

Borough Council of
**King's Lynn &
West Norfolk**



RESOURCES AND PERFORMANCE – AUDIT AND RISK COMMITTEE

Tuesday 24 April 2012

**Immediately following the Resources and Performance
Panel meeting which commences at 6.00 pm**

Committee Suite
King's Court
Chapel Street
King's Lynn
Norfolk
PE30 1EX



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Borough Council of
**King's Lynn &
West Norfolk**



King's Court, Chapel Street, King's Lynn, Norfolk, PE30 1EX.
Telephone: 01553 616200
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16 April 2012

Dear Member

Resources and Performance – Audit and Risk Committee

You are invited to attend a meeting of the above-mentioned Committee which will be held on **Tuesday 24 April 2012, immediately following the Resources and Performance Panel meeting, in the Committee Suite, King's Court, Chapel Street, King's Lynn**, to discuss the business shown below.

Yours sincerely

Chief Executive

A G E N D A

1. Apologies for absence

To receive any apologies for absence.

2. Minutes

To approve the minutes of the Resources and Performance – Audit and Risk Committee meeting held on Tuesday 27 March 2012 (Pages 825 to 827 previously circulated).

3. Declarations of Interest

Please indicate whether the interest is a personal one only or one which is also prejudicial. A declaration of a personal interest should indicate the nature of the interest and the agenda item to which it relates. In the case of a personal interest, the Member may speak and vote on the matter. If a prejudicial interest is declared, the Member should withdraw from the room whilst the matter is discussed.

4. **Urgent Business Under Standing Order 7**

To consider any business which, by reason of special circumstances, the Chairman proposes to accept as urgent under Section 100(b)(4)(b) of the Local Government Act 1972.

5. **Members Present Pursuant to Standing Order 34**

Members wishing to speak pursuant to Standing Order 34 should inform the Chairman of their intention to do so and on what items they wish to be heard before the meeting commences. Any Member attending the meeting under Standing Order 34 will only be permitted to speak on those items which have been previously notified to the Chairman.

6. **Chairman's Correspondence** (if any)

7. **Matters referred to the Committee from other Council Bodies and responses made to previous Committee recommendations/requests**

To receive comments, and recommendations from other Council bodies, and any responses subsequent to recommendations, which this Committee has previously made. (N.B. some of the relevant Council bodies may meet after dispatch of the agenda)

8. **Internal Audit Plan 2011/12 – Quarterly Progress Report for the Quarter January to March 2012** (pages 1 to 7)

Committee Members are invited to note the attached report.

9. **Protocol for Liaison between Internal and external Audit 2012-2013** (pages 8 to 32)

.Committee Members are invited to note the attached protocol.

10. **The Future Provision of Local External Audit** (pages 33 to 73)

Committee Members are invited to note the attached update report and consider the options raised

11. **Audit and Risk Committee Work Programme** (pages 74 to 75)

Committee Members are invited to consider the attached Audit and Risk Committee's Work Programme.

12. **Date of Next Meeting**

To note that the next meeting of the Resources and Performance - Audit and Risk Committee will take place on **Tuesday 29 May 2012**.

To: Panel Members – Councillors Mrs K Mellish (Chairman), P Beal (Vice-Chairman), Mrs J Collingham, D J Collis, J Collop, Mrs S Collop, C Crofts, M Hopkins, H Humphrey, J Loveless, A Morrison, D Tyler, G Wareham, A White and T de Winton

Portfolio Holder:

Councillor N J Daubney, Leader and Portfolio Holder for Resources

Chief Executive

Deputy Chief Executive and Executive Director, Finance and Resources

All other Executive Directors

Audit Manager

Press

Officers: The following Officer has invited to attend in respect of the item listed below:

Agenda Item 8, 9 & 10 Kate Littlewood, Audit Manager

AGENDA ITEM 8

AUDIT AND RISK COMMITTEE REPORT

| | |
|---|-------------------------------|
| TYPE OF REPORT: Audit | Portfolio: Performance |
| Author Name: Kate Littlewood | CONSULTATIONS: |
| Tel.: 01553 616252 | |
| Email: kate.littlewood@west-norfolk.gov.uk | |
| OPEN | |

Committee: Resources and Performance – Audit & Risk Committee
Date: 24th April 2012
Subject: Internal Audit Plan 2011/12 –progress report for the quarter January to March 2012.

| | |
|-----------------------|---|
| Summary | This report shows the Internal Audit activity for the quarter January to March 2012 against the Strategic Audit Plan 2011/14. |
| Recommendation | To note the report. |

1.0 INTRODUCTION AND BACKGROUND

- 1.1 The CIPFA Code of Practice for Internal Audit in Local Government requires Internal Audit to have an annual plan. Performance against the plan should be monitored by the Audit Manager and reported during the year to the Audit and Risk Committee. The Code also requires the Audit Manager to record the findings, conclusions and recommendations arising from the audits undertaken and to obtain assurances that recommendations are being implemented. This report satisfies these requirements.
- 1.2 The Strategic Audit Plan 2011-14, endorsed by the Audit and Risk Committee on 3rd March 2011, set out the work Internal Audit expected to carry out during the year 2011-12.

2.0 Audit work in the quarter January to March 2012

- 2.1 On completion of each audit a formal report is issued to the relevant line managers, the Executive Director and Portfolio Holder. Copies are also sent to the Chief Executive and the Chief Accountant. The report contains an action plan, with target dates, that has been agreed with the managers to address the observations and recommendations raised by Internal Audit. This forms the basis of the follow-up audit, which is carried out

AGENDA ITEM 8

approximately six months later to assess progress in implementing the agreed actions. The exceptions to this are the Core Audits where the follow-ups are combined with the next annual audit of that area.

2.2 Reports issued during the quarter

The following audits have been completed during the last quarter and reports issued as described above:

- **Housing and Council Tax Benefits**
- **Sundry Debtors**
- **Car Parks**
- Scanning Process
- Refuse and Recycling
- Business Continuity follow up
- Benefits Enquiry Unit follow up
- Community Safety and Neighbourhood Nuisance follow up
- Address Management Team (Street Naming and Numbering and Local Land & Property Gazetteer) follow up
- Website Management follow up
- Cash Receipting and PCI Compliance follow up

Those shown in bold are core audits. A summary of the reports is attached as **Appendix 1** and the full versions are available to members of the Audit & Risk Committee on InSite.

2.3 Work ongoing

The following audits were ongoing at the end of the quarter and will be reported to the Committee in the next quarterly report.

- **Inventories and Asset Management – Draft report**
- **General Ledger**
- Health and Safety – Draft report
- Capital Programme

2.4 Other work carried out in the quarter

Apart from the standard audits, Internal Audit also undertook other work during the last quarter including the following:

- Ongoing review of Risk Management procedures.
- PCI-DSS Compliance
- Technology Forge
- Open Revenues – Data Conversion
- Job Evaluation Panel

AGENDA ITEM 8

3.0 Performance Indicators

- 3.1 Delivery of the Audit Plan – a target of 95% has been set to take in to account any work that may overlap at year end and also to allow for any additional work that may arise during the year. The table below summarises the position against the approved Audit Plan 2011/12.

| 2011/12 Status of Audits | Audit days used | Percentage of Plan (in days) |
|-----------------------------|-----------------|---------------------------------|
| Completed and reported | 312 | 85% |
| In Progress | 53 | 14% |
| Outstanding | 5 | 1% |
| Total Planned Audits | 370 | 100% |

All the audits planned for the quarter were either completed or close to completion as expected. The 'Outstanding' time relates to an audit of the Town Hall which will be carried over to the 2012-13 plan.

- 3.2 Audit Questionnaires returned with satisfactory scores – Satisfaction questionnaires are issued with the final report to the Executive Director for completion and return to the Audit Manager. Of the 29 questionnaires issued this year, 20 have been returned, of which 95% had satisfactory scores. The reason for the 5% with lower scores was reported in the last quarterly report in January 2012.
- 3.3 Productive Time – a target of 70% for the full year was set and overall this year the final figure is 65%. 'Productive Time' refers to the amount of time that is spent on planned audit work and does not include management time, training and general administration. In addition the team completed work relating to the review of Financial Regulations; creation of the new Retention Policy and ongoing work assisting with PCI-DSS compliance. The work supporting the Audit and Risk Committee also took more time than anticipated and this allowance has been increased for 2012-13.

4.0 Work planned for the next quarter April to June 2012

- 4.1 Work will start on the 2012-13 audit plan as presented to the Committee on 31st January 2012. As well as completing the ongoing work listed in paragraph 2.3, the following audits are planned for the next quarter:

| Audit Title | Days | Date |
|---|------|-------|
| Town Hall (from 2011-12 plan) | 5 | April |
| Grounds Maintenance | 7 | April |
| Environmental Quality – Land drainage | 10 | April |
| General ICT Controls (incl. Networks) | 10 | April |
| Rental Income (incl. Industrial rents, Beach huts and Allotments) | 7 | May |
| Car Leasing | 5 | May |
| Printing | 5 | May |
| Economic Regeneration | 5 | May |

AGENDA ITEM 8

| Audit Title | Days | Date |
|------------------------------------|-------------|-------------|
| GIS | 10 | May |
| S106/ CIL | 10 | June |
| Markets | 3 | June |
| Annual Governance Statement review | 3 | June |

4.2 Other work to be carried out in this quarter will include the Annual Audit Report from the Audit Manager; ongoing work to assist with the data conversion relating to the Shared Services agreement for Revenues and Benefits; and preparation of a Service Level Agreement for future audits relating to the Shared Services Agreement. In addition the Audit Manager will continue to manage and report on the Corporate Risk Register.

4.3 There are also a number of Follow-up reports falling due within this quarter. An allocation of time is not given to individual follow-up audits. Instead a total amount of 15 days is allowed in the audit plan each year for this work.

5.0 Conclusion

Progress for the year has been satisfactory, with no major issues arising during the year to disrupt the planned work. The outstanding audits are very close to completion and will be presented at the next quarterly report in July.

AGENDA ITEM 8

Notes to support the summary in Appendix 1

The following tables provide an explanation of the terms used to grade the recommendations contained in the final audit reports, and the overall opinion attributed as the result of each audit.

Recommendations

The observations and recommendations are allocated a grading High, Medium or Low as defined below:

| | |
|--------|--|
| High | Major risk requiring action by the time the final report is issued. |
| Medium | Medium risk requiring action within six months of the issue of the draft report. |
| Low | Matters of limited risk. Action should be taken as resources permit. |

Please note - 'Low' recommendations are not summarised in this report due to the insignificant nature of the issue.

Audit Opinion

At the conclusion of the audit an overall audit opinion is formed for the audit area. The definition for each level of assurance is given below.

| | |
|-----------------------|---|
| Full Assurance | A sound system of internal control that is likely to achieve the system objectives, and which is operating effectively in practice. |
| Substantial Assurance | A sound system of internal control, but there are a few weaknesses that could put achievement of system objectives at risk. |
| Limited Assurance | A system of internal control with a number of weaknesses likely to undermine achievement of system objectives, and which is vulnerable to abuse or error. |
| No Assurance | A fundamentally flawed system of internal control that is unlikely to achieve system objectives and is vulnerable to serious abuse or error. |

AGENDA ITEM 8

APPENDIX 1

| Audits completed in Q4 2011-12 | Overall Opinion |
|--|-----------------------|
| <p><u>Housing and Council Tax Benefits</u> Report published in March 2012. 2 Medium recommendations relating to checks being carried out on payments over £550 on interim payment runs, and investigating the possibility for Blackberries to be issued to Visiting Officers.</p> | Full Assurance |
| <p><u>Sundry Debtors</u> Report published in February 2012. 3 Medium recommendations relating to updating the 'Authorisation to Exercise Delegated Powers' list, setting up some additional rejection codes for Direct Debits, and reviewing access rights to the Sundry Debtors system.</p> | Substantial Assurance |
| <p><u>Car Parks</u> Report published in February 2012. No recommendations were made in this report. The follow-up work relating to last year's audit showed that all recommendations had either been implemented or were ongoing.</p> | Full Assurance |
| <p><u>Scanning Process</u> Report published in February 2012. 5 Medium recommendations relating to:</p> <ol style="list-style-type: none"> 1 Providing corporate policy guidance on the creation of documents. 2 Introducing Service Level Agreements for Scanning Processes with all Service Areas. 3 Revising scanning procedures, especially those relating to Revenues and Benefits. 4 converting IDOX Users from individual access rights to role-based access rights. 5 creation and successful testing of a Query to run a date-based audit trail. | Substantial Assurance |
| <p><u>Refuse and Recycling</u> Report published in March 2012. No recommendations were made in this report.</p> | Full Assurance |

AGENDA ITEM 8

APPENDIX 1

| Follow-up audits completed in Q4 2011-12 | Original report | Follow-up progress |
|--|--|-----------------------------------|
| <p><u>Business Continuity</u> A follow-up was carried out in May 2011, but some recommendations were still outstanding. Progress on these was further checked in January 2012 and all had been implemented with scenario testing planned for March 2012. This has now been completed.</p> | <p>November 2010 Limited Assurance</p> | <p>January 2012 Good</p> |
| <p><u>Benefits Enquiry Unit</u> The report issued in July 2011 included 1 Medium recommendation, which has now been implemented.</p> | <p>July 2011 Full Assurance</p> | <p>January 2012 Very Good</p> |
| <p><u>Community Safety and Neighbourhood Nuisance - CCTV</u> The report issued in July 2011 included 2 Medium recommendations. One requiring the new Code of Practice to be placed on the website, and the second was to develop a standard charging policy. Both have been implemented.</p> | <p>July 2011 Full Assurance</p> | <p>January 2012 Very Good</p> |
| <p><u>Address Management Team (Street Naming & Numbering and Local Land & Property Gazetteer)</u> The report issued in August 2011 included 4 Medium recommendations. Work on all recommendations is ongoing and is satisfactory.</p> | <p>August 2011 Substantial Assurance</p> | <p>March 2012 Very Good</p> |
| <p><u>Website Management</u> The report issued in September 2011 included 3 Medium recommendations. All have been implemented or are ongoing.</p> | <p>Sept 2011 Substantial Assurance</p> | <p>March 2012 Very Good</p> |
| <p><u>Cash Receipting and PCI Compliance</u> The report issued in September 2011 included 4 Medium recommendations. All have been implemented or are ongoing.</p> | <p>Sept 2011 Very Good</p> | <p>March 2012 Very Good</p> |

AGENDA ITEM 9

AUDIT AND RISK COMMITTEE REPORT

| | |
|---|-------------------------------|
| TYPE OF REPORT: Audit | Portfolio: Performance |
| Author Name: Kate Littlewood | CONSULTATIONS: |
| Tel.: 01553 616252 | |
| Email: kate.littlewood@west-norfolk.gcsx.gov.uk | |
| | |
| If not for publication, the paragraph of Schedule 12A of the 1972 Local Government Act considered to justify that is paragraph 3. | |

Committee: Resources and Performance – Audit & Risk Committee
Date: 24th April 2012
Subject: Protocol for liaison between internal and external audit 2012-13

| | |
|-----------------------|--|
| Summary | Each year internal and external agree a protocol to co-ordinate the work for that year. |
| Recommendation | To note the protocol. |

1.0 Introduction and Background

- 1.1 Each year internal and external audit agree a protocol (**Appendix 1**) to co-ordinate the work for that year. This helps to reduce duplication of work and conflicts in timetable so that both sets of auditors are not working in an area at the same time.
- 1.2 The protocol also sets out agreed key controls and levels of sampling that would enable the external auditors, PWC, to place reliance on the work of internal audit in accordance with International Auditing Standard (ISA) 610.
- 1.3 The testing described in the protocol is standard material and as such does not increase the workload of internal audit. However it does reduce the amount of testing that external audit need to do and helps to keep the level of fees down.

