

CHANGES TO EXTERNAL AUDIT ARRANGEMENTS

Submitted by: Head of Finance

Portfolio: Finance and Budget Management

Ward(s) affected: All

Purpose of the Report

To inform Members of changes which are due to take place with regard to external audit arrangements.

Recommendation

That the information be noted.

Reasons

The current arrangements for external audit of the Council are being changed from the Audit Commission to a private sector auditor as a consequence of the abolition of the majority of the Audit Commission's functions.

1. Background

- 1.1 At present the Audit Commission is statutorily responsible for regulating local authority external audit. It appoints the auditor who will carry out each authority's external audit work. Currently this work is carried out across the country by a mixture of private accountancy firms and the Audit Commission's own in house audit practice. Newcastle's auditor has always been the Audit Commission in house practice.
- 1.2 The audit related work which the auditor carries out includes:
 - The annual audit and certification of the Council's Statement of Accounts and underlying accounts and provision of an annual Audit Letter.
 - Providing an Annual Governance Statement for the Council including a Value for Money (VFM) Opinion.
 - Certification of claims the Council has made to central government and other governmental agencies.
 - Carrying out and publishing national research on topics relevant to local authorities generally, often with a VFM focus.
 - One-off studies of the situation in individual authorities in relation to particular topics.
 - Special investigations where serious fraud or financial impropriety is alleged or where there is a public interest issue.
 - Determining whether specific items of expenditure or income can be lawfully expended or received by individual authorities following representations from interested parties.
 - Co-ordination of the National Fraud Initiative, an exercise that matches data within and between public bodies in order to detect fraud.
- 1.3 In August 2010 the Department for Communities and Local Government (DCLG) announced plans to put in place new arrangements for auditing local public bodies. Following consultation, the government confirmed in the Queen's Speech in May 2012 that it intended

to publish a draft Bill on the future arrangements for local public audit. The Local Audit Bill has now been published for consultation and outlines how the current audit regime and the Audit Commission will be replaced. The legislation should be enacted in time for the new arrangements to commence on 1 September 2012.

- 1.4 The Audit Commission's in house practice currently undertakes the majority of audits for local public bodies. In July 2011 DCLG Ministers confirmed their preference for transferring this work to the private sector by outsourcing contracts. Accordingly, the Audit Commission carried out a procurement exercise to give private sector bidders the chance to compete for the Audit Commission's audit work. In March 2012 the Commission announced the results of this exercise, awarding five year contracts to four private accountancy firms, based on bids to carry out work within defined geographical areas.
- 1.5 The Audit Commission will remain in place until April 2015 (when it will be abolished) to oversee the contracts and other statutory functions but will be significantly smaller after the outsourcing, most of its audit staff having been transferred to their new employers by October 2012. A new body, as yet unspecified, will take over, from April 2015 to manage the final two years of the outsourced local audit contracts.

