

**REPORT OF DEPUTY CHIEF EXECUTIVE & CORPORATE DIRECTOR FOR RESOURCES**

**GOVERNMENT RESPONSE TO COMMUNITIES AND LOCAL GOVERNMENT (CLG) SELECT COMMITTEE REPORT ON AUDIT AND INSPECTION**

**1 PURPOSE OF REPORT**

This report updates the Committee on the latest Government position in respect of the abolition of the Audit Commission.

**2 RECOMMENDATIONS**

To note the Government's position in respect of the abolition of the Audit Commission and consider the impact on the Audit Committee's future workload.

**3 REASONS FOR CONSIDERATION**

The 29 July meeting of this committee noted a letter from CLG giving an update on the future of local audit and the timetable for outsourcing the associated work. This report gives details of the Government's response to the CLG Select Committee's report on the future of external audit in local government.

**4 OVERVIEW OF WORK UNDERTAKEN**

The Government has published its response to the CLG Select Committee's report on audit and inspection. This response to the Select Committee provides an indication of the Government's position before they formally respond to the consultation. A briefing note provided by the Local Government Information Unit (LGIU) outlining the issues is attached as **Appendix 1**. In summary, the Select Committee's position on issues directly affecting the Audit Committee and Government's response is as follows:

- Although the work of the Audit Commission is generally well respected the Government is still of the opinion that its decision to abolish the Audit Commission was correct and will allow a refocus of local government audit work on local considerations and yield cost savings.
- The Select Committee notes that "the legislation will have to provide clear and uncontestable protections for assuring the independence of audit committees and auditors". The Government has reaffirmed its commitment to ensure that under any future system of local public audit, auditor independence will remain.
- The Committee considered that audit committees must be chaired by an independent person of proven competence and should have a majority of

independent members and that members of such committees should be remunerated.

- The Government still favours a longer term move to individual local councils appointing their own external auditor on the advice of an independent Audit Committee, with an independent and remunerated chair and vice chair.
- In the short term, councils will retain their current audit arrangements for the audit of the 2011-12 accounts, and then move to an out-sourced audit provider appointed by the Audit Commission for 2012-13. In the longer term, the Government will legislate for a move to a fully locally procured process.

5. **BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION**

None

6. **PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT**

Minutes and report from the Audit Committee dated 29 July 2011

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## Local Government Information Unit Policy Briefing

## Government response to CLG select committee report on audit and inspection

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## Overview

On 7 July 2011 the House of Commons Communities and Local Government Committee published its Fourth Report, summarising their work on the future of external audit in local government. This was subject to a [LGIU Briefing](#) published in July.

This briefing deals with the Government's response to the Committee's report, which was published on 17 October 2011.

The Government's response highlights a number of specific paragraphs in the Committee's report and comments further on the opinions and recommendations made. It also makes reference to the previous Government consultation paper "[The Future of Local Public Audit](#)" published in March 2011 - see separate LGIU Briefing [here](#).

The Government is still considering the comments made as part of this consultation and intends to publish its formal response later in the autumn. However, this document provides some important clues as to the Government's intentions on the future of local public audit in advance of its formal response and subsequent draft legislation.

In addition, the Audit Commission has recently announced that it will outsource all audit work from the 2012-13 financial year. The procurement process is now underway and will result in a substantial change in the role of the Audit Commission which will remain in the short term, acting as a 'client' rather than a provider of audit services.

In summary, the Government's response to the Committee's report is as follows:

- The Government is still of the opinion that its decision to abolish the Audit Commission was correct and will allow a refocus of local government audit work on local considerations and yield cost savings.
- The Government will ensure that under any future system of local public audit, auditor independence will remain.
- The Government still favours a longer term move to individual local councils appointing their own external auditor on the advice of an independent Audit Committee, with an independent and remunerated chair and vice chair.
- Any new local public audit system is likely to include a requirement for a wider scope of audit including the need to consider value for money issues.

## Briefing in full

### **The abolition of the Audit Commission**

The Committee report noted that the Government's decision to abolish the Audit Commission was widely viewed by those giving evidence as "policy-driven" and it was generally agreed that the quality of the Commission's audit service was respected. The Committee accepted that "sometimes policy-led decisions have to be taken quickly and without lengthy prior evaluation and consultation. The decision appears to have been taken without a clear evidence base."

The Committee report also stated that further delay in finalising arrangements should be avoided and the Government should concentrate on a successful implementation of its proposals. However, it considers that once the new arrangements are in place, the Government should instigate "a wide ranging review of public sector audit and how it fits into the wider context of accountability for the expenditure of public money".

The Government response to these points is that it remains of the view that the Audit Commission had become less focussed on accountability to citizens and more on reporting to Government. Whilst the Government agrees with the Committee that the Audit Commission's audit practice "is well respected and has done a consistently good job", the Government considers that there is no rationale for what is currently the fifth largest auditing practice in the UK to remain in the public sector.

The Government is not convinced that a review of public sector audit is required at this stage.