2.0 Outcomes

- 2.1 By agreeing the protocol, the arrangements between internal and external are formalised and expectations are clearly stated.

Protocol for liaison between internal and external auditors 2012/13

*Borough Council of
King's Lynn and
West Norfolk*

March 2012



AGENDA ITEM 9



Members of the Audit and Risk Committee
Borough Council of King's Lynn and West Norfolk
King's Court
Chapel Street
Kings Lynn
Norfolk PE30 1PX

March 2012

Ladies and Gentlemen

Protocol for liaison between internal and external auditors

As part of our continuation as the Council's external auditors for 2012/13 and in line with the process adopted for the 2012/13 financial year, we have agreed a protocol with the Council's Internal Audit Manager to facilitate effective liaison in line with the managed audit approach.

Yours faithfully

A handwritten signature in black ink, appearing to read 'PricewaterhouseCoopers LLP', is written over a light blue rectangular background.

PricewaterhouseCoopers LLP
Enclosure

cc Dave Thomason – Deputy Chief Executive
Kate Littlewood – Audit Manager

*PricewaterhouseCoopers LLP, The Atrium, St Georges Street, Norwich, NR3 1AG
T: +44 (0) 1603 615244, F: +44 (0) 1603 631060, www.pwc.co.uk*

Table of Contents

| | |
|--|----|
| Introduction | 1 |
| Background | 2 |
| Planning and Liaison | 3 |
| Reliance on the work performed by Internal Audit | 5 |
| Audit work performed | 6 |
| <hr/> | |
| Accounts | 6 |
| Grant claims | 7 |
| Fraud | 7 |
| <hr/> | |
| Appendix A: Sample Sizes | 8 |
| Appendix B: Summary of Key Internal Financial Controls | 10 |

Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end, and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement.

Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Member or officer in their individual capacity, or to any third party.

AGENDA ITEM 9

Introduction

1. This document sets out the proposed working relationship between the PricewaterhouseCoopers LLP (PwC) audit team and the internal audit department of the Borough Council of King's Lynn and West Norfolk (referred to as 'Internal Audit').
2. The purpose of this document is to set out the general approach and principles to be put in place to facilitate the delivery of a managed audit. This will aid joined-up working, reducing duplication of audit work.
3. This document sets out:
 - Confirmation of the liaison arrangements with Internal Audit;
 - The requirements to be followed in placing reliance on internal audit work and our expectations for reliance on Internal Audit work;
 - Additional information on sample sizes; and
 - A detailed summary of controls and suggested testing which we consider to be key in testing internal financial control systems.
4. These arrangements are subject to regular review by both parties and necessary amendments can be made subject to mutual agreement.

AGENDA ITEM 9

Background

5. Each Local Authority has a responsibility to put in place proper arrangements for the governance and stewardship of its resources. Internal Audit is an important part of these arrangements. As per the Accounts and Audit Regulations 2011, Regulation 6, authorities must review the effectiveness of their Internal Audit function on an annual basis.
6. Under the Audit Commission Act 1998 and the Code of Audit Practice the external auditor appointed by the Audit Commission is responsible for reviewing and reporting on the Council's:
 - Financial statements and Annual Governance Statement; and
 - Arrangements for securing economy, efficiency and effectiveness in its Use of Resources.
7. The external auditor does not have a role in directing the work of Internal Audit, nor does it have a direct role in the quality assurance process.
8. Although internal and external auditors carry out their work with different objectives in mind, many of the processes are similar in respect of the review of the controls in place over the Council's financial systems. Therefore, it is appropriate that they should work together closely. The Audit Commission emphasises this need for co-operation in a number of its publications:
 - The Code of Audit Practice 2005 states that external auditors should establish effective co-ordination arrangements between internal and external audit and seek to place maximum reliance on the work of Internal Audit wherever possible;
 - 'It Takes Two' (published in 1996) is a good practice guide to assessing and improving co-operation between internal and external auditors; and
 - The Managed Audit Good Practice Guide 1995 promotes a more efficient audit by encouraging reliance on the control environment, which includes Internal Audit.

AGENDA ITEM 9

Planning and Liaison

9. To facilitate effective planning and liaison between ourselves and Internal Audit the following communications will be made:
 - Liaison meetings as and when required;
 - Communication of the respective Audit Plans and update on progress against plan during the year;
 - Informing the other party of changes in the audit approach compared to the Audit Plan, including delays to the scheduled/expected work plan;
 - Forwarding of all finalised external audit reports arising as a result of work performed to Internal Audit;
 - Forwarding of all internal audit reports relating to the Council's fundamental financial systems (see Appendix B) and any other reports considered to be relevant once finalised to us;
 - Communication of the annual reports/letters;
 - Communication of fraud investigations and alerts initiated on a timely basis; and
 - Significant concerns regarding the internal controls or financial performance of the Council.
10. Internal Audit will also provide us with the following upon request:
 - Risk Analysis;
 - Statement of assurance/opinion on the Council's systems of internal control, as reflected in the Council's Annual Governance Statement; and
 - Audit files.
11. All communications should be made on a timely basis.

AGENDA ITEM 9

12. The key points of contact will be as follows:

| Name | Position | Telephone Number | Email Address |
|-------------------------------|--------------------------------------|------------------|-------------------------------------|
| Internal Audit | | | |
| Kate Littlewood | Audit Manager | 01553 616252 | kate.littlewood@west-norfolk.gov.uk |
| PricewaterhouseCoopers | | | |
| Alison Ridley | Senior Manager | 01603 883317 | alison.m.ridley@uk.pwc.com |
| Abigal Armstrong | Senior Associate (Audit Team Leader) | 01603 883345 | abigal.k.armstrong@uk.pwc.com |

AGENDA ITEM 9

Reliance on the work performed by Internal Audit

13. In accordance with International Standard on Auditing (ISA) 610, in order to place reliance on the work performed by Internal Audit, it will be necessary for us to review the working papers and reports of Internal Audit and re-perform testing on a sample basis. To facilitate this, we will need to satisfy ourselves that:
 - The scope and quality of the work is appropriate;
 - Audit programs are adequate;
 - Working papers adequately document work performed;
 - Conclusions are appropriate in the circumstances;
 - Reports are consistent with the results of work performed;
 - Any exceptions or unusual matters are properly resolved; and
 - Supervision and review within Internal Audit appears to have been appropriately carried out (e.g. review by senior audit personnel of work performed).
14. We will also need to ensure that the conclusions made by Internal Audit have been reached using testing sample sizes that are equal to, or in excess of, the sample sizes we would have needed to apply to reach the same conclusions. We provide further guidance as to the sample sizes required in Appendix A.
15. Internal Audit should also be subject to a review of effectiveness, as per the amended Accounts and Audit Regulations 2011.
16. The degree to which we can place reliance on the work of Internal Audit is also affected by the timing and/or completion of their audits. This is commented upon in more detail in the following section.

AGENDA ITEM 9

Audit work performed

Accounts

17. As detailed in our Audit Plan, our Accounts audit is carried out in accordance with our Accounts Code objective which requires us to comply with the International Standards on Auditing (ISAs) (UK & Ireland) issued by the Auditing Practices Board (APB). We plan and perform our audit so as to be able to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. We use professional judgement to assess what is material. This includes consideration of the amount and nature of transactions.
18. Our audit approach is based on a thorough understanding of the Council's business and is risk-driven. It first identifies and then concentrates resources on areas of higher risk and issues of concern to the Council. This involves breaking down the accounts into components. We assess the risk characteristics of each component to determine the audit work required.
19. We adopt a top-down, controls-based approach to the audit, where we drill down the management structure and review key business processes. From this, we focus our work on verifying, evaluating and validating, where possible, the controls management use to ascertain how much assurance we can draw from them. We supplement this work on the Council's key controls with detailed analytical procedures and additional substantive tests as necessary.
20. It is the review of key business systems and controls on which we will seek to place reliance on the work of Internal Audit wherever possible. To enable this, it is of key importance that this work is completed by Internal Audit prior to the commencement of our initial fieldwork. Under current timescales, this would be 31 January 2013. Should the timing need to be brought forward or changed, this would be discussed and agreed as part of the liaison meetings.
21. The most significant matters on which we plan to place reliance on the work of Internal Audit are:
 - The understanding, evaluating and validating of the controls over the following key financial systems, including:
 - Purchasing and payables/creditors;
 - Income receivable/debtors;
 - Payroll and pensions;
 - Fixed Assets;
 - Cash/Treasury Management;
 - Housing and Council Tax Benefits;
 - Council Tax;
 - National Non-Domestic Rates;

AGENDA ITEM 9

- General Ledger maintenance;
 - Budgetary controls - including budget setting and monitoring; and
 - Car park income.
- Review of the assurance given by Internal Audit in relation to the Annual Governance Statement; and
 - Assessment of fraud risk (as required under ISA 240) and the investigation of matters arising including monitoring the implementation of actions required by the results of the National Fraud Initiative.
22. We detail in Appendix B the key controls we would expect to be tested as part of Internal Audit's work on the Council's key financial systems. We understand that Internal Audit may decide to test these controls on a cyclical basis, every two years. In such a scenario, we would expect Internal Audit to:
- Document and confirm their understanding of the key financial system and that there have been no significant changes to its operation when compared to the previous audit. Where there has been a significant change, full testing of the key controls would still be expected; and
 - Perform a walk-through of each of the key controls to confirm the understanding gained above that the key financial controls have not changed.
23. The above procedures would assist Internal Audit in confirming that there have been no significant changes and in providing evidence for the Council's Annual Governance Statement. If a key financial system has experienced significant change and has not been tested or has not been tested for over two years, then we will need to perform additional work to gain the audit assurance required for our opinion on the Council's financial statements.

Grant claims

24. At present there are no formal arrangements for joint working in respect of grant claims. However, we will maintain a dialogue with Internal Audit in order to share matters of concern so that both parties can consider them when planning work in this area.

Fraud

25. Internal audit will notify us and the Audit Commission promptly of all frauds exceeding £10,000, and any cases of corruption or any fraud cases of particular interest of complexity. If appropriate, PwC will offer support and assistance to Internal Audit in investigating significant frauds.
26. In the event that we suspect a fraud, we will pass the case over to the control of Internal Audit who will then be expected to oversee the investigation of the case and keep us informed of progress. We reserve the right to retain control over a fraud investigation, although this is only likely in exceptional circumstances.

Appendix A: Sample Sizes

Sample sizes

In relation to manually performed controls, the following ranges should be used:

| Frequency of Control | Number of items to test |
|-----------------------------|--------------------------------|
| Annual | 1 |
| Quarterly | 2 |
| Monthly | 2-5 |
| Weekly | 5,10,15 |
| Daily | 20,30,40 |
| Multiple times a day | 25,30,45,60 |

The reference to “items” refers to the number of occurrences for the control. The ranges above are based on the population of individual instances where the control is expected to operate.

The choice of the number of items to test in relation to a specific control will be based on:

- The significance of the risk addressed by the control;
- The importance of the control to addressing the risk;
- The degree to which the control is cumulative;
- The relevance and reliability of the audit evidence to be obtained in supporting that the control prevents, or detects and corrects, material misstatements at the control assertion level. (The assertions are: completeness, accuracy, validity and restricted access);
- The extent to which audit evidence is obtained from tests of other controls related to the assertion. (Therefore, if other controls tested verify the accuracy of items, it may be considered that a lower number of items within the range would be appropriate for testing if the control addresses this same audit assertion);
- The expected deviation from the control; and

AGENDA ITEM 9

- The amount of assurance required from the testing of the control (e.g. a greater number of items should be tested if a high level of assurance is required from the control).

Where controls are automated, rather than manual, (i.e. performed by the information system), then only a sample size of 1 is required.

Documentation of sample sizes

In all cases, the justification for the sample sizes chosen for testing should be documented. In addition, sample sizes should be chosen from across the whole financial year, up to the date of testing, to ensure that appropriate consideration is given to whether the control is in place and working effectively over this period.

AGENDA ITEM 9

Appendix B: Summary of Key Internal Financial Controls

The following tables set out the key controls that we seek to test on an annual basis to support our audit work under the Code of Audit Practice. The tables do not detail a complete list of all controls within the financial system and therefore it may be appropriate to supplement these controls with further controls to meet Internal Audit objectives.

The tables cover the following areas:

- Purchasing and payables/creditors;
- Income receivable/debtors;
- Payroll and pensions;
- Fixed Assets;
- Cash/Treasury Management;
- Housing and Council Tax Benefits;
- Council Tax;
- National Non-Domestic Rates;
- General Ledger maintenance;
- Budgetary controls - including budget setting and monitoring; and
- Car park income.

