


|   |   |  |
|---|---|--|
|  <b>Finance &amp; Audit Scrutiny Committee<br/>- 15 November 2011</b>  |   | <b>Agenda Item No.</b><br><br><div style="text-align: right; font-size: 2em;"><b>6</b></div> |
| <b>Title</b>  | Future of Local Government External Audit |  |
| <b>For further information about this report please contact</b>   | Mike.snow@warwickdc.gov.uk                |  |
| <b>Wards of the District directly affected</b>  | N/A                                       |  |
| <b>Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006?</b> | No  |  |
| <b>Date and meeting when issue was last considered and relevant minute number</b>   | N/A                                       |  |
| <b>Background Papers</b>  |   |  |

|  |                                |
|--|--------------------------------|
| <b>Contrary to the policy framework:</b>                                   | No                             |
| <b>Contrary to the budgetary framework:</b>                                | No                             |
| <b>Key Decision?</b>   | No                             |
| <b>Included within the Forward Plan? (If yes include reference number)</b> | No                             |
| <b>Equality &amp; Sustainability Impact Assessment Undertaken</b>          | Yes/No (If No state why below) |
|  |                                |

| <b>Officer/Councillor Approval</b>   |             |               |
|--|-------------|---------------|
| <b>Officer Approval</b>  | <b>Date</b> | <b>Name</b>   |
| Chief Executive/Deputy Chief Executive   | 21/10/11    | Chris Elliott |
| Head of Service  |             |               |
| CMT  | 21/10/11    |               |
| Section 151 Officer  |             | Mike Snow     |
| Monitoring Officer   | 21/10/11    | Andrew Jones  |
| Finance  |             | Richard Barr  |
| Portfolio Holder(s)  |             | Andrew Mobbs  |
| <b>Consultation &amp; Community Engagement</b>   |             |               |
| Insert details of any consultation undertaken or proposed to be undertaken with regard to this report. |             |               |
|  |             |               |
| <b>Final Decision?</b>   |             | Yes/No        |
| <b>Suggested next steps (if not final decision please set out below)</b>                               |             |               |

## **1. SUMMARY**

- 1.1 The purpose of this paper is to provide the Finance and Audit Scrutiny Committee with an update of the Department for Communities and Local Government (DCLG) proposals for transferring the work of the Audit Commission's in-house audit practice to the private sector.

## **2. RECOMMENDATION**

- 2.1 That the Finance and Audit Commission note the progress on transferring the work of the Audit Commission's in-house audit practice to the private sector and how this will impact upon the appointment of the Council's external auditors.

## **3. REASONS FOR THE RECOMMENDATION**

- 3.1 Members are asked to note the current position in the appointment of local government auditors.

## **4. POLICY FRAMEWORK**

### **4.1 Policy Framework**

As a public body, local authorities are required to have their accounts subject to external audit.

### **4.2 Fit for the Future**

The audit of the accounts includes a Value For Money assessment which the auditors are required to undertake.

## **5. BUDGETARY FRAMEWORK**

- 5.1 The cost of the 2011/12 is estimated at £118,000, which is allowed for within the current year budget. In addition, there will be the cost of the audit of the grant claims, estimated at £35,000.
- 5.2 Until last year, the Council also incurred further external audit costs in respect of the various assurance frameworks that were in place to be scrutinised by the external auditors including, notably, the Comprehensive Area Assessment. The Coalition Government announced in 2010 that this work was to cease, thereby saving the Council an estimated £15,000 per annum.
- 5.3 With new external auditors due to be in place for 2012/13 under the procurement process currently being arranged by the Audit Commission, there may be financial implications for the Council with regard to the cost of the future auditors. Based on the timetable (paragraph 7.5), the cost of the future audit arrangements is not likely to be known until the start of 2012/13.

## **6. ALTERNATIVE OPTION(S) CONSIDERED**

- 6.1 Alternative options are not applicable to this report.

## 7. **BACKGROUND**

- 7.1 On 13th August 2010, the Secretary of State for Communities and Local Government, Eric Pickles, announced plans to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice into the private sector and put in place a new local audit framework. Local authorities would be free to appoint their own independent external auditors. A new decentralised audit regime would be established and councils would still be subject to robust auditing.
- 7.2 In March 2011 a consultation paper, "Future of Local Public Audit", was issued. This set out the Government's proposals for this new audit regime, the key features of which are as follows:
- (i) Broadly, the new regime will mirror that used for private companies, but with additional safeguards to protect the public purse
  - (ii) The new regime will follow 4 design principles: Localism and decentralisation; Transparency; Lower audit fees; and High standards of auditing
  - (iii) Councils will be responsible for appointing their own external auditors, chosen from firms who will be registered with, and regulated by, a "supervisory body" (one of the main accountancy bodies).
  - (iv) Councils must have an Audit Committee, containing at least some independent members, which will be responsible for advising on the appointment of external auditors and possibly monitoring their work (see section 6 below).
  - (v) Arrangements will apply in the event that a council fails to appoint an external auditor. These could involve the Secretary of State making an appointment. Special rules will apply in the case where an external auditor wishes to resign, or where the council wishes to remove them. This is to protect the integrity and independence of the auditor's role.
  - (vi) The council will be required to re-appoint formally external auditors on an annual basis, but will have to go through a competitive appointment process every 5 years to ensure value for money. The council could only appoint the same firm for two consecutive 5-year terms. It is likely that councils will collaborate on the procurement of auditors in order to achieve better value. Members of the public would have the right to make representations about the appointment of the external auditor.
  - (vii) The external auditor will still be empowered to issue Public Interest Reports, and will receive and investigate issues raised by citizens, although the right of electors to formally object to the Council's accounts will cease.

