

South Somerset District Council

Notice of Meeting



Audit Committee

Making a difference where it counts

Thursday 23rd June 2011

10.00 a.m.

**Committee Room 3/4,
Council Offices,
Brympton Way,
Yeovil,
Somerset BA20 2HT**

The public and press are welcome to attend.

Disabled Access is available at this meeting venue.



If you would like any further information on the items to be discussed, please ring the Agenda Co-ordinator, **Andrew Blackburn** on Yeovil (01935) 462462
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This Agenda was issued on Wednesday, 15th June 2011

Ian Clarke, Assistant Director (Legal & Corporate Services)



2007-2008
Neighbourhood and
Community Champions:
The Role of Elected Members
2006-2007
Improving Rural Services
Empowering Communities
2005-2006
Getting Closer to Communities

This information is also available on our
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INVESTOR IN PEOPLE

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Audit Committee Membership

Chairman Derek Yeomans
Vice-Chairman Ian Martin

John Calvert Roy Mills
John Dyke John Richardson
Marcus Fysh Colin Winder
Tony Lock

South Somerset District Council – Corporate Aims

Our key aims are: (all equal)

- Increase economic vitality and prosperity
- Enhance the environment, address and adapt to climate change
- Improve the housing, health and well-being of our citizens
- Ensure safe, sustainable and cohesive communities
- Deliver well managed, cost effective services valued by our customers

Members' Questions on Reports prior to the Meeting

Members of the Committee are requested to contact report authors on points of clarification prior to the Committee meeting.

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Information for the Public

The purpose of the Audit Committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority's financial and non-financial performance, to the extent that it affects the authority's exposure to risk and weakens the control environment and to oversee the financial reporting process.

The Audit Committee should review the Code of Corporate Governance seeking assurance where appropriate from the Executive or referring matters to management on the scrutiny function.

The terms of reference of the Audit Committee are:

1. To approve the Strategic and Annual Internal Audit Plans;
2. To receive summaries of Internal Audit reports and seek assurance from management that action has been taken.
3. To consider the reports of external audit and inspection agencies and seek assurance from management that action has been taken.
4. To consider the effectiveness of SSDC's risk management arrangements, the control environment and associated anti-fraud and corruption arrangements and seek assurance from management that action is being taken.
5. To review the annual Statement of Internal Control and monitor associated action plans.
6. To review the SSDC's Code of Corporate Governance and ensure it is kept up to date and reflects best practice. This will include regular reviews of the Council's Constitution and an overview of the risk management.
7. To receive reports from management on the promotion of good corporate governance.
8. To review and approve the annual Statement of Accounts, external auditor's opinion and reports to members and monitor management action in response to issues raised.

Meetings of the Audit Committee are held monthly including at least one meeting with the Council's external auditor.

Agendas and minutes of this committee are published on the Council's website at www.southsomerset.gov.uk

The Council's Constitution is also on the web site and available for inspection in council offices.

Further information can be obtained by contacting the agenda co-ordinator named on the front page.

Audit Committee

Thursday 23rd June 2011

Agenda

Preliminary Items

1. **To approve as a correct record the Minutes of the previous meeting held on 28th April 2011**
2. **Apologies for Absence**
3. **Declarations of Interest**

In accordance with the Council's Code of Conduct, which includes all the provisions of the statutory Model Code of Conduct, members are asked to declare any personal interests (and whether or not such an interest is "prejudicial") in any matter on the agenda for this meeting. A personal interest is defined in paragraph 8 of the Code and a prejudicial interest is defined in paragraph 10.

4. **Public Question Time**

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Audit Committee – 23rd June 2011

5. Audit of Financial Controls 2010/11

Strategic Director: Mark Williams, Chief Executive
Assistant Director Donna Parham (Finance and Corporate Services)
Lead Officer: Donna Parham, Assistant Director (Finance and Corporate Services)
Contact Details: donna.parham@southsomerset.gov.uk or 01935 462225

Purpose of the Report

This report introduces the report from the Audit Commission on their findings from their Audit of Financial Controls for 2010/11 (attached as Appendix 1 at the back of this agenda).

Recommendations

The Audit Committee is asked to note the contents of the Audit of Financial Controls report for 2010/11.

Introduction

The Audit of Financial Controls Report is included within the remit of the Audit Committee under its terms of reference as follows:

“To consider the effectiveness of SSDC’s risk management arrangements, the control environment and associated anti-fraud and corruption arrangements and seek assurance from management that action has been taken”

“To consider the reports of external audit and inspection agencies and seek assurance from management that action has been taken”

The Report

The report shows the work carried out by the Audit Commission in preparing the background for the audit of the Statement of Accounts. The authority must put in place arrangements to ensure proper conduct of its financial affairs, and monitor their adequacy and effectiveness. The Audit Commission would be unable to give an unqualified opinion on the Statement of Accounts if the authority has insufficient arrangements in place.

There are two recommendations that have been made to strengthen SSDCs financial arrangements outlined on page 7 of the Audit Commission’s report.

- All budget holders should explain the action that is being taken to recover debts to comply with the Council’s financial procedure.
- *The Financial Procedure Rules have been strengthened in May 2011 to improve instructions for managers on debt recovery. We are currently reviewing the recovery of debt to see if this would be better as a centralised function.*
- The Council should complete the exercise to check the validity of single persons discounts

AC

- *Council Tax has been carrying out a review of single persons discounts and will report the outcomes of this to Audit Committee by the end of September 2011.*

Financial Implications

None as a consequence of this report.

Background Papers: *Audit Commission Report – Audit of Financial Controls 2010/11.*

Audit of

Financial

Controls

South Somerset District Council

Audit 2010/11

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Summary report

Introduction

- 1** My audit plan for 2010/11, which I presented to the Audit Committee on 24 March 2011 explained the work I would be carrying out to meet my Code of Audit Practice (the Code) responsibilities.
- 2** It is my responsibility as auditor of South Somerset District Council (the Council) to give an independent assessment of whether the financial statements give a true and fair view of the financial position of the Council and the income and expenditure of the year ended 31 March 2011.
- 3** It is the Council's responsibility to put in place arrangements to ensure proper conduct of its financial affairs, and to monitor their adequacy and effectiveness.
- 4** Under the International Standards on Auditing (UK and Ireland) (ISAs) I am required to gain an understanding of the Council's arrangements to identify and assess risks of material misstatement to its financial statements. This will comprise an assessment of audit risks for the organisation and the systems it uses to produce the financial statements.
- 5** My assessment of these arrangements will determine the approach required for the audit of the Council's financial statements from June to September.
- 6** In addition, ISA 265 specifically requires me to communicate deficiencies in internal control to those charged with governance; the Audit Committee.
- 7** The Council has implemented the recommendations that I made to the Audit Committee in September 2010. The findings are summarised in the following table.

Table 1: **Review of progress with the recommendations from the Annual Governance Report 2009/10**

2009/10 Recommendation	Follow up finding	Audit conclusion
R1 The Council should amend its accounts to remove the offsetting of valuations gains and losses.	The Council has put through the amendments in the 2010/11 accounts.	The Council has implemented my recommendation.
R2 The Council should ensure that managers complete Authority to Appoint forms for all new employees, including casual staff.	Authority to Appoint forms are required and it was identified that the exception had been the result of a change of employment contract status relating to an employee who moved to casual employment.	The Council has implemented my recommendation.
R3 The Council needs to be able to demonstrate that all salary costs that are classified as capital meet the criteria of the SORP (and Financial Reporting Standard 15).	The Council has removed administrative salaries from capital expenditure.	The Council has implemented my recommendation.
R4 In such cases where the Council can demonstrate that salaries are capital then the Council should correctly allocate the costs to either the acquisition of fixed assets or written off where there is no asset (REFCUS).	The Council has not capitalised salaries in 2010/11.	The Council has implemented my recommendation.