AGENDA ITEM 9

Purchasing and payables/creditors

| Key Control | Type of testing |
|--|---|
| Appropriately authorised orders should be raised for all purchases. The person authorising the order should be different to the person raising it. | Review of orders to check for appropriate authorisation. |
| Goods received are registered onto the POPs system or matched to orders raised if processed manually. Invoices received should be matched to orders and the POPs system prior to payment for accuracy and confirmation of receipt of the goods/service. | Review of invoices against orders and POPs system. |
| Invoices input into the system for payment should be checked for accuracy. The supplier reference number on the invoice is matched against the order raised. | Review of information recorded within the POPs system back to the invoice to ensure accuracy of information recorded. |
| BACS payments should be appropriately authorised. | Review a sample of BACS runs to ensure they have been appropriately authorised. |
| Creditor control accounts/purchasing system to general ledger system interfaces should be reconciled and all reconciling items should be identified, investigated and resolved on a timely basis. An independent review of the reconciliation should be performed on a timely basis. | Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis. Agreement of system balances as noted on the reconciliation to prints from those systems. Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items. |
| Appropriate segregation of duties and restricted access should be ensured. | Consideration of whether duties are appropriately segregated between those responsible for ordering and those responsible for payments. Review of access rights to the purchasing and payables system. |
| Procurement analyse amounts paid to suppliers to identify large or unusual amounts for further investigation. | Review the analysis performed by procurement to ensure it is performed on at least a quarterly basis and that large and unusual items have been appropriately identified and investigated. |
| Amendments to standing data (e.g. suppliers details) should be appropriately authorised and accurately input on to the system. An exception report of standing data amendments is run on a regular basis and checked to | Review exception reports run from the system to ensure they have been reviewed on a timely basis. Where the above control is not operating effectively, obtain a list of |

AGENDA ITEM 9

| Key Control | Type of testing |
|--|--|
| supporting documentation to ensure changes made were valid. | amendments made to supplier's details (from the system) and check against appropriate supporting documentation to confirm accuracy of change to data and that the change was appropriately authorised. |
| Tendering procedures should be followed for all purchases above the limit set. | Review of procedures and testing to ensure that procedures were followed. |

AGENDA ITEM 9

Income receivable/debtors

| Control | Type of testing |
|---|--|
| Invoice requisitions should be appropriately authorised and raised in a timely manner before being forwarded to Sundry Debtors. | Review of invoice requisitions to check for appropriate authorisation. |
| Invoices raised by sundry debtors should be checked to invoice requisitions to ensure accuracy and completeness of invoices raised. Invoices raised by LynnSport or Care Line do not use invoice requisitions. | <p>Check of invoices raised by sundry debtors to invoice requisitions to agree value of invoice raised.</p> <p>Check a sample of Care Line and LynnSport invoices raised to supporting documentation to confirm what it has been raised for and that the right amount has been raised.</p> |
| Only authorised personnel should be able to raise invoices. This includes personnel in the sundry debtors section as well as staff authorised within LynnSport and Care Line who can raise their own invoices. | Review access rights to the receivables system to raise invoices. Ensure only appropriate staff have this access. |
| Receipt of income should be reconciled to the amount banked. | Review a sample of income reconciliations to ensure they have been appropriately completed and reviewed. |
| Debtor control accounts/receivables system to general ledger system interfaces should be reconciled and all reconciling items should be identified, investigated and resolved on a timely basis. An independent review of the reconciliation should be performed on a timely basis. | <p>Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis.</p> <p>Agreement of system balances as noted on the reconciliation to prints from those systems.</p> <p>Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items.</p> |
| Appropriate segregation of duties and restricted access should be ensured. | <p>Consideration of whether duties are appropriately segregated between those responsible for raising invoices and those responsible for recording income.</p> <p>Review of access rights to the receivables system.</p> |
| Appropriate procedures should be in place for monitoring the recoverability of aged debts. | <p>Document the procedures undertaken to recover aged debts.</p> <p>Testing of aged debts to ensure that appropriate procedures have been followed.</p> |
| Bad debts should be written off after appropriate authorisation per the financial regulations. | Testing of write-offs to confirm the appropriate authorisation was obtained prior to write-off. |

AGENDA ITEM 9

Payroll and Pensions

| Control | Type of testing |
|--|--|
| Starter forms should be appropriately completed by the HR department and employee (based on the employment contract) prior to input into the payroll system. Input of details into the payroll system should be checked for accuracy. | Testing new starters per the system back to starter forms and employee contracts to confirm the accuracy of the input into the system and appropriately completed supporting documentation exists. |
| Leaver forms must be appropriately authorised and accurately input into the payroll system. | Testing leaver forms to ensure that they have been correctly authorised and input into the payroll system. |
| Amendments to standing data must be authorised by the employee and appropriate manager and accurately input into the payroll system | Testing amendments per the system back to amendment forms to confirm the accuracy of the change on the system and that the amendments have been appropriately authorised. |
| Payroll control accounts/payroll system to general ledger system interfaces should be reconciled and all reconciling items should be identified, investigated and resolved on a timely basis. An independent review of the reconciliation should be performed on a timely basis. | <p>Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis.</p> <p>Agreement of system balances as noted on the reconciliation to prints from those systems.</p> <p>Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items.</p> |
| Managers should be asked to verify the completeness and accuracy of employee information on the payroll system on at least a quarterly basis. | Review the summary of employee listings issued and received, ensuring all have been received and action taken as appropriate. |
| Appropriate segregation of duties and restricted access should be ensured. | <p>Consideration of whether duties are appropriately segregated between those responsible for inputting details and those authorising payments.</p> <p>Review of access rights to the payroll system.</p> |

AGENDA ITEM 9

Fixed Assets

| Control | Type of testing |
|---|---|
| All capital additions should be appropriately authorised in accordance with procedures. | Testing of capital additions to ensure appropriate authorisation has been obtained. |
| All capital disposals should be appropriately authorised in accordance with procedures. | Testing of capital disposals to ensure appropriate authorisation has been obtained. |
| The fixed asset register is reconciled to the general ledger on a regular basis. The reconciliation should be signed and dated by the preparer as evidence of completion. An independent review of the reconciliation should be performed and evidenced by the reviewer (signature and date). | Testing of the reconciliations between the fixed asset register and the general ledger. |
| Restricted access to the fixed asset register should be ensured. | Review of access rights to the fixed asset register. |
| Capital expenditure should be monitored and controlled against budget. The budget set should be realistic and based upon appropriate assumptions. | Review the processes in place for setting and agreeing the capital budget. Review the controls in place to monitor and control performance against the capital budget. |

Cash and Treasury Management

| Control | Type of testing |
|--|---|
| Bank reconciliations for all bank accounts should be performed on a monthly basis and all reconciling items fully identified, investigated and resolved as necessary. The reconciliation should be signed and dated by the preparer as evidence of completion. An independent review of the reconciliation should be performed and evidenced by the reviewer (signature and date). | Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis. Agreement of system balances as noted on the reconciliation to prints from those systems. Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items. |
| Appropriate segregation of duties and restricted access should be ensured. | Consideration of whether duties are appropriately segregated between those responsible for purchasing and those responsible for payments. Review of access rights to the cash receiving system. |

AGENDA ITEM 9

Housing and Council Tax Benefits

| Control | Type of testing |
|--|---|
| Claimant details are input correctly and the appropriate supporting information obtained. This could include information verified as being checked by the DWP. | Test a sample of claimants and ensure their details have been correctly entered onto the benefits system and appropriate supporting evidence has been retained (including that information has been verified by the DWP, where applicable). Review the system in place for sample checking claims processed to ensure operating effectively. |
| Backdated claims are supported by a backdating form and are subject to authorisation by the backdating officer to ensure this is performed in accordance with the rules. | Test a sample of backdated claims and ensure appropriate evidence has been retained of the backdating officer's review and that backdating was appropriately awarded. |
| BACS payments should be appropriately authorised. | Review a sample of BACS runs to ensure they have been appropriately authorised. |
| All payments over £650 (£550 on an ad hoc basis) should be subject to independent review to ensure accuracy of the payment. | Test a sample of payments >£650 and ensure there is evidence of review. |
| Visiting officers visit claimants to gain assurance that details are unchanged. This is performed in accordance with the recommended schedule. | Review the procedure for allocating visiting officer visits and ensure claimants are visited within the specified period of time. Test a sample of visits to ensure they have taken place and the appropriate evidence has been seen. |
| Overpayments are checked to ensure they have been accurately allocated. | Test a sample of overpayments to ensure correctly calculated. |
| Overpayments per the benefits system are reconciled to the debtors system. | Test a sample of reconciliations between the benefits and debtors system to ensure overpayments have been correctly raised. |
| The recovery of overpayments is monitored and action taken to collect debts. | Review the process for monitoring overpayment recovery and ensure action is taken on a timely basis to collect debts outstanding. |
| The benefits system is reconciled to the Council Tax and General Ledger systems on at least a monthly basis. | Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis. Agreement of system balances as noted on the reconciliation to prints from those systems. Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items. |
| Appropriate segregation of duties and restricted access should be ensured. | Consideration of whether duties are appropriately segregated between those responsible for inputting details and those authorising payments. Review of access rights to the benefits system. |

AGENDA ITEM 9

Council Tax

| Control | Type of testing |
|--|--|
| The Council ensures the record of properties as per the Council Tax (CT) system reconciles to the list of properties notified to them by the Valuation Office. | Test a sample of reconciliations between the CT system and the Valuation Office reports/notifications. |
| CT exemptions/discounts are reviewed on a weekly basis to identify exemptions due for review in the next 7 days, exemptions which have no end date and exemptions passed their review date but which have not been reviewed. | Test a sample of exemption reports and ensure evidence of review and appropriate follow-up of exceptions. |
| There is a sample check of all CT processing. | Review evidence of sample checking to ensure it is being performed and that action is being taken if issues are identified. |
| CT precepts per property band are input onto the CT system before the start of the financial year and reviewed for accuracy by a senior officer. | Obtain evidence that the precepts entered onto the CT system have been evidenced as reviewed by a senior officer. Agree the precepts to those approved by the Council and notified by the parish and County Councils and Police Authority. |
| A reconciliation of returned Direct Debits is performed against the value of reversals on the CT system. | Test a sample of reconciliations and ensure there is evidence of review and follow-up and resolution of reconciling items. |
| There is a daily reconciliation of cash receipts / cash postings / reversals against movement on outstanding debt. | Test a sample of reconciliations and ensure there is evidence of review and follow-up and resolution of reconciling items. |
| Refunds are authorised by a senior billing officer. Refunds over £1,000 must have a payment voucher authorised by the Head of Revenues. | Test a sample of refunds and ensure appropriately authorised. |
| The Council Tax system is reconciled to the General Ledger and benefits systems on at least a monthly basis. | <p>Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis.</p> <p>Agreement of system balances as noted on the reconciliation to prints from those systems.</p> <p>Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items.</p> |
| Appropriate segregation of duties and restricted access should be ensured. | <p>Consideration of whether duties are appropriately segregated between those responsible for inputting details and those processing payments.</p> <p>Review of access rights to the council tax system.</p> |

AGENDA ITEM 9

National Non-Domestic Rates

| Control | Type of testing |
|--|---|
| The Council ensures the record of properties and their total rateable value as per the National Non-Domestic Rates (NNDR) system reconciles to the list of properties and total rateable value notified to them by the Valuation Office. | Test a sample of reconciliations between the NNDR system and the Valuation Office reports/notifications. |
| NNDR exemptions/discounts are reviewed on a weekly basis to identify exemptions due for review in the next 7 days, exemptions which have no end date and exemptions passed their review date but which have not been reviewed. | Test a sample of exemption reports and ensure evidence of review and appropriate follow-up of exceptions. |
| There is a sample check of all NNDR processing. | Review evidence of sample checking to ensure it is being performed and that action is being taken as a result of issued identified. |
| The NNDR rateable value multiplier is put onto the NNDR system reviewed for accuracy by a senior officer. | Obtain evidence that the multiplier entered onto the NNDR system have been evidenced as reviewed by a senior officer. Agree the multiplier used to notification received. |
| A reconciliation of returned Direct Debits is performed against the value of reversals on the NNDR system. | Test a sample of reconciliations and ensure there is evidence of review and follow-up and resolution of reconciling items. |
| There is a daily reconciliation of cash receipts / cash postings / reversals against movement on outstanding debt. | Test a sample of reconciliations and ensure there is evidence of review and follow-up and resolution of reconciling items. |
| Refunds are authorised by a senior billing officer. Refunds over £5,000 must be authorised by the Executive Director for Finance and Resources. Refunds under £5,000 must be authorised by the Revenues and Benefits manager. | Test a sample of refunds and ensure appropriately authorised. |
| The NNDR system is reconciled to the General Ledger system on at least a monthly basis. | Review reconciliations to ensure they have been appropriately prepared and reviewed (and evidenced as such) on a timely basis. Agreement of system balances as noted on the reconciliation to prints from those systems. Testing of reconciling items to ensure these have been investigated and are appropriate reconciling items. |
| Appropriate segregation of duties and restricted access should be ensured. | Consideration of whether duties are appropriately segregated between those responsible for inputting details and those processing payments. Review of access rights to the NNDR system. |

AGENDA ITEM 9

General Ledger Maintenance

| Control | Type of testing |
|--|---|
| All manual journals raised are appropriately authorised and input into the system. | <p>Testing of manual journals from the system back to supporting documentation to confirm accuracy of input.</p> <p>Testing of manual journals from supporting documentation to the system to confirm accuracy of input and completeness of processing.</p> |
| Access rights to the system should be reviewed regularly to ensure that the appropriate access levels have been given to the appropriate individuals and to allow segregation of duties. | <p>Review and testing of controls regarding setting of access rights and monitoring of these rights.</p> <p>Review of access rights to the general ledger.</p> |

Budgetary Control

| Control | Type of testing |
|---|---|
| Budgets should be approved prior to the start of the financial year and be based upon appropriate and reasonable assumptions. | Review of the approval of the budget and the underlying assumptions. |
| Budgets should be assigned to appropriate personnel and should be monitored regularly throughout the year. | Review of procedures in place regarding budgetary control. Testing to ensure procedures are being followed, including discussion of procedures with budget holders and obtaining evidence to corroborate their explanations for variances against budget. |
| Budgetary information should reconcile to the general ledger. | Agreement of budget reports (including those presented to Members) back to the general ledger. |

