

Report for Information

Report to Audit committee

21 June 2011

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Report of Head of finance

Subject Independence of the audit committee

Purpose

For the audit committee to consider the proposals of the government for the future structure of local authority audit committees as set out in Department of Communities and Local Government consultation paper "Future of local public audit".

Recommendation

At this stage it is suggested that the committee considers and awaits the outcome of the government's proposals to change the role and function of audit committees, set out below, as these may address the committees concerns and put them into context.

Strategic Objectives/Service Priorities

The report helps to achieve the strategic priority "One council"

- customer focus – putting customers at the heart of everything we do;
- continuous improvement of our services; and
- customer conscious – efficient and effective service delivery.

Background Documents

The future of public audit – Department of Communities and Local Government.

Background

The Audit Committee want to explore options which might make the committee more effective, in particular by having technical support for example by having an independent chair, external independent members or increased training. The government, as part of its proposals for disbanding the Audit Commission, has now made proposals on the future structure of audit committees and their independence.

The audit committee can make recommendations to cabinet on how the effectiveness of the audit committee can be improved in the short term. If this involves bringing in independent members of the committee, either from audit firms

or suitably qualified individuals the council would need to make budget provision to pay these members and would also need to amend the constitution.

At this stage it is suggested that the committee considers the government's proposals to change the role and function of audit committees, set out below, as these may address the committees concerns.

Government proposals

The government is proposing to change the way that audit services are provided to local authorities. The changes will mean that the audit commission will no longer provide these, and that local authorities will need to procure their audit services. Below are the government's proposals which they expect to be part statutory and part supported by a code of best practice. The government's proposals also encompass the role of the audit committee, in particular the role the committee would play in the selection of external auditors.

Structure of audit committees

It is envisaged that in the new system, an audit committee could be structured in the following way:

- *The chair should be independent of the local public body. The vice-chair would also be independent, to allow for the possible absence of the chair.*
- *The elected members on the audit committee should be non-executive, non-cabinet members, sourced from the audited body and at least one should have recent and relevant financial experience (it is recommended that a third of members have recent and relevant financial experience where possible).*
- *There would be a majority of members of the committee who were independent of the local public body.*

Independent members of the committee

When choosing an independent member of the committee, a person can only be considered for the position if:

- *he or she has not been a member nor an officer of the local authority/public body within five years before the date of the appointment*
- *is not a member nor an officer of that or any other relevant authority*
- *is not a relative nor a close friend of a member or an officer of the body/authority*
- *has applied for the appointment*
- *has been approved by a majority of the members of the council*
- *the position has been advertised in at least one newspaper distributed in the local area and in other similar publications or websites that the body/local authority considered appropriate.*

From 'The future of public audit – Department of Communities and Local Government.

Role of the Audit Committee in the appointment of independent auditors

Current System

- 1 As auditors are currently appointed by the Audit Commission there is no role for an audit committee in the appointment of auditors, although the Audit Commission always consults local public bodies before it confirms and audit appointment. However, some local public bodies do have Audit Committees (some of which are independent) with roles in relation to both internal and external audit
- 2 Health bodies currently have their own form of audit committees following the Financial Reporting Council best practice guidance, comprising of independently appointed non-executive directors governed by their own rules and requirements.

The government proposals

- 3 *It is likely that we would want to specify in legislation some responsibilities that the audit committee should have in relation to the engagement of an auditor and monitoring the independence and quality of the external audit. However, we would not wish to limit the scope of an audit committee so that a local body had no flexibility in designing the role.*
- 4 *The expanded role of the audit committee would include the provision of advice and guidance to the full council or equivalent (the audit committee may wish to have regard to advice from the section 151 officer) on appropriate criteria for engaging an auditor and advice as to how these criteria could be weighted. The audit committee would be given copies of the bids to evaluate in order that they may advise the full council on the selection process and may, if they wish, indicate which auditor, in their view, presents the best choice.*
- 5 *The full council would need to have regard to the advice of the audit committee but would not need to follow its advice. The full council or equivalent would be responsible for selecting an auditor and engaging that auditor on a contractual basis.*
- 6 *Advice provided by the audit committee to the full council would be published, although consideration will need to be given to the treatment of commercially confidential material.*
- 7 *If the full council did not follow the advice of the audit committee, then it would need to publish on its website a statement from the audit committee explaining its advice and a statement from the full council or equivalent setting out the reasons why the council or equivalent has taken a different position.*

Option 1

- 8 *We could specify only one mandatory duty for the local body's audit committee, ie to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.*
- 9 *It would then be left up to the local public body and the audit committee to decide whether the audit committee should have a wider role in the other issues, eg setting a policy on the provision of non-audit services by the statutory auditor or reviewing the relationship between the auditor and the audited body.*
- 10 *The option would ensure that the audit committee provided advice to the local public body at crucial moments, but would allow the local public body and the audit committee flexibility to decide on any other functions it may carry out. However, if only the minimum was followed, this may not provide an adequate check on ongoing independence through the auditor's term.*

Option 2

- 11 *We could specify a much more detailed mandatory role for the audit committee which could include, but may not be restricted to the following:*
- *providing advice to the full council on the procurement and selection of their external auditor*
 - *setting a policy on the provision of non-audit work by the statutory auditor*
 - *overseeing issues around the possible resignation or removal of the auditor*
 - *seeking assurances that action is being taken on issues identified at audit*
 - *considering auditor's reports*
 - *ensuring that there is an effective relationship between internal and external audit*
 - *reviewing the financial statements, external auditor's opinions/conclusions and reports to members and monitor management action in response to the issues raised by external audit*
 - *providing advice to the full council on the quality of service they are receiving*
 - *reporting annually to the full council on its activities for the previous year.*

From 'The future of public audit – Department of Communities and Local Government.

- 12 *In the light of the above it is suggested that the audit committee are advised on the progress of these proposals and wait for clarity on the future direction that the government set out before suggesting any changes to the way the audit committee operates in Norwich City Council.*