Source: 2009-10 South Somerset District Council Annual Governance Report

Audit approach

8 Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements.

9 My audit of the financial statements is undertaken in two phases:

- during the period of account I review the systems that generate entries in the financial statements in excess of £1.5 million (the materiality threshold) and, in particular, test the controls in these systems that prevent material errors in the statements; and
- I test entries in the completed financial statements. This takes place after the year end usually from June to September.

10 ISA 315 requires the auditor to show our understanding of the financial information systems that provide material balances in the accounts and to assess the risk of material misstatement arising from the activities and controls within these systems.

11 Under ISA330 'the auditor's procedures in response to assessed risk,' the auditor can rely on controls if they have not changed since they were last tested. The auditor should test the operating effectiveness of such controls at least every third year. Where there are a number of controls for which the auditor determines that it is appropriate to use audit evidence obtained in prior audits, the auditor should test the operating effectiveness of a sample of these controls each audit.

12 In this context, my 2010/11 work includes walk through testing on the material information systems to confirm my understanding of the key controls.

13 The material information systems for the Council are;

- General Ledger
- Accounts Payable (creditors)
- Accounts Receivable (debtors)
- Payroll
- Property, plant and equipment (capital)
- Council Tax
- NNDR
- Housing Benefit
- Cash receipting (including car park income)
- Treasury Management

14 In 2010/11 I have undertaken a detailed review of Internal Audit's working papers and supplemented its work with my own procedures for key controls of all of the above material information systems.

Main conclusions

15 I assessed the controls operating for each information system that lead to material balances in the financial statements (above £1.5 million)

16 I have documented below the findings from the testing of controls and recommendations for improvement in the future. I have also set out the approach I propose to follow at the post statement audit, to gain the required assurances the 2010/11 financial statements are materially correct.

17 My conclusions are summarised in Table 2:

Table 2: Summary of results of controls testing

This table summarises the conclusions of external audit on the reliance that can be placed on key financial controls

System	Findings	Conclusions
General Ledger	I have not identified any significant weaknesses in key controls in the general ledger that would affect my opinion.	Subject to year end testing, I can place reliance on the key controls in the general ledger.
Accounts payable (creditors)	I have not identified any significant weaknesses in key controls in the system of accounts payable that would affect my opinion.	Subject to year end testing, I can place reliance on the key controls in accounts payable.
Accounts receivable (debtors)	A key control is that budget holders explain actions to recover aged debts. However, not all budget holders have supplied this information. The financial accountant is clarifying the wording of the financial procedure. The Council is expecting to have explanations of the action taken to recover all aged debts.	I will review the action taken by the Council and review year end controls.
Payroll	I have not identified any significant weaknesses in key controls in the payroll system that would affect my opinion.	Subject to year end testing I can place reliance on the key controls in payroll.
Property Plant and Equipment	Some of the key controls operate only after the end of the financial year. Other controls such as quarterly reconciliation to the general ledger and coding of capital expenditure operate throughout the financial year and I can place reliance upon these controls.	I will undertake my review of year end controls in June and July.
Council Tax	The Council has used data matches from Experian to identify where there are discrepancies with single person discounts. The Council has informed me that it has resolved all the cases where there is no council tax benefit involved. Where there is no response from the council tax payer in benefit cases there will be a benefit intervention review. The Council will report the results of the exercise once it is completed.	I will review the Council's work on ensuring that only valid discounts have been awarded. I will review the operation of year end controls.

System	Findings	Conclusions
Non domestic rates	I have not identified any significant weaknesses in key controls operating in the system of non domestic rates that would affect my opinion.	Subject to year end testing I can place reliance on the key controls in non domestic rates.
Housing Benefits	I have not identified any significant weaknesses in key controls within housing benefits that would affect my opinion.	Subject to year end testing I can place reliance on the key controls in housing benefits.
Cash receipting (including car park income)	I have not identified any significant weaknesses in key controls within cash receipting that would affect my opinion.	Subject to year end testing I can place reliance on the key controls in cash receipting.
Treasury management	Interest receivable is not material for my opinion but I seek assurance on investments from year end testing of balances.	I will seek direct confirmation from counter parties for entries in the balance sheet.

Source: Internal Audit and External Audit

18 I have the following recommendations to improve internal control.

Recommendation

- R1** All budget holders should explain the action that is being taken to recover debts to comply with the Council's financial procedure.
- R2** The Council should complete the exercise to check the validity of single person discounts.

Appendix 1 Action Plan

Recommendations

Recommendation 1

All budget holders should explain the action that is being taken to recover debts to comply with the Council's financial procedure.

Responsibility	Assistant Director (Finance and Corporate Services)
Priority	Medium
Date	31 July 2011
Comments	In May 2011 the Council revised its financial procedures. The Council is reviewing its arrangements for debt recovery.

Recommendation 2

The Council should complete the exercise to check the validity of single person discounts.

Responsibility	Revenues and Benefits Manager
Priority	High
Date	30 September 2011
Comments	The work has been completed where recipients of the discount are not also receiving benefits. There will be a review of benefit cases where no reply has been received.

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- any director/member or officer in their individual capacity; or
- any third party.



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Audit Committee – 23rd June 2011

6. 2010/11 Internal Audit Annual Report and Opinion

Head of Service: Gerry Cox, Head of Internal Audit Partnership
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Contact Details: andrew.ellins@southwestaudit.gov.uk or 01935 462378

Purpose of the Report

This report provides an update on the position of the Internal Audit Plan at the end of 2010/11 and also provides Internal Audit's overall Opinion on the systems of internal control at South Somerset District Council.

Recommendation

To note the content of the Internal Audit Annual Report and Opinion.

Background

The Audit Committee agreed the 2010/11 Internal Audit Plan at its February 2010 meeting. An update was provided in August 2010 (for quarter one), November 2010 (for quarter two) and in February 2011 (for quarter three).

Appendix A - Detailed Internal Audit Annual Report and Opinion for 2010/11
Appendix B - Audit Assurance Definitions
Appendix C - Service Actions with Partial Assurance

Financial Implications

There are no financial implications associated with these recommendations.

Background Papers: None



South Somerset District Council

Annual Report and Opinion 2010-2011

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Purpose and Background Page 2

Summary of Internal Audit Activity:

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APPENDICES:

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Annual Opinion:

The Group Audit Manager is required to provide an annual opinion report to support the Annual Governance Statement.

Purpose of Report and Recommendation

The Accounts and Audit Regulations (England) 2011 requires public authorities to publish an Annual Governance Statement (AGS).

The Statement is an annual review of the Systems of Internal Control and gathers assurance from various sources to support it. One such source is Internal Audit. The Head of Internal Audit should provide a written annual report to those charged with governance to support the AGS. This report should include the following:

- an opinion on the overall adequacy and effectiveness of the organisation's risk management systems and internal control environment
- disclose any qualifications to that opinion, together with the reasons for the qualification
- present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies
- draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Annual Governance Statement
- compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and criteria
- comment on compliance with these standards and communicate the results of the internal audit quality assurance programme.