AGENDA ITEM 9

Car Parks income

| Control | Type of testing |
|---|---|
| Cash collected from car park ticket machines is reconciled to that expected per the ticket machine records. Any significant differences are investigated. | Review and testing of the reconciliation process across all of the Council's car park ticket machines. |
| Cash recorded within the bank statement matches that collected from the car park ticket machines. | Review and testing of the reconciliation process between cash banked and that per the car park ticket machines. |
| Cash collection and counting is performed by at least two people within a secure environment. Both sign as evidence of the amount counted/collected. | Observation and testing of the cash collection and counting process (where this is applicable, i.e. not performed by a third party, contracted firm). |
| Car Park income is monitored against budget and between locations and machines. | Review and testing of the car park income budget monitoring process. |

AGENDA ITEM 9

In the event that, pursuant to a request which the Borough Council of King's Lynn and West Norfolk has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this proposal, it will notify PwC promptly and consult with PwC prior to disclosing such information. The Borough Council of King's Lynn and West Norfolk agrees to pay due regard to any representations which PwC may make in connection with such disclosure and the Borough Council of King's Lynn and West Norfolk shall apply any relevant exemptions which may exist under the Act to such information. If, following consultation with PwC, the Borough Council of King's Lynn and West Norfolk discloses any such information, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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AGENDA ITEM 10

AUDIT AND RISK COMMITTEE REPORT

| | |
|---|---|
| TYPE OF REPORT: Audit | Portfolio: Performance |
| Author Name: Kate Littlewood | CONSULTATIONS: Deputy Chief Executive |
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| | |
| If not for publication, the paragraph of Schedule 12A of the 1972 Local Government Act considered to justify that is paragraph 3. | |

Committee: Resources and Performance – Audit & Risk Committee
Date: 24th April 2012
Subject: The future provision of local external audit.

| | |
|-----------------------|--|
| Summary | Since March 2011 the Department for Communities and Local Government has been consulting on proposals for local public bodies to appoint their own independent external auditor. This report presents the response from the Government and options that Members need to consider. It also includes the results of the recent tender process by the Audit Commission to outsource their in-house audit work. |
| Recommendation | To note the update and consider the options raised. |

1.0 Introduction and Background

- 1.1 At present the Audit Commission appoints the Council's external auditors and monitors their standards of work.
- 1.2 Until recently the Audit Commission was responsible for undertaking 70% of the local government audit themselves, with the remaining 30% being awarded to five private audit firms. The latter applies to this council with the external auditors being PriceWaterhouseCoopers (PWC)
- 1.3 As a result of the decision in August 2010 by the Secretary of State for Communities and Local Government (CLG) to disband the Audit Commission, alternative procedures needed to be established to enable external auditors to be appointed in future.

AGENDA ITEM 10

- 1.4 A consultation document from the CLG was reported to this Committee on 1st June 2011 together with the proposed response. The response was submitted to the CLG the following day.
- 1.5 Since then the Audit Commission has carried out a tender exercise to outsource its own audit work to private audit providers. The results of this exercise were announced on 5th March 2012.

2.0 Main Issue

- 2.1 In January 2012 the CLG published the 'Government response to the future of local audit consultation', which sets out what the Government now proposes for the new arrangements for audit of principal public bodies. A full copy of the document is attached as **Appendix 1**.
- 2.2 The proposals contained within this document are largely in line with the views expressed by this committee in the original consultation. However there are implications that the Committee needs to consider and possibly take to Cabinet and Council at some point in the future.
- 2.3 The CLG proposes external auditors are appointed by full Council on the advice of an Independent Auditor Appointment Panel (IAAP). The IAAP will also act as arbiter if the relationship between the council and the auditor breaks down, and will also receive public interest reports.
- 2.4 The distinctive feature of the IAAP is that it must have an independent chair and a majority of independent members. This is to maintain the element of independence required when assessing which auditor to appoint. Although it is the full Council which will officially appoint the auditor, it will be acting on the advice of the IAAP or will need to publish its reason for not doing so.
- 2.5 There may be an option to share an IAAP with other local public bodies. This may help to alleviate the issues around finding suitable willing independent members and to reduce costs.
- 2.6 Alternatively the proposals suggest that '*Where a body already has an independent audit committee, they may use that committee to meet this requirement*'. However, in line with the requirements of the IAAP, the committee will need to consist of a majority of independent members and independently chaired.
- 2.6 The issues to be considered at some point are:
 - Does the Council prefer to use and IAAP, or
 - Should the Audit and Risk committee be used, in which case its format will need to be radically altered to conform to the independence criteria stated?
 - If an IAAP is used, should we establish one solely for this council or do we join with other councils to share one?

AGENDA ITEM 10

- 2.7 To provide guidance on when this decision needs to be made, a timetable is shown in Section 4.

3.0 Intervening Auditor Appointments

- 3.1 On 5th March 2012, the Audit Commission announced the firms that will take-over its in-house audit work from 2012-13. There were ten contracts spread over four regions, for five-year periods. Ernst & Young won the contract for the Eastern Region. PWC did not win any of these contracts.
- 3.2 The existing contracts for the work not performed by Audit Commission staff will continue until 2016-17. This applies to our auditors, PWC. However, approaches have been made to the Audit Commission to establish if we can be transferred to Ernst & Young as the contract with PWC has already exceeded the time recommended by good practice to maintain auditor independence.
- 3.3 The announcement also claimed that there are potential savings of 40% from fee reductions with the outsourced contracts and it has been confirmed that this reduction will also apply to the Council's current arrangements.

4.0 Timescales

- 4.1 Upto Spring 2012 – further discussions to be held by the CLG with local public bodies to confirm the details of the proposals.
- 4.2 Spring 2012 – The preferred approach will be established and the draft Bill ready for pre-legislative scrutiny.
- 4.3 Financial year 2012-13 – Audit Commission outsourced contracts to commence and expected to run to 2016-17.
- 4.4 2016-17 – Local public authorities expected to commence procurement exercise to appoint their external auditors for 2017-18 onwards. The necessary procedures and bodies will need to be in place by this time.

5.0 Conclusion

- 5.1 The response provides a clearer indication of the direction the Government is moving in and recognises that further work is still needed to finalise the details.
- 5.2 The need for an independent body, to provide advice to the Council during the procurement process and to act as an arbiter if necessary, is being established. However whether that body is in addition to the existing audit committee or if the existing committee will need to change radically to fit the

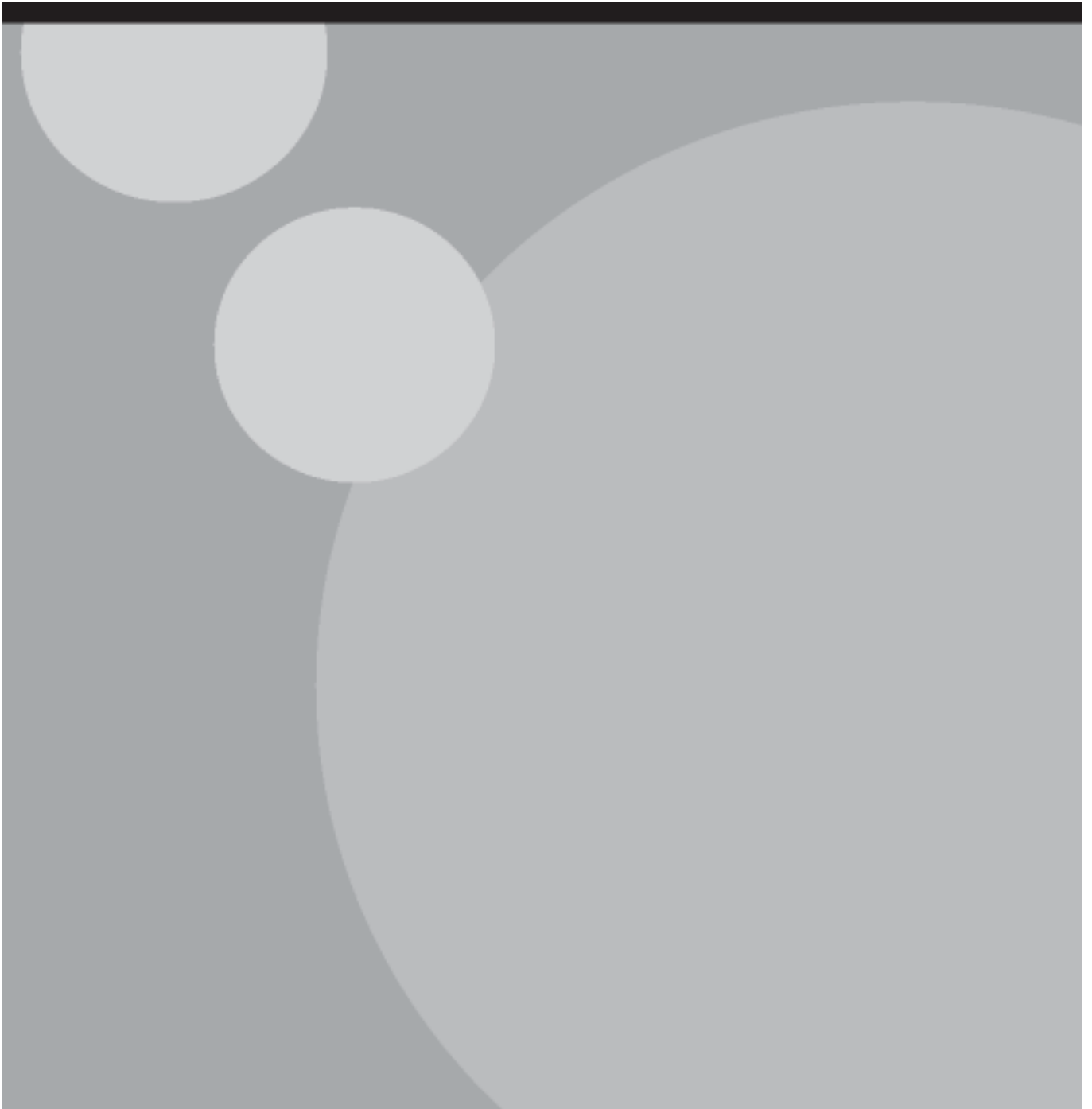
AGENDA ITEM 10

profile required needs to be decided before 2016-17 when the procurement process begins.

- 5.3 Any further updates will be brought to this Committee to allow fully informed discussions to take place at the appropriate time.



Government response to the future of local audit consultation



AGENDA ITEM 10

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AGENDA ITEM 10

Contents

| | |
|---|-----------|
| Executive Summary | 1 |
| 1. Background | 6 |
| 2. Consultation Questions and Government Response | 9 |
| Design principles | 9 |
| Regulation of local public audit | 11 |
| Commissioning local public audit services | 16 |
| Scope of the audit and the work of auditors | 24 |
| 3. Other functions of the Commission | 29 |
| 4. Implementation and next steps | 32 |
| Annex A: How different types of public bodies will appoint their local auditors | 33 |

AGENDA ITEM 10

Executive Summary

1. Following the announcement of its decision to abolish the Audit Commission in August 2010, the Government consulted on its proposals for a new local public audit framework from 31 March to 30 June 2011. Those proposals were designed to deliver the Government's objective for a new local public audit framework that places responsibility firmly in the hands of local bodies, giving them the freedom to appoint their own auditors, with appropriate safeguards for auditor independence, from an open and competitive market for local public audit services. They were also designed with the fundamental principle of accountability in mind – providing a system of local public audit that allows local bodies to be held to account for the public money at their disposal, locally to residents and service users, and also as part of a framework of accountability that provides assurance to Parliament about the public money it votes to Government departments and which is in turn devolved to the local level.
2. This document (the Government response) sets out the key themes and views which were raised during the consultation and what the Government now proposes for the new arrangements for audit of principal public bodies. The response provides little detail on the audit arrangements for local health bodies. The Department of Health is working through the implications of Monitor's changing role and the proposed establishment of the Clinical Commissioning Groups, and will specify the detailed arrangements for audit of local health bodies, under the new framework, in due course.

Key elements of the new local public audit framework

3. The design principles of the new framework for local public audit are that it should be localist and transparent, achieve a reduction in the overall cost of audit, and uphold high standards of auditing, ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit. The key elements are:

Regulation

- There should be a consistent regulatory regime for audit, covering the private sector and the local public bodies (paragraph 24).
- The **National Audit Office** is best placed to produce the Code of Practice and supporting guidance for audit of local public bodies, subject to Parliamentary approval. The National Audit Office will be required to consult key partners in developing the Code (paragraph 26).
- The **Financial Reporting Council** will be the overall regulator, mirroring its role under the Companies Act 2006. The Financial Reporting Council

AGENDA ITEM 10

will be responsible for recognition and supervision of **Recognised Supervisory Bodies** (professional accountancy bodies responsible for supervising the work of auditors, and for putting rules and arrangements in place which their members must fulfil before they can be registered auditors) and for **Recognised Qualifying Bodies** (professional accountancy bodies responsible for awarding audit qualifications) (paragraphs 31-32).

AUDITOR REGISTRATION

- Mirroring the Companies Act 2006, Recognised Supervisory Bodies will:
 - have the roles of registration, monitoring and discipline for local public audit
 - put in place rules and practices covering eligibility of firms to undertake local public audit; and
 - keep a register of firms eligible to undertake local public audit (paragraphs 33-34).

MONITORING AND ENFORCEMENT

- As under the Companies Act 2006, Recognised Supervisory Bodies will monitor the quality of audits undertaken by their member firms, and investigate complaints, disciplinary cases and issues identified during the monitoring of firms on the register of local public auditors (paragraph 43).
- The Accountancy and Actuarial Disciplinary Board (part of the Financial Reporting Council) investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. We consider that the Accountancy and Actuarial Disciplinary Board should continue to have these powers for local public audit (paragraph 45).
- There will be additional oversight and monitoring of the audits of significant local public bodies (referred to as “Bodies of Significant Public Interest”) - the Financial Reporting Council (through its Audit Inspection Unit, or as appropriate through delegation to a Recognised Supervisory Body) will monitor the quality of the audits of these bodies, mirroring the arrangements for Public Interest Entities under the Companies Act (paragraph 47).