The Committee says that there were wide discrepancies in evidence on the likely savings to be achieved through the abolition of the Audit Commission. In response, the Government commits it to publishing a draft impact assessment before bringing forward legislation which will estimate the costs and savings from disbanding the Audit Commission. It also points to the following additional evidence:

- DCLG has already saved £10 million in grant to the Audit Commission by abolishing the Comprehensive Area Assessment. In addition to the overall cost of the CAA inspection process that has been estimated by the Audit Commission as being £6 – 19.5 million in 2010 and £9.7 – £31.6 million thereafter.
- The Audit Commission has already made further savings by reducing its national studies programme
- Once the work of the in-house audit practice has been outsourced, the Commission will be much reduced in size and the overheads related to the smaller body will, consequently, be much lower. This has already been reflected in a proposed 10% reduction in audit fee scales for 2012-13.

### **Auditor Independence and Local Appointment**

The Committee believes that the Government's proposals to enable local councils to appoint their own auditors, on the advice of an independent audit committee, is a departure from the established practice that public bodies should not appoint their own auditors. In the light of this, the Committee notes that "the legislation will have to provide clear and uncontestable protections for assuring the independence of audit committees and auditors". The Committee also considered that audit committees must be chaired by

an independent person of proven competence and should have a majority of independent members and that members of such committees should be remunerated.

The Government response reaffirms that it is committed to maintaining auditor independence in any new local public audit framework. The Government is still of the view that “the appointment of an auditor to be undertaken by full council on the advice of an independent audit committee seems the most practical and effective way of ensuring auditor independence”.

The government still seem to favour the formation of an independent audit committee to advise councils on the appointment of their external auditor. However, they acknowledge that many consultation responses have included the issue of whether suitable independent people can be found to serve on such committees and in response they are currently looking at ways to make their proposals work in practice. This includes encouraging local public bodies to share audit committees. The Government also “intend[s] to talk to both the Local Government Group and CIPFA as to ways in which we can make such a system work (for example, creating a register of suitable independent members”.

### **Public Interest Reporting**

The Committee stated that public interest reporting is an essential element of public auditing, and recommended that the audit committee has an explicit requirement in legislation to support the auditor in any reasonable recommendation for a public interest report. Also, the professional oversight body responsible for accrediting local government auditors should consider the competency of audit firms to carry out this work as part of their oversight role.

Whilst the Government’s plans are still being finalised, its response demonstrates that it is of the opinion that the audit committee will have a role in mediating between the local council and the auditor in relation to public interest reports. Its view is that the safeguards proposed on the dismissal of auditors in a local audit model will be robust enough to enable auditors to prepare public interest reports without fear of repercussions from the local council.

### **Audit Scope**

The Committee generally agreed with the Government’s proposals to require the National Audit Office to take over responsibility for the production of an audit code and for the accountancy profession to ensure consistency and quality of local public audits. The Committee did note that this might result in the NAO incurring additional costs and the Government has written to the Public Accounts Commission to alert them of this possibility.

Both the Committee and the Future of Public Audit consultation considered the overall scope of public audit and, specifically, whether the wider scope in the current system, which includes value for money work, should continue. The Government’s response includes comments that there was a mixed response to this issue but a slight majority of respondents favoured leaving the high level audit scope unchanged, including the requirement for auditors to consider value for money issues.

The audit code of practice currently specifies how auditors should discharge their duties and the Government is of the view that any new code for a local public audit environment would make specific reference to such issues.

## **Competition in the audit market**

The Committee was concerned with the current domination of the audit market by a small number of very large firms and wished to ensure that any new system of local public audit contributed to the opening up of the market to competition. Clearly this is a wider issue for the Government, but the response notes that the Audit Commission is currently in a procurement process for public audit work from 2012-13 and this process will, in the short term, determine how many local suppliers are available. Further, it is noted that existing Audit Commission audit staff will be transferred to successful bidders, thus allowing experience and expertise to be retained. Whilst the Government would welcome the formation of a new audit company by former Audit Commission employees, clearly the Government cannot influence the procurement process itself.

## **Performance Management**

The Government's response reiterates its view that local councils should be responsible for measuring their own performance rather than being subject to a centrally enforced process such as the Comprehensive Area Assessment. This will include councils reporting locally on their performance against objectives and the Government confirms that it has no intention to re-introduce a National Indicator Set or required performance measures in local government.

The Secretary of State will retain the power to intervene in serious cases of failure under Section 15 of the Local Government Act 1999 under any future system of audit, but would only use such powers in "cases of serious corporate failure".

The Government agrees with the Committee in its conclusion that there are advantages to a unified approach to reporting on the value for money of public expenditure across central and local government. This might be achieved by requiring the NAO to undertake such work in local government, but this would require changes in primary legislation and would as such be subject to further parliamentary scrutiny. The Government also envisages that a decision to carry out any such work would be at the discretion of the Comptroller and Auditor General and also subject to securing funding from the Public Accounts Commission.

## **Comment**

The Government's overall position on the future of local public audit seems not to have significantly changed in the light of the Committee's investigation and report. The most valuable insights in its response are the indications of its current thinking on the future of local public audit after the abolition of the Audit Commission. Whilst further details on this are expected later this year, the Government has reiterated its view that local councils will be required to appoint their own external auditor on the advice of an independent audit committee that is chaired by an independent person. This represents a substantial departure from the current audit appointment process and a change to the overall committee structure for every council.

In the short term, councils will retain their current audit arrangements for the audit of the 2011-12 accounts, and then move to an out-sourced audit provider appointed by the Audit Commission for 2012-13. In the longer term, the Government will legislate for a move to a fully locally procured process. Draft legislation and a timetable for this move are awaited from the Government.