The purpose of this report is to satisfy this requirement and Members are asked to note its content.

Background

The Internal Audit service for South Somerset District Council is provided by the South West Audit Partnership (SWAP). SWAP has adopted and works to the Standards of the Institute of Internal Auditors. The Partnership is also guided by the Internal Audit Charter which is reviewed annually. Internal Audit provides an independent and objective opinion on the Authority's control environment by evaluating its effectiveness. Primarily the work of the Unit is based on the Annual Plan agreed by Senior Management and this Committee. This report summarises the activity of SWAP for the year April 2010 to March 2011.

Summary of Work 2010/11

The agreed Annual Audit Plan covers 5 key areas of Activity:

- 1) OPERATIONAL AUDITS
- 2) INFORMATION SYSTEMS
- 3) KEY CONTROLS
- 4) GOVERNANCE & FRAUD
- 5) SPECIAL REVIEWS

Audits Completed—Operational

Operational Audits—are a detailed evaluation of a service or functions control environment. A risk evaluation matrix is devised and controls are tested; risks are assessed against the risk appetite agreed with the SWAP Management Board. Where weaknesses or areas for improvement are identified, actions are agreed with management, prioritised and target dated. Based on the findings of each review, an overall Control Assurance is offered. Agreed actions are entered onto the Magique System and monitored through to completion by this Committee. Where Partial Assurance is given the relevant Service Manager should be called by the Committee to provide assurance that the risks are being managed and to see this through to satisfactory completion.

Operational Audits completed by SWAP during the Period April 2010 to March 2011, together with the Control Assurance offered, are summarised in the following table:

Audit Area	Audit Opinion	Audit Area	Audit Opinion
Asset Management Follow-Up	▲★★★★ Reasonable	Innovation Centre	▲★★★★ Reasonable
Building Control	▲★★★★ Reasonable	Financial Controls	
Careline (Piper Lifeline)	▲★★★★ Reasonable	Octagon Contracts	▲★★★★ Reasonable
Catering (Canteen Service)	▲★★★★ Reasonable	Printing and Copying	In Progress
Childcare Nursery	▲★★★★ Reasonable	Private Sector Housing Grants	▲★★★★ Reasonable
Community Safety	▲★★★★ Comprehensive	Section 106 Follow-Up	▲★★★★ Reasonable
Corporate Policy and Performance	▲★★★★ Reasonable	Streetscene	Deferred to 2011/12
Countryside (Health and Safety)	▲★★★★ Reasonable	Tourist Information Centres	Dropped—Additional work on the Innovation Centre
Housing—Choice Based Lettings	▲★★★★ Reasonable	VAT	▲★★★★ Reasonable

Summary of Work 2010/11

Continued.....

Audits Completed — Information Systems

Information Systems—IS audits are completed to provide the Authority with assurance with regards to their compliance with industry best practice. As with Operational Audits, an audit opinion is given. The following IS audits were in the plan for 2010/11:

Audit Area	Audit Opinion
IT Corporate Back-Up Routines	▲★★★ Reasonable
IT Network Security— Firewall Change Management	▲★★★ Reasonable
IT Threat Protection	▲★★★ Reasonable
IT South West Information Security Group	Non-Opinion

The Corporate Backup Routines review aims to ensure that the Council is taking adequate precautions to ensure that data is available for recovery should the worst happen to the data centre or Council offices. Overall the function appeared well controlled with only 2 recommendations resulting from the review.

Firewall Change Management was interested in how the Council controls access to its network through the use of firewalls and how changes to these devices was restricted and monitored. Reasonable assurance was awarded as only 4 medium priority actions were recommended but this must be viewed in the context of the low volume of transactions combined with the immaturity of the existing procedures. It is likely that this area will be re-visited in 12 months time.

Threat protection is a review into how the Council ensures that its servers and systems remain virus free. Once again systems were found to be well controlled with only a single medium priority risk and 2 low risks being identified.

Summary of Work 2010/11

Continued.....

Audits Completed—Key Controls

Key Control Audits — The Key Control Audit process focuses primarily on key risks relating to the Council’s major financial systems. It is essential that all key controls identified by the External Auditors are operating effectively to provide management with the necessary assurance. The findings from these reviews are considered by the External Auditors when they assess the Council’s Financial Statements at year end.

Key Control Audits completed by SWAP during the period April 2010 to March 2011 and previously reported to Committee are as follows:

Audit Area	Opinion
Capital Accounting	▲★★★★ Comprehensive
Council Tax	▲★★★★ Reasonable
Creditors	▲★★★★ Comprehensive
Debtors	▲★★★★ Reasonable
Housing Benefits	▲★★★★ Comprehensive
Main Accounting and Budgetary Control	▲★★★★ Comprehensive
NNDR	▲★★★★ Reasonable
Payroll	▲★★★★ Reasonable
Treasury Management	▲★★★★ Comprehensive

In all there were only 6 actions resulting from these reviews of which only 1 was a level 4 Service priority action. These have been assigned to responsible officers and target dates for completion have been agreed. It is likely that the External Auditors will focus on these findings when they carry out their work to sign off the Council’s Accounts.

Summary of Work 2010/11

Continued.....

Audits Completed—Key Controls, Main Income Streams

These other Key Control Audits have been performed as South Somerset consider these Services to have a significant impact on the Councils ability to meet its overall budget. These are areas of high and in many cases volatile income streams where poor internal controls could result in material losses.

Key Control Audits– Main Income Streams completed by SWAP during the period April 2010 to March 2011 and previously reported to Committee are as follows:

Audit Area	Opinion
Car Parks Follow-Up	▲☆☆☆ Partial
Goldenstone's	▲☆☆☆ Reasonable
Homelessness	▲☆☆☆ Reasonable
Licensing Follow-Up	▲☆☆☆ Reasonable
Octagon Theatre	▲☆☆☆ Reasonable
Yeovil Recreation Centre	▲☆☆☆ Reasonable

In all there were 47 actions resulting from these reviews which have been assigned to responsible officers and target dates for completion have been agreed. Only 3 actions were Service level 4 priority and there were no significant Corporate risks identified through these 6 reviews.

Details of audits with only partial assurance are provided in Appendix C.

Summary of Work 2010/11

Continued.....

Audits Completed — Governance and Fraud

Governance and Fraud Reviews — The Governance, Fraud and Corruption Audit process focuses primarily on key risks relating to cross cutting areas that are controlled and/or impact at a Corporate rather than Service specific level. It also provides an annual assurance review of areas of the Council that are inherently higher risk

The following 11 reviews of this type were completed:

Audit Area	Opinion
Business Continuity (Major Partnerships and Contractors)	▲☆☆☆ Reasonable
Data Quality - Performance Indicators	▲☆☆☆ Reasonable
Equalities and Diversity - Impact Assessments	▲★★★★ Comprehensive
Fees and Charges	▲☆☆☆ Reasonable
Health and Safety - Internal Awareness and Training	▲☆☆☆ Reasonable
Income Collection (Analytical Review including Budgets and Methods of Payment)	▲☆☆☆ Reasonable
Performance - NI179 Efficiency Statements	▲★★★★ Comprehensive
Performance - NI188 Use of Natural Resources	▲★★★★ Comprehensive
Risk Management (Risk Registers including Major Projects)	▲★☆☆ Partial
Register of Interests - Members	▲★★★★ Comprehensive
Register of Interests - Staff	▲★☆☆ Partial

These reviews resulted in 23 improvement to Internal Control, however, only 1 was Service priority level 4 and there were no significant Corporate risks identified. Details of audits with only partial assurance are provided in Appendix C.

