protection if they decide to issue a public interest report.</p> <p>DCLG needs to consider what protection it will provide to the auditor and how its costs will be indemnified.</p> |
| <p>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?</p> |
| <p>Yes. Auditors should be able to continue to provide non-audit services (where by doing so it does not compromise its independence) and should disclose what non-audit services it provides publicly.</p> <p>Provision of non-audit services continues in other sectors and indeed the government's response to the house of lords inquiry states that: <i>'in many cases the auditor will be best placed to highlight risks relating to a particular institution's business or business model which it has considered during the audit. While the risk committee might often want to seek additional external advice, it might also wish to ask the auditor to provide assurance work for it outside the statutory audit, especially when this is closely linked to the audit work. The Government would not wish to see the auditor prohibited from giving advice to the risk committee (the law already requires public disclosure of any non-audit services).'</i></p> |
| <p>36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?</p> |
| <p>Yes, but there will need to be clear guidance for auditors on how to apply the ethical standards for this audit framework.</p> |
| <p>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?</p> |
| <p>In our view, it is sensible to designate the audit committee of the local public body.</p> <p>Beyond that (eg for auditors), it would depend on the cost implications. Existing firms may have processes in place, however, any new firms will not and this would be another element for them to consider and put into place which could potentially be a barrier to entry.</p> |
| <p>38. Do you agree that we should modernise the right to object to the accounts? If not, why?</p> |
| <p>Yes. The current system is outdated given other ways in which electors may gain access to local authority spending information. It also has enormous resource/cost/legal implications.</p> |
| <p>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?</p> |
| <p>Yes.</p> |
| <p>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?</p> |

We do not think it is either sensible or cost-effective to bring auditors within the remit of the Freedom of Information Act.

As DCLG will be aware, the time/cost/systems and resources required to implement and deal with FOI requests is significant. An audit firm is bound by confidentiality clauses and duties and therefore would have to spend a significant amount of time reviewing each request to ensure it was not breaching this duty. We understand from public audit agencies that to implement systems to deal with FOI requests, they recruited additional members of staff or re-allocated resources from other areas. Processes include training for all staff to deal with the impact of FOI, including assessing each request on a case by case basis against the legislation. Some requests have resulted in the local public body having to take legal advice on whether or not it is required to release the information. Putting such systems into place, would therefore result in a significant cost to the audit firm. Our understanding is that these costs are recovered at a flat rate from the local public bodies through audit fees. Where particular requests take up a large amount of time, these are charged separately to the body to which the FOI request refers.

Each request would therefore have an impact on the audit fee as the audit firm would need to recover the cost of FOI from somewhere. It could also be a deterrent for new firms wanting to enter into the market if they were required to set up complex and unique systems to deal with FOI requests for a small aspect of their work.

An alternative solution would be to route all FOI requests in relation to the audit via the local public body as most requests for information are usually about the local public body's information. These bodies are already required to have systems in place. If the request is about the audit itself, then the local public body who will have communicated with the audit firm on its audit engagement, audit scope, its findings etc, could determine whether or not it should release the information under FOI having carried out the necessary assessment and consulted with the auditor as appropriate.

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)?

As under question 40.

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

We do not think, however, that a parish council will have the relevant skills or expertise to appoint their auditor and it may be disproportionate to place this additional burden on them would inevitably incur a cost.

For the smaller end of the scale, our view is that either DCLG or a separate body (such as the National Association of Local Councils) could be responsible for parish councils and take on the role of appointing auditors to parish councils. If either of these two options are not feasible, then our view is that the precepting authority (to whom the parish is accountable) could take responsibility for either the appointment of the auditor through the audit committee or for carrying out some checks of how the precept has been spent. The precepting authority could use its own internal auditors or perhaps even its own external auditors for this purpose (recognising that there would be additional cost involved in using its own external auditors as this would be done as part of a separate engagement).

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? |
| As per question 42. |
| 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? c.) Who should produce and maintain this guidance? |
| <p>There should be separate guidance on the appointment of auditors/independent examiners for whichever body takes on this role. In addition, there will need to be guidance on governance, accounting practices etc. There will also need to be support for the bodies as well as the auditors.</p> <p>It is not clear from the consultation proposals whether the independent examiners have to be qualified and who will regulate their activities.</p> <p>Whichever body takes this role on, there will be a cost implication and DCLG will need to determine what these will be and fund the appropriate bodies accordingly.</p> |
| 45. Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment? |
| The approach appears to replicate the Charity Commission approach for charities. However, under this framework, the Charity Commission acts as regulator. Under the proposals outlined in this consultation paper, there appear to be no similar safeguards for what is essentially public money. |
| 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, these other bodies will need other options. |
| 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? |
| <p>Yes, in our view the approach appears to be quite complex for smaller bodies. The threshold of £6.5m is too high and does not work for local public bodies.</p> <p>The approach appears to replicate the Charity Commission approach for charities. However, under this framework, the Charity Commission acts as regulator. Under the proposals outlined in this consultation paper, there appear to be no safeguards for what is essentially public money.</p> |
| 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? |
| Our view is that DCLG need to consider the financial reporting, audit and independent |

| |
|---|
| examination thresholds, appointment of auditors, and regulation of auditors' aspects in more detail for smaller bodies. |
| 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? |
| Our view is that DCLG need to consider the financial reporting, audit and independent examination thresholds, appointment of auditors, and regulation of auditors' aspects in more detail for smaller bodies. |
| 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? |
| Our view is that DCLG need to consider the financial reporting, audit and independent examination thresholds, appointment of auditors, and regulation of auditors' aspects in more detail for smaller bodies. |

E sumita.sha@icaew.com

Copyright © ICAEW 2011
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is reproduced accurately and not used in a misleading context;
- the source of the extract or document, and the copyright of ICAEW, is acknowledged; and
- the title of the document and the reference number (ICAEWRep 68/11) are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

icaew.com