### 7.3 Scope of external audit:

The consultation paper includes 4 options for determining the scope of external audit work. These are:

- Option 1 In line with the audit of private companies, the external auditor will give an opinion on whether the financial statements give a true and fair view of the council's financial position, and review other information published with the accounts such as the annual governance statement.
- Option 2 As with option 1, but also providing a conclusion as to whether the council has arrangements in place for securing value for money.
- Option 3 As with option 2, but also providing conclusions on "regularity and propriety", including compliance with laws and financial resilience.
- Option 4 As with option 1, but the external auditor would also review an annual report, which the council would be required to publish.

It is inevitable that the options with a wider scope (especially option 3) will necessitate a greater volume of external audit work, and therefore higher audit fees. Option 2 broadly mirrors the current arrangements with the Audit Commission (having already removed the majority of the external inspection framework). Option 1 represents a "lighter touch", but members would need to acknowledge that there would be no external assurance about the council's ability to deliver value for money. Option 4, the consultation paper suggests, would increase transparency, but would also place an additional burden on councils.

### 7.4 Role and composition of Audit Committee:

The consultation paper proposes that external auditors should be formally appointed by Full Council, on the advice of an Audit Committee. It is proposed that the Audit Committee should contain independent members, and non-executive members of the Council. The chair would be independent. The role of the Audit Committee could be restricted to simply making an annual recommendation to Full Council to appoint External Auditors, or it could be expanded to include various monitoring and regulatory functions.

### 7.5 The consultation closed in June and the Government plans to publish its response to the consultation during the Autumn, although no specific date has yet been quoted.

In parallel with the consultation process, a review of the decision to abolish the Audit Commission was carried out by the Communities and Local Government Select Committee. This published its findings on 7 July 2011 and the Government response was published in October 2011.

Because the process of implementing a new audit framework required primary legislation and could not take place quickly, the Government was keen to explore ways of implementing the transfer of the Commission's audit work to the private sector without waiting for the rest of the framework. It therefore commissioned consultants, FTI, to assess ways of achieving this transfer to achieve best value for the taxpayer. Following receipt of the FTI report, DCLG

ministers announced in July 2011 that the option offering the best value for money, as well as being the quickest and, in their view, the most straightforward, would be to outsource, by means of a public procurement exercise, the 70 per cent of audits of principal bodies currently delivered by the Audit Practice from the 2012/13 audit year. The Commission's Board agreed this approach and is carrying out a procurement process to give private sector bidders the chance to compete for the Commission's audit work. This will mean all of the Commission's in-house work will be outsourced in time for the audit of 2012/13 accounts. The procurement timetable is set out below:

| <b>Key milestone</b>  | <b>Principal bodies' procurement</b> |
|---|--------------------------------------|
| Issue Contract Notices in the Official Journal of the European Union              | 5 September 2011                     |
| Issue pre-qualification questionnaires (PQQ) on request                           | From 5 September 2011                |
| Deadline for return of PQQs   | 7 October 2011                       |
| Issue invitations to tender and anonymised TUPE information to selected suppliers | w/c 24 October 2011                  |
| Deadline for submission of tenders  | 16 December 2011                     |
| Approval of contract awards   | w/c 20 February 2012                 |
| Consultation with audited bodies on appointments                                  | 23 April – 13 July 2012              |
| Approval of auditor appointments  | w/c 23 July 2012                     |
| Appointments for 2012/13 commence   | 1 September 2012                     |
| Staff transfer to firms awarded contracts   | 31 October 2012                      |