Summary of Work 2010/11

Continued.....

Audits Completed — Special Reviews

Special Reviews — Occasionally, when Management identify a potential area of weakness or an unexpected problem arises in a service area, Internal Audit are requested to undertake a review to provide advice and, if appropriate, recommendations for improvement. Where this process is followed, it is likely that the review will not have an audit opinion. In some cases it has been necessary to defer planned reviews in order to complete these special reviews, but wherever possible the impact on the plan has been minimised.

The following reviews of this type were completed:

Audit Area
Air Control Industries Site and Chard Regeneration Scheme
Cemeteries and Crematoria
Innovation Centre
Whistleblowing

As with other reviews, where areas of weakness have been identified, targeted action plans have been produced and agreed.

Performance:

The Head of Internal Audit Partnership reports performance on a regular basis to the SWAP Management and Partnership Boards.

SWAP Performance

The beginning of last year saw the introduction of a second County Council into the South West Audit Partnership. SWAP now covers the two County Council's of Somerset and Dorset, the five Somerset Districts, two District Council's in Dorset, one District in Devon and one District Council in Gloucester. In addition to these 11 key partners, SWAP also provides an internal audit service to a number of subsidiary bodies, including the Somerset Waste Partnership.

With regards to the 2010/11 Annual Plan for South Somerset District Council, there were a total of 47 reviews planned. It was necessary to defer 2 of these audits. However, an additional 5 reviews (including 2 whistleblowing investigations) were conducted at the specific request of Management. In total we have undertaken 50 reviews.

Most audits have been completed to report stage with 2 drafts to be finalised and one review in progress at the time of this report. These are targeted to be finalised before the end of June 2011.

At the close of each audit review a Customer Satisfaction Questionnaire is sent out to the Service Manager or nominated officer. The aim of the questionnaires is to gauge satisfaction against timeliness, quality and professionalism. As part of the Balanced Scorecard presented to the SWAP Boards, a target of 85% is set where 75% would represent good. The latest Scorecard for the Partnership shows the current average feedback score to be 81%. For South Somerset the average feedback score was 86%.

Annual Opinion:

The Group Audit Manager is required to provide an annual opinion report to support the Annual Governance Statement.

Group Audit Manager's Opinion

Off the 50 Audits undertaken in 2010/11 there were 6 which were non-opinion. For the remaining 44 where we gave an audit opinion, we were pleased to provide the highest level 'Comprehensive Assurance' to 10, we gave 30 'Reasonable Assurance' and only 3 have been afforded a 'Partial Assurance'. There is 1 review in progress at the time of this report.

The reviews that received Partial Assurance are;

- **Risk Management - Risk Registers including Major Partnerships**
- **Register of Interests – Staff**
- **Car Parks Follow-Up**

A summary of all Significant Corporate Risks would have been attached as Appendix C, however, our audit work in 2010/11 found no issues that required us to raise such concerns with Management. This is testament to an effective internal control environment at South Somerset.

I have attached in Appendix C, extracts from the Audit Report Management Summaries which briefly explain why only Partial Assurance could be provided at the time of the audits.

As in previous years, I am encouraged by the management response and readiness to accept recommendations. All recommendations are input to the Magique system and regularly reported to this Committee and seen through to satisfactory implementation.

Annual Opinion:

Continued.....

Group Audit Manager's Opinion - Continued

It is not possible for the Annual Internal Audit Plan to cover and provide assurance on all areas of the Council's business. In order to seek assurance, the Group Manager, Finance annually seeks the assurance of Senior Managers as to the adequacy of the internal control environment for their service areas. A signed Operational Statement has been returned for each service offering assurance that necessary controls are in place and operating as intended.

As identified already, all audit recommendations are entered onto the Magique system for monitoring by Management and this Committee. This process is based on a self assessment by the service manager and where target dates are not achieved and signed off, the Committee will call the relevant service manager to account.

Over the year SWAP have found the Senior Management of South Somerset District Council to be supportive of SWAP findings and responsive to the recommendations made. In addition there is a good relationship with Management whereby they feel they can approach SWAP openly into areas where they perceive potential problems and again welcome the opportunity to take on board recommendations for improvement.

I have considered the balance of audit work and outcomes against this environment and feel able to offer 'Reasonable Assurance' that the systems of internal controls are in place and working well. I am confident that where weaknesses have been identified, management have confirmed that they have or will take the necessary action to address these findings.

Audit Framework Definitions

Control Assurance Definitions

Comprehensive	▲ ★ ★ ★	I am able to offer comprehensive assurance as the areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed.
Reasonable	▲ ★ ★ ★	I am able to offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally risks are well managed but some systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
Partial	▲ ★ ★ ★	I am able to offer Partial assurance in relation to the areas reviewed and the controls found to be in place. Some key risks are not well managed and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
None	▲ ★ ★ ★	I am not able to offer any assurance. The areas reviewed were found to be inadequately controlled. Risks are not well managed and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.

Categorisation Of Recommendations

When making recommendations to Management it is important that they know how important the recommendation is to their service. There should be a clear distinction between how we evaluate the risks identified for the service but scored at a corporate level and the priority assigned to the recommendation. No timeframes have been applied to each Priority as implementation will depend on several factors, however, the definitions imply the importance.

Priority 5: Findings that are fundamental to the integrity of the unit's business processes and require the immediate attention of management.

Priority 4: Important findings that need to be resolved by management.

Priority 3: The accuracy of records is at risk and requires attention.

Priority 2: Minor control issues have been identified which nevertheless need to be addressed.

Priority 1: Administrative errors identified that should be corrected. Simple, no-cost measures would serve to enhance an existing control.

Definitions of Risk

Risk	Reporting Implications
Low	Issues of a minor nature or best practice where some improvement can be made.
Medium	Issues which should be addressed by management in their areas of responsibility.
High	Issues that we consider need to be brought to the attention of senior management.
Very High	Issues that we consider need to be brought to the attention of both senior management and the Audit Committee.

Risk Management - Risk Registers including Major Partnerships

Although guidance and procedures are in place, particularly for the management of service risks, the approach to documenting the risks of major projects was found to be inconsistent and there was a lack of evidence that all the project sponsors were monitoring projects after funding had been approved.

It appears that Managers have been anticipating the implementation of TEN and have as a result seen the updating of Magique as a low priority. There is also evidence that some services use Magique more than others.

Reporting to Senior Management on significant risks has ceased since the Council restructured but this needs to be brought back on schedule. The Procurement & Risk Manager has agreed that the implementation of the system will provide an ideal opportunity to address the issues around the regularity of system updates by managers, through training and guidance.

Register of Interests – Staff

South Somerset District Council have demonstrated their compliance with the Local Government Act through the guidance given in the Staff Code of Conduct. They also have a robust procedure for dealing with any complaints.

Unfortunately despite these controls, there is a lack of uniform good practice across the Council at present and we cannot give reasonable assurance as it is likely that some staff have not declared interests which could have an impact if they were found to be undertaking other duties that conflict with their Council duties.

By implementing the recommendations made in this report, reasonable or comprehensive assurance can be given.