Commissioning local public audit services

AUDITOR APPOINTMENT

- Local public bodies will have a duty to appoint an auditor from the register of local public auditors, on the advice of an Independent Auditor Appointment Panel (paragraph 60).
- The Independent Audit Appointment Panel will have an independent chair and a majority of independent members (paragraph 60).

AGENDA ITEM 10

- We intend to frame requirements in a way that will allow local public bodies to share appointment panels (and therefore independent members) to ease admin burdens and reduce costs (paragraph 61).
- The Police and Crime Commissioner will make appointments for police bodies; (paragraph 73).
- The appointment process will be transparent. Local public bodies will be required to publish details of the auditor appointment on their website within 28 days of making the appointment, together with the Independent Audit Appointment Panel's advice and, if they did not follow that advice, a statement explaining why (paragraph 63).
- Where the local public body is not an elected body, the auditor appointment will usually be made directly by the Independent Audit Appointment Panel or its equivalent (paragraph 75).

ROLE OF INDEPENDENT AUDITOR APPOINTMENT PANELS

- Government intends to prescribe specific functions to the Independent Audit Appointment Panel limited to the external audit, including advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports (paragraph 67).
- The arrangements will allow local public bodies to share Independent Audit Appointment Panels, and to expand on the remit of their Panel if they wish, choosing a model which best suits their circumstances (paragraph 67).

FAILURE TO APPOINT AN AUDITOR

- Local public bodies will be required to appoint an auditor by 31 December in the year preceding the financial year to be audited, and notify the Secretary of State if they have not done so. The Secretary of State will be able to direct the local public body to appoint an auditor or make the auditor appointment directly. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment (paragraphs 79-80).

ROTATION OF AUDIT FIRMS AND AUDIT STAFF

- Local public bodies will be required to run a procurement competition for its audit services at least every five years (paragraph 86).
- Auditors will have to comply with the standards and rules set by the regulator. Applying the current standards means the audit engagement partner will be able to undertake audit for a local public body for an initial five years and be reappointed for a further two years. The audit manager will be able to be appointed for a maximum of ten years. After these periods, these key audit staff will not be able to work with the local public body for a further five years (paragraph 85).

AGENDA ITEM 10

RESIGNATION OR REMOVAL OF AN AUDITOR

- There will be rigorous, transparent processes for auditor resignation or removal, designed to protect auditor independence, quality of audit, and accountability to the electorate. These broadly mirror those in the Companies Act, but are adapted to reflect the principles of public audit (paragraphs 90-91).

AUDITOR LIABILITY

- Auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body (paragraph 96).

SCOPE OF LOCAL PUBLIC AUDIT AND AUDITORS' WORK

- The scope of local public audit will remain broadly similar. As now, auditors of local public bodies will be required to satisfy themselves that the accounts have been prepared in accordance with the necessary directions; proper practices have been observed in the compilation of the accounts; and the body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources (paragraph 99).
- The detail of how auditors should fulfil these requirements will, as now, be set out in a code of audit practice. The value for money component should be more risk based and proportionate, with auditors basing their assessment of risk on evidence of the local public body's arrangements for securing value for money provided by the local public body (paragraph 100).
- *Public Interest Reporting:* The duty for auditors of local public bodies to undertake Public Interest Reporting will be retained, as will their ability to charge audited bodies for reasonable work. The duty on audited bodies to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting will be retained. A new duty will be placed on audited bodies to publish the Public Interest Report (paragraphs 105-107).
- *Non-audit services:* Auditors will be permitted to provide non-audit services to the audited body, subject to adhering to the Auditing Practices Board's ethical standards and the Independent Auditor Appointment Panel's approval (paragraph 110).
- *Public interest disclosure:* The local public auditor and the Independent Auditor Appointment Panel will be defined as designated persons under the Public Interest Disclosure Act, to enable individuals to make disclosures under the Act (paragraph 112).
- *Transparency:* The new framework will retain the rights of local electors to make formal objections to the accounts, but give auditors greater discretion regarding whether to pursue an objection (paragraph 115).

AGENDA ITEM 10

- *Freedom of Information:* The auditor's public office holder functions will not be brought within the remit of the Freedom of Information Act (paragraph 118).

NON AUDIT FUNCTIONS OF AUDIT COMMISSION

- *Proposed arrangements for Grant Certification:* following the Audit Commission's closure, Government considers that for new grants, the grant paying bodies should agree certification arrangements with grant recipients and auditors (paragraph 122).
- *National Fraud Initiative:* Government proposes to continue the National Fraud Initiative, and is discussing with partners and the local public sector about how best to achieve this (paragraph 126).
- *VFM studies regarding the local public sector:* The Government considers that there is scope for rationalisation in the number of these value for money studies compared to the number previously undertaken and would like to see a coherent and complementary programme of offerings across all providers.

Implementation and next steps

4. Chapter 4 sets out the next steps. In summary these are to:
 - do some further work with smaller bodies and their representatives on regarding audit arrangements for smaller bodies, to explore options for these bodies before firming up proposals, and setting out our preferred approach in Spring 2012;
 - hold further discussions with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented;
 - publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament; and in advance of introduction of an Audit Bill as soon as Parliamentary time allows.
5. The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice. The outsource contracts that the Commission will put in place will start from 2012-13 and are expected to run for three or five years giving local councils and other public bodies the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a small residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

AGENDA ITEM 10

CHAPTER 1

Background

6. On 13 August 2010, the Secretary of State for Communities and Local Government 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 and there would be a new audit framework for local health bodies. A new decentralised audit regime would be established and local public bodies would still be subject to robust auditing.
7. In March 2011, the Government published the Future of Local Public Audit consultation paper seeking views on proposals for how the new local audit framework could work following the disbandment of the Audit Commission. These proposals were developed by the Department for Communities and Local Government following discussion with a wide range of partners and bodies that would be affected by the changes. These included the Audit Commission, the National Audit Office, the Financial Reporting Council, accountancy professional bodies, local government, other local public bodies and Government departments with an interest.
8. The consultation paper set these proposals within the context that the current arrangements for local public audit, whereby a single organisation is the regulator, commissioner and provider of local audit services is unnecessarily centralised, and that there is a lack of transparency and clarity as well as potential conflicts between the role.
9. The proposals in the consultation paper built on the statutory arrangements and professional ethical and technical standards that currently apply in the companies sector with adaptations to ensure that the principles of public sector audit are maintained.

About the consultation

10. In total, 453 responses were received to the consultation. The majority of these responses were from local government: parish and town councils, district councils, county and unitary local authorities and their representative bodies. Responses were also received from professional accountancy and regulatory bodies, auditing firms and other audited public bodies and members of the public. The majority of the members of the public who responded identified that they had auditing/accounting experience or were involved directly with the financial reporting for a council. A breakdown of the total responses can be seen below:

AGENDA ITEM 10

| Type of respondent | Number of responses |
|---|--------------------------------------|
| Upper tier local authorities | 91 |
| Lower tier local authorities | 117 |
| Parish and town councils | 134 |
| Individual members of the public | 30 (including 4 councillors) |
| Audit and accountancy firms | 14 |
| Professional auditing and accountancy bodies | 5 (including Audit Commission) |
| Other audited public bodies | |
| Fire authorities | 21 |
| Police authorities | 12 |
| National Park Authorities | 4 |
| Probation Authorities | 4 |
| Pension authorities | 2 |
| Others | 5 |
| Non-categorised responses | 14 |
| Total | 453 |

11. A summary of the responses to the consultation is available at:
www.communities.gov.uk/publications/localgovernment/localauditsummaryresponses

AGENDA ITEM 10

Format of the Government response

12. Chapter 2 contains the Government response to the consultation. It is organised into sections following the order in the original consultation document. We have set out the proposals which the Government made, summarised the key themes and views submitted in consultation responses, and presented the Government's response to these.
13. Chapter 3 covers other functions of the Audit Commission that were not dealt with in the consultation. Chapter 4 covers next steps and implementation.

AGENDA ITEM 10

CHAPTER 2

Consultation questions and government response

Design principles

14. The consultation proposed that the new local public audit framework should be based on the principles of localism and decentralisation, transparency, continuing to ensure high standards of auditing, while opening up the market and securing lower audit fees. Our aim is also to ensure the quality of audit by having regard to the principles of local public audit:
 - the independence of public sector auditors
 - the wide scope of public audit
 - good reporting arrangements to democratically elected representatives.
15. The vast majority of respondents agreed that the consultation document had identified the correct design principles of:
 - localism and decentralisation
 - transparency
 - lower audit fees; and
 - high standards of auditing.

Some respondents (including some professional auditing and accountancy bodies), commented that they did not believe that the decentralised approach outlined in the consultation document would achieve lower audit fees. Local authorities exhibited less concern.

The Government's response

16. The responses received to the consultation support the Government's proposed design principles. The proposals that are set out in this response and on which we intend to legislate are all vital elements of a new local public audit framework which is localist and transparent, and upholds high standards of auditing, where audit remains independent, robust and efficient.
17. The Government is also committed to developing a new local public audit framework where audit fees remain competitive, stripped of the need to cover the central costs and overheads of the Audit Commission. Having a single body that is regulator, commissioner and provider of local audit services provides a unique monopoly position and weak incentives to drive down costs. The key drivers of audit fees in the new local public audit framework (aside from commercial and market considerations) will be the scope of audit (i.e. what auditors are actually required to do) and regulation of the work of auditors. We are working with our partners to ensure that these elements of the new

AGENDA ITEM 10

framework do not add unnecessary cost into the new system. The streamlining the Commission has done since the Government's decision to abolish the Commission is already resulting in lower audit fees for local bodies, with the smaller overheads of the Commission enabling it to propose a 10% reduction in fee scales for 2012-13¹ for the first year of audits done under outsourcing.

PROBATION TRUSTS

18. As the financial results of probation trusts are consolidated into the National Offender Management Service accounts, which are audited by the Comptroller & Auditor General, the consultation proposed that in future probation trusts should be audited by the Comptroller & Auditor General. The audit of probation trusts would therefore not fall under the new local public audit framework.
19. The majority of those who answered this question (local authorities) agreed that the audit of probation trusts should fall within the Comptroller & Auditor General's regime. The four probation trusts that responded were evenly split as to whether they should be included in the Comptroller & Auditor General's regime or not.

The Government's Response

20. The Government considers that it would be appropriate for the audit of probation trusts to fall within the Comptroller & Auditor General's regime. We intend to lay an order before Parliament under the Government Resources and Accounts Act 2000 which – if approved by Parliament – would add an amendment to Schedule 1 to the Offender Management Act 2007 and transfer responsibility for the audit of probation trusts to the Comptroller and Auditor General from April 2012.

HEALTH BODIES

21. It is currently envisaged that the new local public audit framework outlined in this Government Response will apply to Clinical Commissioning Groups. These are new health bodies proposed in the Health and Social Care Bill. The precise audit requirements for Clinical Commissioning Groups have not yet been finalised and will depend on the passage of the Health and Social Care Bill. The application of the new local public audit framework for Clinical Commissioning Groups will be specified in due course.
22. The audit arrangements for Foundation Trusts were not included in the consultation because they do not currently fall under the Audit Commission regime. Under the current arrangements, a Foundation Trust's board of governors appoints their own auditor, on advice from an audit committee. Monitor currently regulates the audits, including providing the Code of Audit Practice and guidance. The audits include an opinion on the financial statements and a conclusion on value for money. We intend that the audit arrangements for Foundation Trusts will remain broadly the same, but some changes will be necessary to reflect Monitor's changing role.

¹ See <http://www.audit-commission.gov.uk/audit-regime/audit-fees/201213/Pages/default.aspx>

AGENDA ITEM 10

Regulation of local public audit

23. The Government considers that having a new and separate regulator for local public audit would be inefficient and risks duplication. This would also have an impact on fees. We therefore consider that, to the extent possible, there should be a consistent regulatory regime for audit, covering the private sector and the local government and health sectors. The same arrangements for regulation would apply for all local health bodies.
24. The consultation proposed that the National Audit Office would be responsible for developing and maintaining the audit codes of practice which set out the approach to audit that auditors must follow when auditing local public bodies. Before preparing or altering a code applicable to any accounts, the National Audit Office will be required to consult appropriate local public bodies and professional accountancy bodies. The National Audit Office would also be responsible for producing any supporting guidance. 93% of respondents agreed that the National Audit Office is best placed to produce the Code of Audit Practice and the supporting guidance.

The Government's response

25. The Government considers that, subject to Parliament's agreement, the National Audit Office is best placed to produce the Code of Practice which auditors will be required to follow when auditing local public bodies. We have also discussed with the National Audit Office how it might support auditors in fulfilling their responsibilities under the Code. The National Audit Office recognises the need for annual and in-year guidance to promote consistency in audit approach and is in principle committed to providing support to auditors which is:
 - principles-based not prescriptive;
 - addresses key themes/issues (not every query);
 - informed by technical forum of local auditors (led by the National Audit Office); and
 - leaves discretion for an auditor to agree local audit approach based on their risk assessment.

AGENDA ITEM 10

REGISTRATION OF AUDITORS

26. Under the Companies Act 2006 the Professional Oversight Board, part of the Financial Reporting Council, has statutory powers delegated to it for the recognition and supervision of those professional accountancy bodies responsible for supervising the work of auditors, Recognised Supervisory Bodies, or offering an audit qualification, Recognised Qualifying Bodies. Recognised Supervisory Bodies are responsible for putting rules and arrangements in place which their members must fulfil before they can be registered auditors. People with responsibility for company audit work must also hold a recognised qualification, awarded by a Recognised Qualifying Bodies.
27. The consultation proposed that the Financial Reporting Council would oversee the regulatory regime for local public audit, as it does for the statutory audit of companies under the Companies Act 2006. The Financial Reporting Council would share responsibility for registering statutory local public auditors and monitoring the quality of their audits with Recognised Supervisory Bodies.
28. 88% of responses were in agreement that the Companies Act 2006 should be replicated for local public audit. Some of the professional bodies responded that there would need to be some adaptation for the system to work for public bodies.
29. Overall, respondents indicated preferences for one of the existing regulatory bodies to take on the role for maintaining and reviewing the register of statutory local public auditors.

The Government's response

30. It is our intention that, as under the Companies Act 2006, the Financial Reporting Council will be the overall regulator². We are therefore proposing that the Secretary of State will have powers which will allow him to authorise professional accountancy bodies to act as Recognised Supervisory Bodies for local public audit. In practice, the Secretary of State will delegate these powers to the Financial Reporting Council/Professional Oversight Board. This mirrors the arrangements under the Companies Act 2006.
31. The effect of this is that the Financial Reporting Council will be able to:
 - authorise existing Recognised Supervisory Bodies to have statutory responsibilities in respect of local public audit, in addition to their responsibilities for statutory audits of companies;

². It should be noted that the Department for Business Innovation and Skills (BIS) and the Financial Reporting Council (FRC) are currently consulting jointly on reforms to the FRC's governance and structure. The consultation can be accessed at www.frc.org.uk/about/frcreform.cfm and is due to close on 10 January 2012. Both BIS and the FRC are working with DCLG to ensure the FRC has a proportionate role in the regulation and oversight of local public audits, as envisaged under the local public audit framework, in any revised structure for the FRC which results from the consultation.

AGENDA ITEM 10

- authorise additional professional bodies to be Recognised Supervisory Bodies with statutory responsibilities in respect of local public audit.
32. As under the Companies Act 2006, the Recognised Supervisory Bodies will have the roles of registration, monitoring and discipline for local public audit, and will be given delegated authority to put in place rules and practices covering:
- The eligibility of firms to be appointed as local public auditors (subject to the Financial Reporting Council's oversight, which might include guidance produced by the Council); and
 - The qualifications, experience and other criteria individuals must reach before being permitted to carry out a local public audit and sign off an audit report.
33. In line with the register of those eligible for appointment as auditor under Part 42 of the Companies Act 2006, all eligible local public auditors will be placed on a register, which will be kept by the Recognised Supervisory Bodies. This register will list:
- the audit firms that are able to undertake the audit of local public bodies;
 - those individuals linked to each firm that are eligible to sign an audit report on behalf of that firm and able to take responsibility for local public audit work (though the names of individuals will not appear on the published register).

ELIGIBILITY FOR REGISTRATION

34. The consultation document asked how the right balance could be 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. The majority of responses suggested that firms should be required to demonstrate their track record in public sector audit and/or their ability to source the appropriate expertise. Other responses included the need to set proper high-level criteria, including the correct skills and qualifications for firms and individuals, but in a way that would not preclude new firms entering the market.

The Government's response

35. The Government considers that while it is important not to preclude new entrants to the local public audit market, it is also vital that any firm able to be appointed as a local public auditor has a number of suitable individuals with the necessary qualifications and experience to undertake local public audit work. Once enacted, legislation will provide that Recognised Supervisory Bodies (subject to the Financial Reporting Council's oversight, and in line with any guidance which the Council produce) will be responsible for determining the level of expertise and experience necessary for any firm to be eligible to be appointed as a local public auditor. We are confident that building on the rules and arrangements these bodies already have in place under the Companies Act 2006, but tailored appropriately to meet the specific requirements of local public auditors, will provide the right balance to ensure that an appropriate level of

AGENDA ITEM 10

experience and expertise is maintained in the system, while not precluding new firms from entering the market.

36. In order to ensure that individuals within firms are suitably qualified and have the necessary levels of skills and experience, the Government considers that each individual eligible to sign an audit report on behalf of the firm will need to:-
- hold an audit qualification (“appropriate qualification” in accordance with the Companies Act 2006 [Section 1219]); or
 - hold a corresponding qualification to audit accounts under the law of another European Economic Area state; or
 - hold a qualification from a body of accountants recognised by the Financial Reporting Council as an appropriate qualification for local public audit;
- and**
- be approved under the rules of the Recognised Supervisory Body to take on that role. In practice, we envisage that the Recognised Supervisory Body will only approve someone where it judges that the individual has the necessary level of skills and experience to take on the role.
37. The Financial Reporting Council will need arrangements to monitor the continued appropriateness of qualifications that it recognises as appropriate for local public audit.

MONITORING AND ENFORCEMENT

38. The consultation proposed that the appropriate professional accountancy bodies should act as Recognised Supervisory Bodies and have responsibility for monitoring the quality of audits undertaken by their members, as they do in the private sector; and investigate complaints or disciplinary cases, as well as issues identified during their monitoring process. They would also be able to stop a firm being eligible for appointment as a statutory local public auditor, by removing them from the register of eligible local public auditors.
39. The consultation said that the Government was considering whether the overall regulator should have a direct role in assuring the quality and undertaking independent investigation of the audits of some specified local public bodies, i.e. those that might be considered analogous to Public Interest Entities under the Companies Act 2006.

AGENDA ITEM 10

40. The consultation also asked for views on the proposal that the overall regulator would have powers to investigate and discipline in these cases. About a third of respondents to the relevant question considered that all principal local authorities should be considered as equivalent to public interest entities, with a smaller number suggesting that all of the bodies currently audited by the Audit Commission should be viewed as equivalent to public interest entities. Nearly half of respondents suggested that regulation and monitoring arrangements should be the same for audits of all local public bodies, with no specially defined group to be subject to additional arrangements. The majority of respondents considered that the role of the regulator in relation to disciplinary cases should be the same for local public audit framework as it is under the Companies Act 2006.

The Government's response

41. We propose that, as under the Companies Act 2006, Recognised Supervisory Bodies will have responsibility for monitoring the quality of audits undertaken by their member firms. This work will fall under the monitoring units of these bodies, and will include:
- reviews of individual audit engagements
 - reviews of the policies, procedures and internal controls of those firms licensed to carry out the public sector audits
 - reporting on the quality of audit to the registration body
 - investigating complaints or disciplinary cases, as well as issues identified during their monitoring process
 - removing a firm from the register of eligible local public auditors.
42. The Recognised Supervisory Bodies will investigate complaints or disciplinary cases, as well as issues identified during the monitoring of firms on the register. Similarly, the Recognised Supervisory Bodies will be able to refer cases for investigation to the relevant arm of the Financial Reporting Council (the Accountancy and Actuarial Disciplinary Board).
43. The Accountancy and Actuarial Disciplinary Board investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. The Government considers that the Accountancy and Actuarial Disciplinary Board should continue to have these powers for local public audit.
44. Under the Companies Act 2006 the overall regulator, through its Audit Inspection Unit, is responsible for monitoring the quality of the statutory audit of "major audits" which includes the audits of public interest entities. The Professional Oversight Board is responsible for determining which audited entities fall within the "major public interest" category (over and above those prescribed in statute), and therefore within the scope of the Audit Inspection Unit, and for approving the Audit Inspection Unit's work programme. The criteria the Professional Oversight Board applies and a list of inspections are published annually by the Board, following consultation with the professional accountancy

AGENDA ITEM 10

bodies. This additional level of monitoring reflects both the size of the company and the importance of that company to the public.

45. As under Companies Act 2006 audits, there will be an additional level of oversight and monitoring for audits of significant local public bodies given the very large level of taxpayers' money at their disposal. We therefore intend to give the Financial Reporting Council responsibility for monitoring (through the Audit Inspection Unit or as appropriate through delegation to a Recognised Supervisory Body) the quality of audits of these bodies (which we are referring to as "Bodies of Significant Public Interest").
46. We propose to include in legislation criteria to define which bodies will be considered Bodies of Significant Public Interest and hence within the scope of the Audit Inspection Unit. We propose that the Financial Reporting Council/Professional Oversight Board will then, each year, decide after consultation with relevant Government Departments whether any local public bodies which are not Bodies of Significant Public Interest should also fall within the scope of the Audit Inspection Unit, over and above those prescribed in legislation. The Financial Reporting Council /Professional Oversight Board will then decide which audits the Audit Inspection Unit will monitor. This is in line with the process under the Companies Act 2006 for determining which audited entities fall within the "major public interest" category, and therefore within the scope of the Audit Inspection Unit.
47. As set out in paragraph 46 above, audits of bodies which do not fall within the Audit Inspection Unit's scope will be monitored by the relevant Recognised Supervisory Body.

Commissioning local public audit services

DUTY TO APPOINT AN AUDITOR

48. The consultation proposed that all larger local public bodies (those with income/expenditure over £6.5m) would be under a duty to appoint an auditor. The auditor would need to be on the register of local public statutory auditors, which should help to ensure that the quality of auditors is maintained. Independence would be maintained in part through a new requirement for local public bodies to put in place independent audit committees. The consultation set out proposals for how such committees could be structured and proposals as to how independence would be defined.
49. The consultation sought to set out proposals which would enable local public bodies to co-operate to procure an external auditor.
50. Nearly three quarters of the responses agreed that the arrangements for audit committees were flexible enough to allow joint appointments. Generally, audited bodies, local authorities in particular, were against the idea of a majority independent audit committee. Those from other sectors, such as audit and accountancy firms and the professional bodies, were generally in favour of the proposals.
51. About a third of respondents agreed that our proposals for audit committees provide the necessary safeguards for the independence of the auditor

AGENDA ITEM 10

appointment. With regard to the make up of the audit committee, of those who indicated a preference, a minimum number of independent members was favoured by a small majority. Other notable comments that arose were that the makeup of the independent audit committee should be a local decision for each audited body and that these arrangements were not suitable for the way police authorities were structured.

52. The majority of respondents agreed that the correct criteria had been identified in the consultation document to ensure the quality of independent members. However, a sizeable minority disagreed. The main cause for disagreement was that the criteria listed appeared more focussed on ensuring the independence of members rather than their quality and capability. Local authorities thought that having the overall necessary skills to perform the audit committee function was important. Auditing and accountancy firms were more clearly in agreement with the criteria identified in the consultation.
53. About half of the respondents considered that financial awareness or experience was desirable, but not essential, for the independent members of an audit committee. Many felt that if the overall skills of the audit committee as a whole were appropriate for the tasks they had to perform, the financial expertise did not have to rest with the independent members.
54. About half of those who responded indicated that they thought it would be difficult to source independent members of a suitable calibre. Most respondents agreed that remuneration would be necessary for the independent members but responses were split with regard to what level, the most popular responses being that the level should be locally determined and that only 'reasonable' expenses should be paid (similar to other committees).

The Government's response

55. Local public bodies are already responsible for procuring large volumes of goods and services in order to discharge their wider functions, e.g. local government's procurement totals around £50bn per annum according to the Local Government Association. The Government considers there to be no barriers in terms of expertise that would prevent local public bodies appointing their external auditors, subject to appropriate safeguards to ensure independence in the appointment process.
56. The Government has confirmed on several occasions its commitment to maintaining auditor independence in the new local public audit framework. The regulatory regime set out in the preceding chapter ensures the quality of audit work is monitored effectively. We consider that requiring the appointment of an auditor to be undertaken by the full council (or equivalent for non-local government bodies) on the advice of an independent audit committee is the most practical and effective way of ensuring independence of appointment. Transparency in the appointment process will also be an important part of ensuring auditor independence.
57. In reaching this conclusion we have listened to the comments made by some local public bodies about the constitution of their existing audit committees, and that it might be difficult to find enough suitable independent members to ensure a majority of independent members. In order to distinguish between the existing

AGENDA ITEM 10

traditional audit committees and the role we propose for such a committee in the appointment process, we intend that the advice on the procurement and appointment of the auditor will be made by an independent audit appointment panel.

58. The Government therefore intends to legislate for a system of local appointment under which all local public bodies with income/expenditure over a threshold (currently £6.5m) will be under a duty to appoint an auditor who must be on the register of local public auditors. Responsibility for the final selection of the auditor and engagement of the auditor on a contractual basis will rest with the local public body. However, that appointment must be made by the full council (or its equivalent) on the advice of an Independent Audit Appointment Panel, independently chaired, with a majority of independent members. Where the body already has an independent audit committee, they may wish to use that committee to meet this requirement.
59. Local public bodies have signalled to us that they are interested in undertaking joint procurement exercises and sharing Independent Audit Appointment Panels or independent members. We want to ensure the arrangements that we put in place facilitate that. We intend to frame requirements in a way that will allow local public bodies to share appointment panels (and therefore independent members) to ease administration burdens and reduce costs. Local public bodies will be able to choose the model which suits their circumstances, and will have the flexibility to work with other bodies to jointly procure an auditor and reduce the costs of meeting this requirement.
60. We intend to work closely with the sector, as we finalise the detail of these proposals, so they are as administratively straightforward and practical as possible.
61. To aid transparency in the appointment process the local public body will be required to publish details of the auditor appointment on their website within 28 days of making that appointment, alongside the advice of the Independent Audit Appointment Panel, subject to considerations of commercial confidentiality. If the local public body did not follow the advice of the Independent Audit Appointment Panel in making its appointment, it will be required to publish on its website a statement setting out the reasons why it had chosen not to follow that advice.

ROLE OF THE INDEPENDENT AUDIT APPOINTMENT PANEL

62. The consultation proposed that the Independent Audit Appointment Panel would have a key role in the selection of the auditor engaged by the audited body, and monitoring the independence, quality and performance of the external audit. It proposed options for specifying in legislation some responsibilities that the Panel should have in relation to the engagement of an auditor, and monitoring the independence and quality of the external audit:-
 - Only specify one mandatory duty for the local public body's Independent Audit Appointment Panel, i.e. to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.

AGENDA ITEM 10

- Specify a more detailed role for the Independent Audit Appointment Panel. This would provide more assurance about the independence of the relationship between the audited body and its auditor, and would also ensure that the Panel had a wider role in reviewing the financial arrangements of the local public body.
63. The majority of respondents indicated a preference for the appointment of the auditor as the only mandatory duty for the Independent Audit Appointment Panel, and any other roles or responsibilities would be a local decision. However, a significant number of responses felt that a more detailed mandatory role for the Panel was preferable.
64. The majority of respondents felt that the process for the appointment of an auditor should not be set out in legislation. Guidance was preferable to a statutory code of practice with the National Audit Office indicated as the preferred provider.

The Government's response

65. The approach that the Government intends to take is to provide for a limited set of functions on the Independent Audit Appointment Panel in legislation, around advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports. We believe that such an approach will provide flexibility for local public bodies to mould this requirement to suit their own circumstances, and facilitate joint working and joint commissioning between local public bodies.
66. We also recognise that in circumstances where a local public body will have both an audit committee (exercising the traditional functions of such a committee) and an Independent Audit Appointment Panel (whether shared or not) there may well be issues about the demarcation of responsibilities between both groups. We intend to work with the sector to produce guidance which would set out how the responsibilities of the Independent Audit Appointment Panel could be exercised (and how those responsibilities might interface with those of a more traditional audit committee). We would welcome a discussion and views on the detailed issues raised by this approach to help shape and inform the requirements and any future guidance issued.

INVOLVEMENT OF THE PUBLIC IN THE APPOINTMENT OF AN AUDITOR

67. The consultation said the Government was considering how local people could make representations about the specification designed by the audit committee for the procurement of an auditor. The options we considered were:
- Pre-appointment - The public could make representations to the audited body's audit committee about any expressions of interest from audit firms for the audit contract; or
 - Post appointment – The public would be able to make representations at any time to the local public body's audit committee about issues relating to the auditor.

AGENDA ITEM 10

68. About equal numbers of respondents agreed as disagreed that this was a proportionate approach to public involvement. Some respondents suggested that public involvement be restricted to any undisclosed conflicts of interest on the part of the auditor.

The Government's response

69. The Government considers that its proposals to require – in the case of local authorities – the appointment to be made by a full council meeting on the advice of an independent auditor appointment panel; the requirement for that advice to be published (and any departure from it publicly justified); and the other measures we are proposing around transparency of the auditor appointment, secure the necessary level of transparency for the public in the appointment process.

APPLICABILITY TO OTHER SECTORS

70. The consultation recognised that the commissioning approach proposed for local authorities might need to be tailored for other local public bodies. Nearly all respondents indicated that the approach should be tailored as appropriate for different local public bodies.

The Government's response

71. The Government intends that in the case of police bodies that appointment would be made by the Police and Crime Commissioner.
72. The table at Annex A details the different types of local public bodies to which the new local public audit framework will apply and sets out the Government's proposals for how the auditor appointment will be made.
73. Where the local public body is not an elected body, then in most circumstances that appointment should be made directly by the Independent Auditor Appointment Panel (or its equivalent). There may be circumstances where it is appropriate for a local public body's board to make that appointment on the advice of the Panel. However, where this is the case transparency (i.e. publication of that advice) will be an important part of the appointment process.

FAILURE TO APPOINT AN AUDITOR

74. The consultation proposed that the audited body would be under a duty to appoint an auditor. However, it also recognised that there could be some instances under the new system where a body does not fulfil this duty. In these circumstances we proposed that the Secretary of State would be able to direct the local public body to appoint an auditor. Alternatively, where a local public body does not fulfil its duty to appoint an auditor the Secretary of State could be provided with the power to make the auditor appointment. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.
75. The majority of the responses favoured the Secretary of State having a power to make the auditor appointment. Most groups of respondents also suggested a staged approach, i.e. where the Secretary of State would direct the public body

AGENDA ITEM 10

to appoint an auditor and, should that fail, the Secretary of State would appoint the auditor.

76. A small majority preferred that a local public body should only be required to inform the Secretary of State in the case where it had failed to appoint an auditor, rather than when they had made the appointment. Other responses suggested that neither scenario warranted informing the Secretary of State as this would go against the principle of localism.

The Government's response

77. The Government considers it important, given the range of functions and legal responsibilities of a local public auditor, that local public bodies are required to appoint an auditor by a specified date in the financial cycle. We consider that requiring an auditor to be appointed by 31 December in the year preceding the financial year for which that auditor is to be appointed would fit with the annual financial and accounting cycle.
78. We also consider that any local public body should be under a requirement to notify the Secretary of State if they have not been able to make an appointment by that date. We are proposing that the Secretary of State would then have powers to either direct the local public body to make an appointment or make that appointment directly himself. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.

ROTATION OF AUDIT FIRMS AND AUDIT STAFF

79. The consultation proposed that the rotation of staff within the audit firm would need to be in line with the current ethical standards, but the audited body would also be required to undertake a competitive appointment process within five years. The audited body would be able to re-appoint the same firm for a (maximum) second five year period, following competition.
80. The majority of respondents were in favour of the proposal to limit a firm's term of appointment to ten years. However, some felt that there should be no limit on the length of a firm's appointment, e.g. it would be a barrier to new entrants.
81. The vast majority of responses agreed that the current ethical standards were sufficient safeguard for rotation of audit staff.

The Government's response

82. The Government considers that there is a balance to be struck between providing enough incentive for audit firms to invest in medium term relationships with local public bodies which would enable them to gain a thorough understanding of that body's operations, and ensuring that those undertaking the audit maintain an appropriate degree of independence and objectivity from the body being audited.
83. Paragraph 64 set out the government's intention to require Independent Audit Appointment Panels, to provide advice on the appointment of the auditor and to have a key role in ensuring auditor independence. Taking this into account, the Government considers that the ethical standards of the Auditing Practices Board

AGENDA ITEM 10

around the rotation of key audit staff provide enough safeguards without the need for mandatory rotation of firms. The ethical standards provide that the audit engagement partner would be able to perform audit work in respect of a local public body for an initial period of five years and then can only be reappointed for a further two years. The audit manager can only be appointed for a maximum of ten years. After these respective periods have elapsed, these key audit staff would not be able to work with the local public body concerned until a further period of five years had elapsed.

84. However, the Government is also convinced of the need to ensure local public bodies are achieving value for money in procuring audit services. It therefore intends to require that a local public body must run a procurement competition every five years for its audit services. The Independent Audit Appointment Panel would be required to provide advice before any appointment. There would, however, be no bar on the incumbent supplier being reappointed as a result of this competition.

RESIGNATION OR REMOVAL OF AN AUDITOR

85. The consultation envisaged that a body might wish to remove its auditor, or an auditor might wish to resign, only in exceptional circumstances, for example, an auditor being in breach of the ethical standards, or a complete breakdown in the relationship between the auditor and audited body. It recognised the importance of having stringent safeguards in place for the resignation and removal of an auditor to protect the independence of the auditor and the quality of the audit. It proposed safeguards that would broadly mirror those in the Companies Act 2006, but would be adapted to reflect the principles of public audit. The process would be designed to ensure that auditors are not removed, or do not resign, without serious consideration and through a process transparent to the public.
86. The majority of responses received to this question agreed that these proposals provide sufficient safeguard against the removal or resignation of the auditor.

The Government's response

87. The Government considers that it is important that there is a fully transparent process in place to deal with issues of auditor resignation or removal. We consider that in the first instance it is vital that auditors and audited bodies try as far as possible to resolve any difficulties or concerns (including through using the mediation and conciliation services of the professional accountancy bodies if appropriate).
88. However, if such differences become irreconcilable, in the case of auditor resignation, we intend to:-
- Require the auditor to give 28 days written notice of his intention to resign to the audited body and its Independent Audit Appointment Panel;
 - Require the audited body to make a written response to the auditor's written notice, which it will be required to send with the auditor's written notice, to its members and the Independent Audit Appointment Panel;
 - Require the auditor to then deposit a statement at the main office of the audited body, and with the Independent Audit Appointment Panel, setting out

AGENDA ITEM 10

the circumstances connected with the resignation of the office that are relevant to the business of the audited body;

- Require the audited body to publish the auditor's statement on its website;
- Require the Independent Audit Appointment Panel to investigate the circumstances that led to the resignation and consider whether any action is required; and
- Require the auditor to notify the appropriate regulatory monitoring body of his decision.

89. In the circumstance where a local public body wished to remove its auditor, the process would be similar. We intend to:-

- Require the audited body to give 28 days written notification of its wish to terminate the contract, to the auditor and its Independent Audit Appointment Panel;
- Provide that the auditor will have the right to make a written response to the notice, which the audited body will be required to send to its members and the Independent Audit Appointment Panel;
- Require the Panel to provide advice to the local public body within that 28 days notice period, having regard to any written response made by the auditor;
- Require the local public body to have regard to the advice of the Independent Audit Appointment Panel before making a decision whether to remove its auditor;
- Following the 28 days notice period, require the audited body to put to a full council meeting (or its equivalent) a resolution to remove the auditor (at which both the auditor and a representative of the Independent Audit Appointment Panel could speak if they wished);
- Require that, if the audited body still wished to remove its auditor, it should publish a statement of its decision on its website within 28 days of the decision of the full council. If the local public body did not follow the advice of the Independent Audit Appointment Panel, it will be required to explain in its statement what that advice had been, and the reasons why it had chosen not to follow that advice, subject to considerations of commercial confidentiality; and
- Require the audited body to notify the appropriate regulatory monitoring body of its decision.

AUDITOR LIABILITY

90. In the private sector auditors are concerned about the consequences of the risks of litigation. Auditors have sought to caveat their opinions by explicitly limiting their duty of care and limit their liability. The Companies Act provides that general provisions that protect auditors from liability are void, but:

- does not prevent a company from indemnifying an auditor against any costs incurred by him in defending proceedings in which judgment is given in his

AGENDA ITEM 10

favour or in the granting of relief by the court in the case of honest and reasonable conduct; and

- allows for a “liability limitation agreement” to be put in place if it is authorised by the members of the company, provided it complies with the content permitted in the Companies Act.

91. The consultation recognised that in the absence of a central body providing indemnity to audit firms, it could be possible for audited bodies and auditors to deal with auditor liability as part of their contractual negotiations. A legislative framework, similar to that in the companies sector, could set out the process for setting and agreeing liability limitation agreements. The majority of respondents agreed with the proposals in the consultation document.

The Government’s response

92. The Audit Commission currently indemnifies auditors for the costs they incur where they are engaged in litigation. In practice, calls on the indemnity are infrequent. The Audit Commission informed the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities that, in the five years to 2010, it had been called upon only once.
93. Auditors from the Commission's in-house audit practice have also faced litigation over the same five-year period. There have been three cases, all of which the in-house auditor won. The costs of in-house auditors not recovered from the other side are met by the Commission, and are also passed on to audited bodies in audit fees, so in effect the indemnity is extended to the Commission’s own auditors.
94. Without a liability agreement, audit firms may increase their fees to match the increased risk they face in undertaking the work. Therefore, the Government considers that auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body. The Government will also consider the feasibility and necessity of a supporting statutory framework which could set out the process for agreeing liability limitation agreements.

Scope of audit and the work of auditors

SCOPE OF LOCAL PUBLIC AUDIT

95. The consultation asked for views on four options regarding the scope of future audits for local public bodies. The narrowest option would comprise an opinion on whether the financial statements give a true and fair view of the audited body’s financial position and income and expenditure and a review of other information included with financial statements. Wider options suggested included an auditor’s conclusion on regularity and propriety, financial resilience and value for money; and a further option of the auditor providing reasonable assurance on an annual report prepared by the local body setting out its arrangements for securing value for money, whether they had achieved

AGENDA ITEM 10

economy, efficiency and effectiveness, regularity and propriety and financial resilience.

96. The responses to the consultation were split between the options but indicated a slight preference for leaving the overall scope of audit unchanged.

The Government's response

97. The Government has considered the wide range of views expressed in the consultation and intends to retain the current broad scope as set out in the Audit Commission Act 1998 so that auditors of local public bodies will continue to be required to satisfy themselves that:-
- the accounts have been prepared in accordance with the necessary directions or regulations and comply with relevant statutory requirements;
 - proper practices have been observed in the compilation of the accounts; and
 - the body has made proper arrangements for securing economy efficiency and effectiveness (value for money) in its use of resources.
98. The latter element is commonly referred to as the Value for Money component of the audit, which is a key difference between the scope of local public audit and statutory audit for private sector companies. The Government considers that the value for money component of the audit could be delivered in a more risk based and proportionate way. This has the potential for a consequent decrease or increase on the level of audit work some local public bodies might see as a result, but we would not expect this in itself to result in an overall increase in the total costs of audit.
99. The auditors will need to base their assessment of risk on evidence around the local public bodies' arrangements for securing value for money. We want to put the responsibility for providing the evidence firmly in the hands of the local public body, without introducing additional burdens by requiring the production of additional reports or documents. The majority of respondents to the consultation were not in favour of local public bodies being required to set out performance and plans in an annual report. One option would be to ask local public bodies to build on the information they already make available on their arrangements for securing value for money - for example, through the Annual Governance Statement. This would be consistent with the design principles of the new framework, by enhancing transparency and delivering a localist approach which shifts responsibility firmly onto local public bodies.
100. We will need input from a range of stakeholders to develop the value for money element of audit fully before implementation. These would include: the National Audit Office (given their envisaged role, subject to Parliament's agreement, in producing the Code of Audit Practice and associated guidance); the Chartered Institute of Public Finance and Accountancy, Local Authority (Scotland) Accounts Advisory Committee and the Society of Local Authorities Chief Executives as the respective authors of the Code of Practice on Local Authority Accounting and the Local Authority Governance Framework, and local public bodies themselves.

AGENDA ITEM 10

PUBLIC INTEREST REPORTING

101. The consultation proposed to retain existing duties for auditors around Public Interest Reporting and asked whether the new processes for resignation and removal of auditors would mitigate the risk that the introduction of local auditor appointment would impact on the auditor's ability or willingness to publish Public Interest Reports.
102. The vast majority of responses agreed that the safeguards outlined in the consultation document would allow the auditor to issue a public interest report, but some had concerns that the safeguards may not work in practice.

The Government's response

103. Government intends to retain the duty for auditors of all local public bodies to undertake Public Interest Reporting under the new framework. As is the case currently audited bodies will be charged for reasonable work involved in undertaking a Public Interest Report. The new framework will also retain the duty on audited bodies to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting.
104. In addition, in order to improve transparency we intend to introduce a new requirement for audited bodies to publish the Public Interest Report, as well as the existing requirement to publish a notice of and agenda for the meeting at which it will be discussed, but local bodies will in future be able to choose the mode for publishing these.
105. However, we recognise the concerns expressed around the need for further safeguards for Public Interest Reporting. We will work with partners to finalise the details of these, in particular the role of the Independent Auditor Appointment Panel, and arrangements for protecting auditors in undertaking and receiving payment for Public Interest Reports, and how the publication of Public Interest Reports may help to increase transparency and engage local people.

PROVISION OF NON-AUDIT SERVICES

106. The consultation proposed that auditors would be able to provide non-audit services to the audited body, with safeguards in the system to prevent any actual or perceived threats to the auditor's independence. It also proposed that auditors should continue to adhere to the ethical standards produced by the overall statutory regulator and permission should be sought from the audit committee who would provide advice to the body on whether non-audit work should be undertaken as well as continuing to monitor the relationship between the auditor and the audited body.
107. The majority of respondents favoured the auditor being able to provide non-audit services to the local public body in line with the regulator's current ethical guidelines and agreed that we had identified the correct balance between safeguarding auditor independence and increasing competition.

AGENDA ITEM 10

The Government's response

108. Auditors of local public bodies will be required to continue to comply with ethical standards and other applicable independence rules set by the regulator.³ The Government considers that the current ethical standards provide sufficient safeguards for auditor independence. We therefore propose to enable auditors to provide non-audit services to the audited body, subject to adhering to the ethical standards produced by the Auditing Practices Board and gaining approval to undertake the work from the Independent Auditor Appointment Panel.

PUBLIC INTEREST DISCLOSURE

109. The consultation proposed that the Audit Commission's role in receiving, acknowledging receipt of and forwarding the facts of disclosure should be broadly transferred to the audit committee of the local public body. It also envisaged that the statutory auditor and the audit committee of the local public body would continue to be prescribed persons under the Public Interest Disclosure Act and would continue with their role with no change from the current system. The majority of responses agreed that was appropriate.

The Government's response

110. The Government considers it important that suitable mechanisms are in place to enable individuals to make disclosures under the Public Interest Disclosure Act. Having considered the responses received, we consider that it makes sense for the auditor and the Independent Auditor Appointment Panel to be designated persons under that Act and we intend to legislate accordingly.

TRANSPARENCY

111. The consultation proposed that the new framework for local audit would modernise the way in which local electors' objections would be considered. It proposed that electors would retain the right to make representations and raise issues and questions with the auditor (this does not apply to health bodies). It also proposed to introduce discretion for the auditor to decide which representations to follow up.
112. The overwhelming majority of respondents agreed that we should modernise the way objections to the accounts are handled. However, whilst respondents accepted that the auditor should have discretion as to whether to pursue particular objections, it was also suggested that standard criteria should be developed to help an auditor determine if he should investigate an individual representation.

The Government's response

113. The Government considers that the right of an elector to make an objection to accounts is a long-established and beneficial principle. However, we note that there are many more mechanisms now by which the electorate can hold local public bodies to account than when the right to object to the accounts was

³ Those most applicable to provision of non audit services are <http://www.frc.org.uk/images/uploaded/documents/ES5vprint.pdf>

AGENDA ITEM 10

introduced more than 150 years ago. Also the costs of auditors investigating objections can be disproportionate to the sums involved in the complaint or to the normal audit costs of the local public body. Auditors currently have little discretion to refuse to investigate objections and the costs of investigating objections are recovered from the local public body. We therefore intend to legislate to provide a power to give the auditor discretion to reject vexatious, repeated or frivolous objections. We would welcome a discussion on whether guidance should be produced to help the auditor exercise that discretion.

FREEDOM OF INFORMATION

114. The consultation proposed that auditors of local public bodies should be brought within the remit of the Freedom of Information Act to the extent that they are carrying out their functions as public office holders, although recognised the potential impact on audit fees and relationship between the auditor and audited body.
115. Some respondents thought that this would be unnecessary as the information would already be available under the Freedom of Information Act from the audited body. All respondents thought that audit fees would increase, and there were mixed views about the impact on working relationships.

The Government's response

116. The Government does not see a compelling case to bring the auditor's public office holder functions within the remit of the Freedom of Information Act. The information held by appointed auditors currently is not subject to the Freedom of Information Act because appointed auditors are not currently 'public authorities' for the purposes of the Freedom of Information Act. We consider that the audited bodies being covered by the Freedom of Information Act and the requirements around publication of the accounts, the auditor's report and Public Interest Report, provide sufficient and transparent access to key material for the public. The inclusion of local public auditors within the remit of the Freedom of Information Act would therefore add little, and has the potential to increase audit fees.

CHAPTER 3

Other functions of the Commission

117. There are a number of functions that are currently exercised by the Audit Commission under the Audit Commission Act 1998, the future operation of which were not covered in the consultation on the Future of Local Audit. Government's current thinking in relation to these functions is set out below.

Grant certification

118. The Audit Commission Act gives power to the Commission to make arrangements for the certification of audited bodies' claims for grants and subsidies from government departments, and charge authorities the full cost of certification. Certification helps grant-paying bodies satisfy themselves that a scheme is operating as intended. It is not an audit but is designed to provide reasonable assurance to grant-paying bodies about an authority's entitlement to grant or subsidy, or about the information provided in a return. Specific instructions or 'Certification Instructions' are developed for each scheme and different levels of assurance arrangements are applied to different thresholds of grant.
119. In 2010-11, certification arrangements were made for 20 schemes, and this has reduced to 16 schemes in 2011-12. Government is reducing the number of ringfenced grant programmes which will lead to a further reduction in the number of grant schemes for the Commission to certify. However, it is expected that a number of grant schemes will be live when the Audit Commission closes – so new certification arrangements are required for these and any new grant programmes.
120. The future arrangements for grant certification were not included in the consultation. Following the Audit Commission's closure, grant paying bodies for new grants will need to develop separate arrangements, either in the form of free-standing tripartite agreements (between the grant paying body, the payee and its auditor) or self-certification. Free-standing tripartite agreements would require the grant paying body to define the assurance requirements and certification instructions, and the local body to procure the necessary certification from its auditor. Some grant programmes may use self-certification to provide assurance: this relies on the internal governance and controls of the grant recipient and requires the Chief Executive or Section 151 Officer to certify the claim, usually through a standardised declaration. These arrangements will be supported by Treasury guidance, to ensure consistency of approach across Government grant programmes. For existing grant programmes currently certified by the Audit Commission, we are working with grant paying bodies to develop transitional arrangements that provide the assurance required.

AGENDA ITEM 10

1.

The National Fraud Initiative

121. The National Fraud Initiative is a secure, fully accredited, data matching service operated by the Audit Commission under statutory data matching powers now provided for in the Audit Commission Act 1998 with the purpose of protecting the public purse from fraud. It is run by a small team of 8 data matching specialists within the Commission.
122. The Commission's data matching powers mandate those bodies that are audited by the Commission to submit data for matching purposes. These include local authorities, health bodies - including Primary Care Trusts, Health Authorities, Foundation Trusts and Strategic Health Authorities - Housing Associations, Police, Fire, and Civil defence and ambulance services, Passenger Transport Executives and others.
123. The Commission currently runs a data-matching exercise every two years (although it is working on proposals to develop the National Fraud Initiative into a real-time data matching service). In 2008-09, it processed some 8,000 datasets from 1,300 organisations (including 100 voluntarily provided from the private sector) and identified fraud, errors and overpayments with a value of £215m. This brought the total value of detected fraud etc. since its inception in 1996 to £664m.
124. The Government is committed to the continuation of the National Fraud Initiative and the Department for Communities and Local Government has been considering the best way of securing that outcome. This has included talking to other parts of Government – the Department for Work and Pensions and the National Fraud Authority (an executive agency of the Home Office) – that are interested in taking on operational ownership of the National Fraud Initiative once the Commission is disbanded. We will be discussing these options further with the local public bodies who submit data and use the National Fraud Initiative.

Value for money studies

125. Section 33 of the Audit Commission Act 1998 gives the Audit Commission a duty to promote or undertake comparative or other studies in local authorities (including police authorities and fire and rescue authorities) so that they can make recommendations to improve the economy, efficiency and effectiveness of local public services, and the financial management of local public bodies. Only the financial management element applies in relation to the health sector. The Commission also has a duty to report on the effect of central government regulation, legislation, and directions on the ability of local authorities to achieve the 3Es (section 34). There is no equivalent power in relation to health. Before undertaking or promoting any value for money study, the Commission has a statutory requirement to consult with a range of parties as appropriate. It has typically consulted both on its forward programme and on a study-by-study basis.

AGENDA ITEM 10

126. The Commission has a long history of publishing recommendations from its national studies. Early reports looked at specific local government services, for example seeking to drive improvement in subjects as diverse as vehicle maintenance and social services for the elderly. The research was also used to provide audit guides that were applied through the appointed auditors in relevant local authorities. More recently, with local public bodies working together across sectors and with a wide range of partners in the public, private and voluntary sectors, the Audit Commission have examined how well that collaboration has delivered efficient and effective outcomes.
127. The Government announced in August 2010 that the Commission's research activities would stop and final reports remain to be published. We consider that there is scope for rationalisation in the number of value for money studies published relating to the local public sector compared to the number previously undertaken. We would like to see a coherent and complementary programme of offerings across providers including the National Audit Office, central Government and the Local Government Association. This was a view supported by the Communities and Local Government Select Committee inquiry into the audit and inspection of local authorities.

AGENDA ITEM 10

CHAPTER 4

Implementation and next steps

128. The preceding paras of this document set out the future proposals for principal local public bodies, currently defined as those with gross revenue expenditure over £6.5m. Under the Audit Commission regime there are different arrangements for the audit of smaller bodies, with a more proportionate form of scrutiny than a full audit (limited assurance audit), with the level of examination based on the income or expenditure of the body. The consultation document proposed different arrangements for smaller bodies would also apply in future. It also recognised the burden on smaller bodies of the local auditor appointment models and outlined different options for auditor appointment. We propose to do some further work with the sector to explore and build consensus around options for these bodies before firming up proposals and setting out our preferred approach in Spring 2012.
129. Having set out the key elements of the arrangements for principal bodies, we plan to hold further discussions with local authorities and other local public bodies, as well as audit firms, to flesh out the underlying detail of the framework, and how it might be implemented. We will also be working with key partners and the Audit Commission to develop appropriate transitional arrangements.
130. The Government will bring forward legislation to close down the Audit Commission and to put in place a new framework in line with the proposals set out in this response as soon as Parliamentary time allows. We intend to publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament.
131. The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice. The outsource contracts that the Commission will put in place will start from 2012-13 and are expected to run for three or five years giving local councils and other public bodies the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a small residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

AGENDA ITEM 10

ANNEX A

How different types of local public bodies will appoint their auditors

| Body | Directly elected/ non-elected | Who Appoints |
|---|----------------------------------|---------------------------|
| A local authority (meaning a county council, district council, London borough council). | Elected | Full Council |
| A Joint authority (meaning an authority established by Part 4 of the Local Government Act 1985). | Non-elected | IAAP |
| The Greater London Authority | Elected | Mayor and London Assembly |
| Mayor's Office for Policing and Crime | Elected | Mayor and London Assembly |
| Mayoral Development Corporation | Non-elected | IAAP |
| A functional body (meaning Transport for London, the London Development Agency, and the London Fire and Emergency Planning Authority) | Non-elected | IAAP |
| The London Pensions Fund Authority | Non-elected | IAAP |
| The London Waste and Recycling Board | Non-elected | IAAP |
| A committee of a local authority, including a joint committee of two or more such authorities | Non-elected | Full Council |
| The Council of the Isles of Scilly | Elected | Full Council |

AGENDA ITEM 10

| | | |
|---|-------------|-------------------------------|
| The Broads Authority | Non-elected | IAAP |
| A national park authority | Non-elected | IAAP |
| Police and Crime Commissioner and Chief Constable | Elected | Police and Crime Commissioner |
| A single purpose fire and rescue authority | Non-elected | IAAP |
| An authority established for an area in England by an order under section 207 of the Local Government and Public Involvement in Health Act 2007 (joint waste authorities) | Non-elected | IAAP |
| An economic prosperity board established under section 88 of the Local Democracy, Economic Development and Construction Act 2009 | Non-elected | IAAP |
| A combined authority established under section 103 of that Act | Non-elected | IAAP |
| The accounts of the collection fund of the Common Council and the accounts of the City fund | Elected | Full Council |
| The accounts relating to the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme Regulations 1995 | Elected | Full Council |
| Passenger Transport Executive | Non-elected | IAAP |

AUDIT AND RISK COMMITTEE WORK PROGRAMME 2012/2013**29 May 2012**

- Internal Audit Plan 2011/2012 – Progress report for the quarter January to March 2012
- Benefit Investigations Unit Annual Report
- Corporate Risk Monitoring Report (October 2011 to March 2011)

14 June 2012

- Final Accounts and Statement of Accounts for year ended 31 March 2012: (Revenue Outturn 2010/2011, Capital Programme and Resources 2011/2015, Annual Treasury Report 2011/2012)

26 June 2012 (Meeting to be held in the Chapel at Mintlyn Crematorium)

- Internal Audit Annual Report 2011/2012
- Fraud and Investigations Unit – Annual Report 2011/2012
- Review of the Effectiveness of the Audit and Risk Committee
- Review of the Effectiveness of Internal Audit Service

24 July 2012

- Internal Audit Plan 2011/2012 – Progress report for the quarter April to June 2012

28 August 2012**11 September 2012**

Special Meeting – to consider the Statement of Accounts 2011/2012
Annual Governance Statement

25 September 2012

23 October 2012

- Internal Audit Plan 2011/2012 – Progress report for the quarter July to September 2012

27 November 2012

- Benefit Investigations Unit Half-Year Report – S Chapman
- Business Continuity – annual update

2 January 2013

- Annual Audit Letter – to be presented by the Council's External Auditor
- Internal Audit – Strategic Audit Plan 2013/14

26 February 2013

- Internal Audit Plan 2011/2012 – Quarterly Progress Report from October to December 2012

26 March 2013

- Business Continuity – Annual Update
- BCKL&WN Audit Plan 2013/2014 (external)

23 April 2013

- Corporate Risk Monitoring Report (October 2012 to March 2013)