- 7.6 New contracts will be awarded for three or five years, commencing from the audit of the accounts for 2012/13.
- 7.7 It is intended that the Audit Commission will award contracts in spring 2012 to allow new auditor appointments to be in place by 1 September 2012. As contracts will not be awarded until spring 2012 auditors will not be appointed until after the start of the 2012/13 financial year. Because an auditor needs to be in place at the start of the financial year, an interim auditor appointment will be made to cover the period 1 April 2012 to 31 August 2012. It is intended that the Council's current external audit provider would be retained to cover this interim period, although formal consultation is still required over this. This 'interim' role will be limited to a 'watching brief', with any costs incurred during this period met by the Audit Commission.
- 7.8 Following the procurement exercise the Audit Commission will appoint the Council's new auditor, to audit the 2012/13 and future years' accounts, with effect from 1 September 2012. The Council will be consulted on this appointment following the award of contracts in spring 2012.
- 7.9 Bids have been invited for ten contract lots in four geographical regions, as set out below:

|                                 | <b>Estimated<br/>lot size<br/>£m (ABNV)</b> |
|---------------------------------|---|
| <b>Northern</b>                 |   |
| North West                      | 12.5  |
| North East and North Yorkshire  | 5   |
| Humberside and Yorkshire        | 6.9   |
| <b>Central</b>                  |   |
| West Midlands                   | 8.9   |
| East Midlands                   | 7.8   |
| Eastern                         | 8.6   |
| <b>London</b>                   |   |
| London (North)                  | 8.4   |
| London (South), Surrey and Kent | 11.7  |
| <b>Southern</b>                 |   |
| South East                      | 11.4  |
| South West                      | 8.2   |

Lot sizes are expressed in terms of 'audited body notional value' (ABNV), which comprises the proposed scale fee for 2012/13. Suppliers invited to tender will be free to bid for all lots available in all regions.

- 7.10 The Commission wants to ensure that it has a sufficient number of different suppliers with contracts in each region to enable it to:
- manage any independence issues that may arise when making auditor appointments to audited bodies; and
  - discharge its statutory duty to consult local government audited bodies on proposed auditor appointments.

For this reason, only one lot will be awarded to any one supplier in any one region. This means that the maximum number of lots in total that any one supplier can win is four.

- 7.11 Within each region, lots will be awarded in order of size with the largest lot (in terms of ABNV) evaluated first. The successful supplier for the largest lot will then be discounted from the evaluation of bids for other lots in the same region. The same process will apply where there are three lots in a region such that the successful suppliers for the largest and second largest lots will be discounted from the evaluation of bids for the third lot.
- 7.12 Throughout the period since the Secretary of State's original announcement in August 2010, it has been expected that there would be scope for those within Audit Practice part of the Audit Commission to be party to an employee-led bid. Arrangements are in place within the Audit Commission to enable this to happen. Recognising that there is likely to be a conflict between the interests of the Commission seeking best value as a potential commissioner of audit services and employees of the Audit Practice as potential bidders in the outsourcing exercise, a staff protocol has been put in place. This sets out the governing principles for all employees, especially those involved in submitting bids.
- 7.13 Based on the arrangements in place for the "lots" set out above, it will not be possible for the in-house team to retain all the work currently undertaken

directly by the Audit Commission. Audit staff not party to successful bids are expected to transfer to the successful bidders in accordance with the timetable set out above. This is likely to mean that, while our audit will be carried out by a different supplier from 2012/13 onwards, the audit team may well stay broadly unchanged, although it will be for the new supplier to decide exactly how they wish to deploy staff transferring from the Audit Commission's practice.

- 7.14 Whilst these arrangements are moving towards putting in place the arrangements promised in August 2010, there have been some criticism of the current procurement programme on the following basis:
- i. It will still be some years before local authorities are free to make their own arrangements to appoint their external auditors.
  - ii. The contract period may not align with those private sector audit contracts are currently in place that will not initially be affected by the forthcoming contracts. With many councils proposing in future to tender with neighbouring authorities, if the contract periods do not align it may mean extending the present private sector audit contracts, especially if new five year contracts are awarded as part of the current tender process. Councils are keen to have full autonomy over the process, but longer contracts will delay this ability.
  - iii. While the present procurement process is being run by the Audit Commission, local government representatives have not been included in the process at all. It is suggested that they should be included on the interview or assessment panels that consider the bids received.
  - iv. The timetable indicates that local authorities will be "consulted" in 2012 about the auditors to be appointed. In reality, it would appear that this consultation will be rather meaningless as there will be no choice – the award of the contract will already have been made. Given the Government's policy intention for councils to be able ultimately to select their own auditors, it is important that the Commission works towards that by directly involving local government in the present selection process.
- 7.15 Several authorities have been "lobbying" the Audit Commission and DCLG on these points. Accordingly a letter was sent from the Chief Executive to the Audit Commission and DCLG (Appendix A).
- 7.16 The proposals for Councils to appoint their own auditors has received much debate. The main discussions concentrate on the possible loss of independence, and how this may conflict with organisations' independence. In addition, there is the risk to authorities as to the level of fees; this being believed to be a greater risk to those that are smaller and geographically more remote. Appendix B reproduces the text from a recent article in Public Finance which discusses some of the issues and views.