2. **Issues**

- 2.1 The firm that will be carrying out the audit work for Newcastle will be Grant Thornton (UK) LLP, who were the successful bidder for the West Midlands contract area, which includes this Council. This is subject to the Audit Commission Board approving their appointment on 26 July. By mid August a letter should have been received formally confirming the appointment. The appointment commences on 1 September 2012.
- 2.2 The audit of the 2011/12 accounts, which is currently taking place, will be carried out under the present arrangements by the Audit Commission practice. This will include preparing and presenting the Annual Governance Statement, attendance at the Audit and Risk Committee when it and the Statement of Accounts are considered and certification of the 2011/12 accounts. The intention is that the work in relation to the 2011/12 accounts will all be completed by the Audit Commission practice, enabling a "clean" handover to the new firm, which will then be responsible for 2012/13 audit work. Clearly, however, if any issues arise in relation to 2012/13 in the period before 1 September, these will have to be dealt with under the present arrangements since Grant Thornton can only start work at the Council from that date. Grant Thornton will complete the certification of the housing and council tax benefit subsidy claim relating to 2011/12 because this has a submission deadline of 30 November 2012.
- 2.3 Audit Commission staff currently employed by the Commission will transfer to the new audit firms on 31 October 2012. The current District Auditors within the area have been appointed as "Engagement Leads" for Grant Thornton's Midlands Audit Practice. It seems likely that, in the beginning at least, the Council will be dealing with largely the same audit teams as now exist, although this may well change over time. This should assist with continuity, hopefully avoiding the need for a completely new set of auditors to have to become familiar with Newcastle's financial situation, processes and accounting system, which could take up some of your officers' time as well. It should also be noted that Grant Thornton have substantial experience of public authority auditing, including local authorities, through their absorption in 2008, of accountancy firm Robson Rhodes, who specialised in this area of work. The general approach to the audit process is as yet an unknown quantity but the above factors perhaps indicate that there may not be a radical change from present practices. Other local authorities, including in Staffordshire, have reported positively on their experience of private sector auditors. Hopefully, Grant Thornton will make contact with your finance officers before they become officially responsible in order to discuss their approach to the audit.

Having one firm responsible for the audits of all authorities in a region may also assist in achieving a consistent approach across those bodies. Overall, the principle of the change does not, therefore, give rise to any particular concerns.

- 2.4 The Midlands Audit Practice is based in Birmingham. It is not clear whether there will be a more locally based office but the firm has said that they intend to have an on site presence, which presumably means audit staff visiting the Council and using the dedicated external audit room on an ad hoc basis in order to keep in touch with audit issues affecting Newcastle and with relevant Council officers. They have said that, as now, they will attend all of the meetings of the Audit and Risk Committee and will liaise with Internal Audit, with whom they would expect to work closely.
- 2.5 The Audit Commission will continue to update its VFM comparator tool and make it available on its website. This is a useful means of comparing the cost of services over a range of local authorities (which can be selected by the user) and it is pleasing that this is being maintained. There will be no more research studies carried out and published by the Commission. However, the Local Audit Bill gives powers to the National Audit Office (NAO) to undertake studies of thematic value for money issues related to local government and it remains to be seen whether the private sector firms will carry out similar work. The NAO will also be responsible for setting the code of audit practice for local government.
- 2.6 The National Fraud Initiative will be retained, although Ministers have yet to decide which body its work will transfer to.
- 2.7 These arrangements are an interim measure. The new contracts will last for five years, although there may be provisions for the successor body to the Audit Commission to extend them for a further period, particularly to spread bids over a year or two to give better opportunity for a wide range of firms to bid. The exact process will not be known until the Bill relating to the future arrangements for local public audit has been enacted. It is intended that once the new contracts expire, local authorities will appoint their auditors themselves, following a procurement process, which will include an independent audit panel to advise on the appointment.

3. **Legal and Statutory Implications**

- 3.1 The Council is required to submit its accounts to external audit under provisions contained in the Accounts and Audit Regulations 2011 and the Audit Commission Act 1998.

4. **Financial and Resource Implications**

- 4.1 The fees payable by authorities for external audit will reduce by around 40% across the board. This has been made possible by utilising the Audit Commission's bulk purchasing power, offering large contracts to successful bidders and probably by a reduction in central overhead costs which had to be recovered from the audit fees. In Newcastle's case this will result in a saving of a little under £60,000.

5. **Major Risks**

- 5.1 It does not appear that there are any major risks attached to the changes. There is no reason to assume that the standard of audit will reduce compared to the present situation.

6. **Key Decision Information**

- 6.1 This is not a key decision, being reported for information, and has not been included in the Forward Plan.

7. **Background Information**

- 7.1 Audit Commission and DCLG websites; handouts from joint Audit Commission/Grant Thornton session “Introductory Events for Audited Bodies” held in Birmingham on 30 April 2012 attended by the Head of Finance.