Car Parks Follow-Up

The 2010 report highlighted a number of control weaknesses, the results of this follow up review shows that only 5 of the 11 agreed actions had been put in place and were being consistently followed. Some improvements have been made by the Engineering and Property Services Manager however I am disappointed that two agreed actions have still not been implemented:

- Quarterly inspections – this has been recognised as a problem each year and it is not an area that should be missed, improvements to collating and monitoring information has been developed and should be introduced from January 2011
- Missed collections from ticket machines are refunded by Loomis – missed collections should be identified within 90 days and a request for a credit note made by the Engineering and Property Services Manager however this is not carried out regularly and checked to ensure received.

Audit Committee – 23rd June 2011

7. Review of Internal Audit

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham (Finance and Corporate Services)
Lead Officer: Donna Parham, Assistant Director (Finance and Corporate Services)
Contact Details: donna.parham@southsomerset.gov.uk or 01935 462225

Purpose of the Report

To inform the Audit Committee of the recent review of the effectiveness of the delivery of Internal Audit through SWAP (South West Audit Partnership) during 2010-11.

Recommendations

That the Audit Committee notes the findings of the review.

Background

The South West Audit Partnership (SWAP) is a partnership that provides the Internal Audit service to all of the six Somerset authorities, Dorset County Council, Weymouth and Portland Borough Council, West Dorset District Council, Forest of Dean District Council, and East Devon District Council as well as a number of related bodies such as the Somerset Waste Partnership.

Internal audit forms a part of the corporate governance and internal control framework that provides accountability to stakeholders on all areas of the corporate plan. Their opinion on the adequacy and effectiveness of the Council's internal control framework forms a part of the evidence used in preparing the corporate Annual Governance Statement (AGS) for 2010-11, which will be published as part of the Council's Statement of Accounts in September 2011.

There is a requirement under Regulation 6 of the Accounts and Audit (Amendment) (England) Regulations 2006 for authorities to review the effectiveness of their system of internal audit once a year and for the findings of the review to be considered by a committee such as the Audit Committee as a part of the consideration of the system of internal control. This review has to be carried out by someone independent of SWAP.

Compliance with CIPFA Code

The 2006 CIPFA Code of Practice for Internal Audit sets out how an internal audit function should be fulfilled. The main focus is the internal audit service itself, but the Code does also refer to the wider elements of the "system of internal audit", including the role of an audit committee. The Code covers:

- scope and terms of reference of internal audit;
- independence;
- ethics and competence;
- audit committees;
- relationships;
- staffing;
- audit strategy and planning;
- how audit work is undertaken;
- due professional care;
- reporting;
- performance, quality and effectiveness.

All aspects of the Code are signed up to by SWAP through the Audit Charter, reviewed and approved by the Audit Committee on an annual basis.

The Review of SWAP

South Somerset District Council's review of Internal Audit has been carried out by the Assistant Director – Finance and Corporate Services (the Council's S151 Officer). The findings have been reported to the Corporate Governance Group as part of the overall evaluation and supporting evidence for the Annual Governance Statement. It was found that overall the team performed well and that this view was supported by the comments of external auditors and client satisfaction. The table below shows some of the overall performance of the service during the year compared to the two previous years:

Performance Measure	2007/08	2008/09	2009/10	2010/11
Levels of satisfaction from feedback questionnaires	80.0%	83.4%	84.39%	86.25%
Audits and reviews completed in year compared to the plan (all at least at final draft stage)	84% (16 out of 19)	87.5% (21 out of 24)	83% (30 out of 36)	105% (39 out of 37)
Managed audits completed in year compared to plan	100% (8 out of 8)	100% (8 out of 8)	100% (9 of 9)	100% (10 out of 10)
Total completed audits and reviews	24	29	39	49 (1 in progress)
Cost of audit service to SSDC	£165,980	£154,310	£156,500	£156,500
Number of actions for improvements agreed by managers	246	175	181	170
Value for Money – average cost of audit day compared to private sector (benchmarking)	No PS data available.	No PS data available.	SWAP = £280 Private Sector = £320	SWAP = £280 Private Sector = £320
SWAP outturn on spend compared to budget – (brackets indicate net income)	Budget £(27,670) Actual £(47,819)	Budget £(31,640) Actual £(11,763)	Budget £0 Actual £(76,117)	Budget £(48,943) Actual £(142,928)

1. The table shows the satisfaction with the audits carried out at SSDC at 86.25%.
2. The number of audits is more than double the number carried out in 2007/08 whilst SSDC has been able to reduce the overall number of audit days it pays for.
3. The number of actions for improvements has decreased in relation to the number of audits carried out for the year. So in 2007/08 an average of 10 improvements per audit were made but in 2011/12 this has reduced to just 3 recommendations. This is in part due to the “call in” procedure from Audit Committee but also shows that the authority has improved in relation to its management of risks and controls. It also reflects the continued quality of SWAP working with managers to bring forward improvements.

4. The outturn position shows that each year the partnership continues to make a net profit from operations. All net income is returned to a reserve specifically set up for SWAP. This enables the partnership to finance once off items such as improvements to ICT.

Service Standards

In assessing SWAP's performance it is important to review the standards of service and that each authority is afforded the same standards and also senior officer time. The following table outlines the minimum standards to be introduced and whether they would have been delivered for South Somerset District Council had they been in place:

Service Standard	Expected Standard	Delivery of Standard
Attendance by Head of SWAP/ Group Audit Manager at Audit Committee.	At least 2 times per annum	4 times in 2010/11
Attendance by Audit Manager at Audit Committee	At least 2 times per annum	3 times in 2010/11
Attendance by Head of SWAP at Corporate Governance Group	4 times per annum	3 times (note only three meetings held)
Liaison meetings with S151 Officer by Head of SWAP/Group Audit Manager	4 times per annum	4 times
Liaison meetings with S151 Officer and Audit Manager	6 times per annum	4 times but now set up on a six weekly basis
Agreement of Audit Plan:		
Prepared for Management Board/S151	By mid January each year	Delivered
Prepared for Audit Committee	By end January each year	Prepared by end January and presented to Audit Committee February 2011 meeting.
Audit Plan monitoring reports	4 times per annum including Annual Report	4 times per annum
Agreement of Audit Charter:		
Prepared for Management Board/S151	By mid January each year	Delivered
Prepared for Audit Committee	By end January each year	Prepared by end of January and presented to Audit Committee in February 2011
To assist with member/officer training in audit and governance	Once per annum	Not required in 2010/11

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2010/11 Action Plan

The following shows progress *in italics* against the actions to be completed in 2010/11:

- SWAP should maintain a register of when the Audit Charter was approved with each partner body. This should include the date of the meeting, a copy of the Charter approved and a copy of the minute approving the Charter;

This recommendation was implemented immediately. A spreadsheet register is now maintained.

- New members of staff should not be allowed to work on audit areas of Partner organisations for a minimum of one year after joining SWAP;

Our previous policy was 6 months, but we have now amended it to one year.

- SWAP auditors should not act in operational duties for Partner organisations;

This referred specifically to two SWAP officers who acted as Data Protection officers and/or Freedom of Information contact. In respect of SSDC, this no longer applies.

- An audit protocol should be prepared jointly with other internal audit bodies with whom they wish to share information;

In Somerset SWAP has a protocol with the Audit Commission, the only major external organisation it engages with in respect of SSDC.

- Agreement of a timetable to complete the skills and competencies matrix is required. The periodic update and evidence of this review should be incorporated into the Staff Development and Review process.

This has been implemented.

- A monitoring process should be set up to ensure SWAP staff fulfil their continuous personal development (CPD) requirements as part of their formal appraisal process.

This has been incorporated into the staff development process. SWAP has a designated professional training officer responsible for monitoring this area.

- A formalised written access and retention policy should be included in the Audit Manual;

SWAP now has a formal document access and retention policy.

- Evidence to support the periodic review and updating of the Audit Manual should be retained;

SWAP admin maintain a register of all key policies and documents, including the audit manual, which includes revision dates. This is frequently monitored.

- SWAP should implement an independent quality assurance framework to review and report on the quality of the audit files.

This has yet to be achieved, although we are actively seeking suitably qualified organisations that could carry out this review on a reciprocal basis. Bringing in an external, qualified, assessor otherwise would be prohibitively expensive. In the meantime, SWAP is implementing a self-assessment exercise.

Opinion

It is the opinion of the Assistant Director – Finance and Corporate Services and the Corporate Governance Group that the system of internal audit is effective.

Actions to be Completed in 2011/12

SSDC requested that the Devon Audit Partnership review the annual return and control environment as part of the assurance framework for the statement of accounts (Letter attached at pages 24-25). In addition to this the Management Board has also reviewed the effectiveness and the following actions are recommended for 2011/12:

- To fully implement the Standards of Service outlined and monitor delivery for each partner.
- To review the governance arrangements of the Partnership.

Financial Implications

The actions outlined can be achieved within budget.

Background Papers: None.



DEVON AUDIT PARTNERSHIP

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EX2 4QJ

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www.devon.gov.uk

Date: 2nd June 2011

When calling or telephoning please ask for: Martin Gould

My Ref: MG/DAP/SWAPAUDIT

Your Ref: DP/DH

Dear Donna

Internal Audit report for the South West Audit Partnership 2010/11

I can confirm that I have now completed my internal audit of the accounting arrangements for the South West Audit Partnership (SWAP) for the year ended 31st March 2011. I am pleased to report that my audit did not find any areas of concern and I am confident that the processes in place are adequate to support the figures contained within the Statement of Accounts for SWAP.

The purpose of my audit was to review the systems of financial and other controls over the Partnership activities and to provide an opinion as to whether the operating procedures are working effectively and satisfactorily. My work was undertaken in accordance with the Code of practice for the Internal Audit of local authorities in the United Kingdom as issued by CIPFA in 2006.

As part of the audit work I undertook an assessment of compliance with relevant procedures and controls and my findings are based on the areas examined and appropriate sample checking. I have also completed Section 4 of the Annual return for Small Bodies in England for the year ended 31 March 2011.

Key Findings

All financial transactions relating to SWAP are recorded using the CEDAR Financial Information Management System operated by South Somerset District Council (SSDC) who provide the accounting service for SWAP.

Orders are raised via the FIMS ordering module by the Admin staff and authorised on line by a member of SWAP's senior management team. Goods are receipted via the system and matched to the service/goods provided. Invoices are received and certified by the SWAP Admin staff and authorised by the Head of SWAP or one of the SWAP senior management team. Most invoices are input directly by SWAP, others are forwarded to SSDC for input.

A number of SWAP staff have purchase cards and statements are checked and reviewed by the admin staff and authorised by one of the senior management team. A review of a sample of Purchase card payments confirmed that good systems of control were in place and purchases coded correctly.

Invoices are raised via the FIMS system and all income receipted and recorded on the system.

Payroll transactions are managed through SSDC and feed into FIMS on a monthly basis. A salary monitor spreadsheet is used to monitor payroll costs and identify any variances from budget. In addition monthly reports from the payroll system are provided to the Head of SWAP to allow verification and identify any variances.

Regular bank reconciliations are performed for the SSDC accounts which include the balances for SWAP. Monthly budget monitoring reports are produced to ensure transactions are accurately recorded and any variances investigated and resolved.

From a review of the FIMS system reports, sample checking of invoices and payments, and a review of the supporting spreadsheets for the final accounts, my view is that the internal control framework is satisfactory and that the accounts fairly represent the transactions of SWAP for the 2010/11 financial year. Satisfactory processes are in place to ensure all transactions have been accurately captured.

The Partnership has maintained a strategic risk register for a number of years, and the register is reviewed and updated on an annual basis and a report taken to the Partnership Committee in January each year. This identifies key strategic risks, current mitigating control measures and responsibility for managing those risks.

I am satisfied therefore that the control objectives identified in Section 4 of the Annual return for Small Bodies in England for the year ended 31 March 2011 are being achieved in all significant respects throughout the financial year to a standard adequate to meet the needs of SWAP.

Yours sincerely

MW Gould

Martin Gould BSc CPFA

Head of Devon Audit Partnership

8. 2010/11 Annual Governance Statement

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham (Finance and Corporate Services)
Lead Officer: Donna Parham, Assistant Director (Finance and Corporate Services)
Contact Details: donna.parham@southsomerset.gov.uk or 01935 462225

Purpose of the Report

This report has been prepared for the Audit Committee to approve the Annual Governance Statement (AGS) for 2010/11.

Recommendation

To approve the 2010/11 Annual Governance Statement (attached at pages 28-34).

Background

As a local authority SSDC is required to demonstrate compliance with the underlying principles of good governance and that a framework exists to demonstrate this. One of the Council's requirements in demonstrating this is to produce an Annual Governance Statement (AGS).

The Chartered Institute of Public Finance and Accountancy (CIPFA) provides guidance on the processes for the establishment, operation and review of the system of internal control. Their guidance also provides help on the format and content of the AGS.

Annual Governance Statement

Regulation 4, of the Accounts and Audit Regulations includes a requirement to publish an Annual Governance Statement (AGS). Previously local authorities were required to include a Statement of Internal Control (SIC) with their statement of accounts. The regulations now require authorities to carry out a review of the effectiveness of their system of **internal control** and may include an Annual Governance Statement in the annual accounts. This is to provide assurance that SSDC has a sound internal control framework in place to manage the risks that might prevent achievement of its statutory obligations and organisational objectives.

The statement also reflects the compliance with the "Statement on the Role of the Chief Finance Officer in Local Government (2010)." This is evidenced within the Annual Governance Statement where the authority meets with best practice.

The Annual Governance Statement will continue to be signed by the Leader of the Council, the Chief Executive, and the Section 151 Officer. The framework used for this review is attached at Appendix A (page 34).

In July 2010 the Audit Committee approved a revised Local Code of Corporate Governance. This updated the Council's code to reflect best practice. In producing the Annual Governance Statement reports from the Audit Commission, South West Audit Partnership, a review of the effectiveness of internal audit, the annual review of the Group Auditor, and a review of all Statements of Operational Service Internal Controls have been undertaken. The review has been completed by the Corporate Governance Group (the Chief Executive, Monitoring Officer, and S151 Officer). There are no significant issues to be addressed and a number of actions are planned to further

strengthen the control framework. The actions will be monitored and reviewed by the Audit Committee in 2011/12.

Financial Implications

There are no financial implications associated with these recommendations.

Background Papers: *Annual Governance Statement 2009/10*
Local Code of Corporate Governance

ANNUAL GOVERNANCE STATEMENT

Part 1 – Scope of responsibility

SSDC is responsible for ensuring that:

- its business is conducted in accordance with the law and proper standards;
- public money is safeguarded and properly accounted for;
- public money is used economically, efficiently and effectively.
- there is a sound system of governance incorporating the system of internal control.

SSDC also has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

In discharging this overall responsibility, SSDC is responsible for putting in place proper arrangements for the governance of its affairs, facilitating the effective exercise of its functions, and which includes arrangements for the management of risk.

SSDC has approved and adopted a code of corporate governance, which is consistent with the principles of the CIPFA/SOLACE Framework “*Delivering Good Governance in Local Government*”. A copy of the code can be obtained on request. This statement explains how SSDC has complied with the code and also meets the requirements of regulation 4(2) of the Accounts and Audit Regulations 2003 as amended by the Accounts and Audit (Amendment) (England) Regulations 2006 in relation to the publication of a statement on annual governance.

In addition to this CIPFA has issued its “*Statement on the Role of the Chief Financial Officer in Local Government (2010.)*” The Annual Governance Statement should therefore reflect compliance of the statement for reporting purposes.

Part 2 – The purpose of the governance framework

The governance framework comprises the systems and process, and culture and values, by which the authority is directed and controlled and its activities through which it accounts to, engages with and leads the community. It enables the authority to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost-effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process that is designed to:

- identify the risks and prioritise the actions to achieving policies, aims and objectives;
- evaluate the likelihood of those risks occurring;

- assessing the impact should those risks occur;
- managing the risks efficiently, effectively and economically.

The governance framework has been in place at SSDC for the year ended 31 March 2011 and up to the date of approval of the annual report and statement of accounts.

Part 3 – The governance environment

The key elements of SSDC's governance arrangements are outlined in the Local Code of Corporate Governance. The main areas and the key areas of evidence of delivery are as follows:

Focusing on the purpose of the authority and on outcomes for the community and creating and implementing a vision for the local area

- The Corporate Plan sets out the priority areas for South Somerset District Council and links these priorities to the Sustainable Community Strategy targets.
- The Sustainable Community Strategy has been produced through the LSP (South Somerset Together) in consultation with our partners and sets out the long-term goals for the community and the key issues that need to be addressed in the future.
- Annual accounts are published on a timely basis to communicate the council's activities and achievements, its financial position and performance
- Guidance has been produced to facilitate partnership working and a Partnership Register published and updated annually. The register has been reviewed by the Scrutiny Committee and recommendations made to the District Executive in April 2011.
- All reports to be considered for approval must show a clear outline of purpose so the community can understand each committee report. All reports must have a clear outline of financial implications before consideration by members.

Members and officers working together to achieve a common purpose with clearly defined functions and roles

- The three statutory officers (Head of Paid Service, Monitoring Officer and s151 Officer) regularly meet as a Corporate Governance Group. The Monitoring Officer and s151 Officer report directly to the Head of Paid Service and are members of the senior Management Board.
- Regular weekly meetings between the Leader and Chief Executive in order to maintain a shared understanding of roles and objectives.
- An arrangement with East Devon District Council has been entered into to share a Chief Executive through a Section 113 agreement outlining the detail of function and role.
- Protocols developed and enforced to ensure effective communication between members and officers in their respective roles.
- Portfolio Holders produced annual Portfolio Holder Statements outlining achievements for the previous year and targets for the following year.

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- There is a clear scheme of delegation for officers and members within the Constitution.
- The s151 Officer leads the promotion and delivery of good financial management through Management Board, Corporate Performance Team, attendance at committee, and specialist workshops and training. The s151 Officer has line management responsibility for finance staff.

Promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour

- The financial management of the Council is conducted in accordance with the rules set out in Part 4 of the Constitution.
- The Council maintains an Internal Audit Service through the South West Audit Partnership (SWAP) that operates to standards specified by the Institute of Internal Auditors (IIA) and the Chartered Institute of Public Finance Accountants (CIPFA).
- The self-assessment questionnaire completed on ethical governance will be used to assist in the forming of a voluntary code once the Standards Committee is abolished.
- Communication through Staff Awareness Sessions, Insite, and Team Brief.

Taking informed and transparent decisions which are subject to effective scrutiny and managing risk

- The Council has adopted a Constitution that sets out how it operates, how decisions are taken and the procedures to follow.
- The District Executive facilitates decision-making and its Sub Committees, four Area Committees and meetings are open to the public except where personal or confidential matters are disclosed.
- Portfolio Holders can make decisions under delegated authority and these are fully publicised. Senior officers can also take decisions under delegated authority.
- Regulation Committee determines planning applications that are referred from Area Committees.
- The Council publishes a Forward Plan that provides details of key decisions to be made by the Council and its committees.
- Area Committees also hold regular workshops where local issues are identified and discussed; Area Action Plans are then established to target specific needs.
- The Council has approved a Risk Management Policy that identifies how risks are managed.
- Responsible officers are required to maintain their part of the Risk Register.
- All Assistant Directors have the following included within their job descriptions, "Lead the service(s) in a full and comprehensive understanding of risk, risk assessment and risk management as it relates to the operational areas relevant to the service(s)."

- Any Internal Audit actions showing the highest risk score of 5 will be outlined annually and monitored within the Annual Governance Statement.

Developing the capacity and capability of members and officers to be effective

- The Council looks to develop skills on a continuing basis to improve performance both of officers and members through the Staff Development and Review process and the use of training and development plans.
- Succession planning encourages participation and development for members and officers.
- Comprehensive member training and development programme recognised through attainment of the “Charter for Member Development.”
- An induction programme is in place for all new staff.
- Clear job descriptions and personal specifications are in place for all roles.
- The s151 Officer and six of the finance team are qualified accountants with several years experience. The finance function has sufficient resources to perform its role effectively.

Engaging the local people and other stakeholders to ensure robust public accountability

- Area Committees ensure further local accountability and local access.
- Budget consultation has been carried out with “hard to reach” groups through Somerset Racial Equality Council.
- Stakeholder input into the Sustainable Community Strategy and Corporate Plan.
- Area action plans are in place to deliver local priorities.
- A summarised Statement of Accounts will be published explaining the key financial areas to the public.

Part 4 – Review of effectiveness

SSDC has responsibility for conducting, at least annually, a review of the effectiveness of its governance framework including the system of internal control. The review of effectiveness is informed by the work of SWAP, the Corporate Governance Group, Management Board and the Corporate Performance Team, who have responsibility for the development and maintenance of the governance environment.

The process that has been applied to maintaining and reviewing the effectiveness of the governance framework includes:

- The monitoring officer has a duty to monitor and review the operation of the Constitution to ensure its aims and principles are adequate. The Council reviews the constitution annually through its Standards Committee.
- The Council has an Overview and Scrutiny Committee that can call in any decision made by an Executive Committee before implementation. This enables them to

consider whether or not the decision is appropriate. Pre-decision scrutiny has evolved to aid in the decision making process.

- The Audit Committee reviews the Annual Statement of Accounts, the Review of the Effectiveness of Internal Audit, and the Annual Governance Statement. It monitors the performance of internal audit quarterly and agrees the Internal and External Audit Plans. It reviews specific parts of the Constitution and makes recommendations on any amendments to full Council. It also has a call in role for any service that receives a “partial” or “no assurance” audit opinion and monitors the action plans are completed through regular reports from the Service Manager and Assistant Director.
- Internal Audit through SWAP is responsible for monitoring the quality and effectiveness of systems of internal control. The Audit Service has a Charter approved by the Council and there are no restrictions on the scope of their work. A risk model is used to formulate the plan and approved by the Audit Committee. The reporting process for Internal Audit requires a report of each audit to be submitted to the Service Manager with copies to the relevant Assistant Director, Assistant Director – Finance and Corporate Services, Assistant Director - Legal and Corporate Services, and Chief Executive. All audit reports include an ‘opinion’ that provides management with an independent judgement on the adequacy and effectiveness of internal controls. Reports include recommendations for improvement that are detailed in an action plan that is agreed with the service manager.
- Internal Audit (SWAP) is subject to regular inspection by the Council’s external auditors who place reliance on the work carried out by Internal Audit.
- For performance management, a ‘traffic light’ monitoring and reporting system is in place reporting quarterly to the Executive Committee.
- The Council’s Financial Procedure Rules are kept under continuous review and revised periodically – the last review was approved in April 2011.
- Each Manager, Assistant Director, and Director is required to review their adherence to the governance framework and demonstrate compliance through reviewing and signing a Statement of Internal Operational Control. Each return is assessed by the Group Auditor and S151 Officer for compliance and any apparent organisational improvements are included in the Governance Action Plan.
- Audit Committee has been advised on the implications of the result of the review of the effectiveness of the governance framework and a plan to address weaknesses and ensure continuous improvement of the system is in place.

In its review the Authority has assessed its overall governance arrangements as reasonable. This has been assessed through a review of SSDC’s governance arrangements as outlined in the diagram at Appendix A.

Part 5 – Significant governance issues

A number of actions are planned to strengthen the control framework and will be monitored by the Audit Committee during 2011/12:

- The framework put in place for **S106 contributions** is complete but it will be monitored in 2011/12 for effectiveness;

- Provide further training for staff on **Information Technology Policies** to ensure all staff are aware and comply with the policies;
- Introduce training and awareness refreshers for the **Corporate Performance Team** on **Risk, Local Code of Corporate Governance, Staff Appraisals**, and best practice in **Service Planning**;
- To consider and introduce/incorporate a policy and training where necessary for staff and elected members on the **Bribery Act 2010**.
- To introduce a **Voluntary Code of Conduct** for elected members following the abolition of the Standards Committee
- Complete the **Fraud and Data Strategy** to link all anti-fraud work.

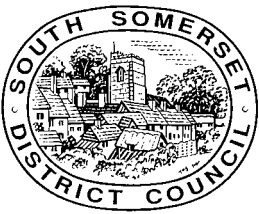
The Authority is satisfied that these steps will address the issues highlighted in 2010/11 and further improve governance arrangements at SSDC.

Signed on behalf of SSDC:

Donna Parham
Assistant Director – Finance and Corporate Services

Mark Williams
Chief Executive

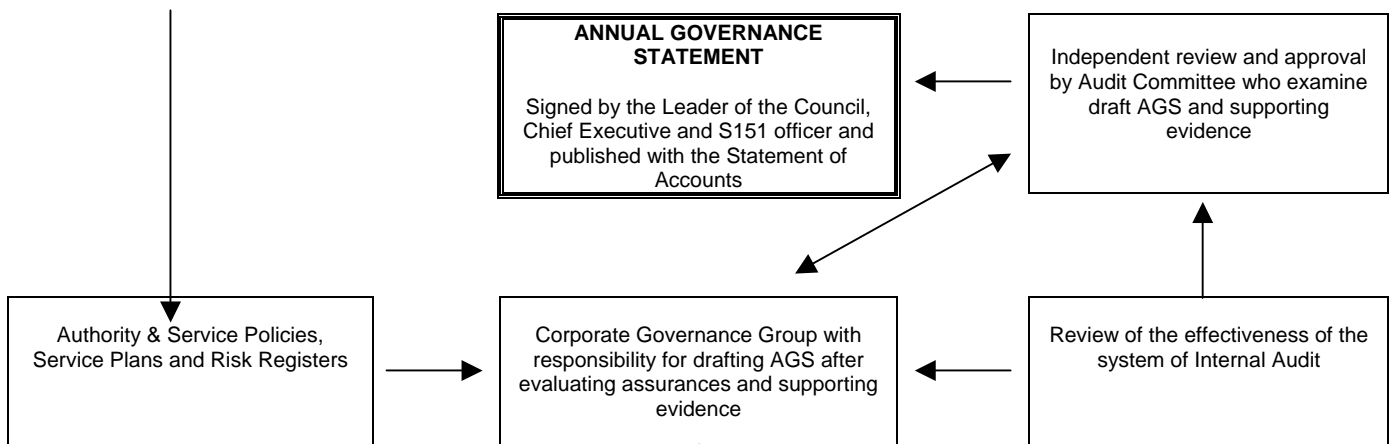
Cllr Ric Pallister
Leader



SSDC'S ANNUAL GOVERNANCE STATEMENT FRAMEWORK

Governance Framework – Key Documents/Functions

- o Constitution
- o Corporate Plan
- o Sustainable Community Strategy
- o Service Planning Framework
- o Business Transformation Projects
- o Access Strategy
- o Communication Strategy
- o Performance Management Framework
- o Schedule of Council Meetings
- o Local Code of Corporate Governance
- o Record of Decisions
- o Partnership Register
- o Code of Conduct for Members
- o Members Induction & Training Programme
- o Code of Conduct for Employees
- o Officer and Member Protocols
- o Confidential Reporting Policy
- o Risk Management Strategy
- o Anti-Fraud & Corruption Policy
- o Whistleblowing Policy
- o Anti Money Laundering Policy
- o Project Management Methodology
- o Capital Strategy
- o Procurement Strategy
- o Medium Term Financial Plan/Strategy
- o Treasury Management Strategy Statement, MRP Strategy, and Annual Investment Strategy
- o Annual Statement of Accounts
- o Financial Procedure Rules
- o Procurement Procedure Rules
- o Scheme of Delegation
- o Complaints Procedure
- o Equalities Plan



Performance Management	Risk Management	Information Governance	Legal and Regulatory Assurance	Members' Assurance
<ul style="list-style-type: none"> • Embedded system • Operates throughout the organisation • Internal and external reviews • Action orientated • National/Local PI/NI's • Periodic progress reports 	<ul style="list-style-type: none"> • Risk management strategy • Embedded in planning processes and project/partnership methodologies • Effectiveness evaluated • Outcomes reported to committee • Training programme 	<ul style="list-style-type: none"> • Training programme • Outcomes reported to committee 	<ul style="list-style-type: none"> • Monitoring Officer's reports • Sections of committee reports • Legal advice 	<ul style="list-style-type: none"> • Standards committee • Audit committee • Scrutiny function
Assurances by Directors/ Heads of Service	Other Sources of Assurance (including third party)	Financial Management	Internal Audit	External Audit
<ul style="list-style-type: none"> • Periodic reports • Statement of operational service internal control 	<ul style="list-style-type: none"> • Reports by inspectors • Service review reports • Fraud reports and investigations • Ombudsman reports • Post implementation reviews of projects 	<ul style="list-style-type: none"> • Medium Term Financial Plan • Revenue Budget and Capital Programme • Revenue and Capital Management reports • Treasury management • Statement of accounts • Compliance with codes of accounting practice • Statutory returns • Grant claims 	<ul style="list-style-type: none"> • Operates under approved terms of reference • Approved risk-based plans • