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Future of Local Audit – analysis of final proposals

Introduction

The Government has now published its final proposals for reform of external audit following consultation. The DCN made a comprehensive submission at the consultation stage jointly with the Society of District Council Treasurers. The final proposals show a number of changes that reflect points we made. In no areas do the final proposals worsen the original proposals.

This paper focuses on those elements of the proposals where we raised concerns and put forward alternatives. It is not a comprehensive resume of the final proposals, which can be found at:

http://www.communities.gov.uk/documents/localgovernment/pdf/2060619.pdf

Timing of changes

It is important to remember that the proposals now published by the Government will not come into effect until 2015 at the earliest. Having announced abolition of the Audit Commission soon after coming into power, the Government quickly decided that it would be difficult to achieve a rapid move to local government procuring audit services directly. It therefore decided to put interim arrangements in place to appoint external auditors for local authorities through a number of contracts based on geographical areas for either three or five years.

As the procurement process is not complete, we do not yet know the length of contracts. Either way, the procurement of audit services is now something that we will have plenty to time to consider and there is no immediate action needed.

Design Principles

We had few comments on the design principles underpinning the new arrangements and there are no significant changes in the final proposals.

Regulation of local public audit

The main issue that we commented on was whether district councils should constitute public interest entities and, therefore, be subject to a further level of monitoring by the overall regulator of audit services. Unsurprisingly, we argued that they should not.

The Government has pushed this one back for a decision further down the line. It proposes to create Bodies of Significant Public Interest through legislation that will be subject to, in the vernacular, an audit of their audit. As this legislation emerges, we will continue to lobby that district councils should fall below the threshold and that one level of external audit only is sufficient.

Commissioning local public audit services

This is the area where we had most comments so I have broken this section down into its constituent parts.

Duty to appoint an auditor

The main thrust of our submission in this section related to the complicated arrangements for procurement, requiring appointment of an audit committee, containing independent members, that would recommend to full council which audit firm to appoint. We argued that the proposed regulations were overly prescriptive and would mitigate against making joint appointments. We questioned the benefit of having independent members involved in the process; the level of prescription around the make up of the audit committee; and the necessity for full council to make the auditor appointment. We also questioned councils' ability to attract independent members with the requisite skills to make informed recommendations.

Somewhat surprisingly in its response the Government sates that, "nearly three quarters of the responses agreed that the arrangements for audit committees were flexible enough to allow joint appointments". That said, there is some movement in our direction.

To avoid confusion with existing audit committees the Government now proposes that the bodies with responsibility for recommending auditor appointments will be called Independent Audit Appointment Panels (IAAPs). The Government plans to legislate that these panels are chaired independently and have a majority of independent members.

The requirement for each full council to make the auditor appointment remains. Where we have seen movement though is that the Government is planning to allow the appointment of joint IAAPs. This will help in the procurement process, as one IAAP will be able to make recommendations to any number of separate councils. The risk remains that councils may reject the IAAPs recommendation, but that is unlikely and this change greatly improves the prospects for simple and successful joint procurement.

Role of the IAAP

We argued that the IAAP should have a single role, to advise the council on the engagement, removal or resignation of the auditor. The Government had proposed a range of options, of which this was the most minimal. We pointed out that the other potential roles mostly overlapped with the remit of councils' existing audit committees.

Success. The IAAPs will simply advise on the appointment, independence, removal or resignation of the auditor, so pretty much in line with what we wanted.

Involvement of the public in the appointment of an auditor

We argued that the government's plans for public involvement were heavy-handed. We questioned how interested the public would be in appointment of external auditors.

More success. The Government has dropped any prescription around consulting the public on the auditor appointment.

Failure to appoint an auditor

We argued that the detailed provisions here were disproportionate because the likelihood of a council failing to appoint an auditor by the due date was small.

Even more success. The government has indicated that it plans to put much more proportionate arrangements in place, with councils only required to notify the secretary of state of a failure to appoint (which I doubt will ever happen). It will also make provision for what happens in such circumstances – directing the council to appoint or making the appointment himself, which seems reasonable.

Rotation of audit firms and audit staff

The main point we made here was that the requirement for full council to re-appoint the auditor annually was unnecessary and potentially costly.

The final proposals do not mention any requirement for councils to re-appoint annually so I assume that this provision, which had no obvious merit, has gone. The requirement to retender for audit services every five years remains but the final proposals have no restrictions on the re-appointment of the same firm ad infinitum (in the original proposals councils would only be able to appoint the same company for a maximum of two consecutive five year terms).

Scope of audit and the work of auditors

We made two key points here. First, the government should not prescribe the scope of audit work, beyond that it should cover an opinion on councils' financial statements. Second, the Government should not require councils to produce an annual report setting out their performance and future plans.

On the former point the Government has decided that the scope of future audits should mirror current arrangements and include a value for money element. Although this is beyond what we argued for, it is better than some options that envisaged an expanded remit. On the latter point the Government states, “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.” From this I assume that the requirement to produce an annual report has gone, although the document does not include a direct statement to this effect.

Transparency

Worthy of note here is the intention to modernise the basis on which a local resident can object to a council’s accounts. There is no detail, other than that the Government intends to legislate to give auditors the power to reject objections without investigation under certain circumstances. This is welcome news.

Freedom of information

The consultation proposed bringing auditors within the remit of the Freedom of Information Act to the extent that they are carrying out their functions as public office holders. We did not support this proposal and the Government has now dropped it.

Conclusion

The final proposals are an improvement on the original and we should welcome the fact that the Government has reacted positively to most of our key points. There is a lot of detail yet to be published and we will need to monitor this to ensure that the Government does not regress on its general approach of freeing up councils to make the arrangements that best suit their needs.

The arrangements for joint procurement remain more complex than we think is necessary and may deter councils from entering into partnerships and securing cost savings as a result. Time will tell. As yet, there is insufficient detail available to determine what form of joint procurement might reap most benefits.

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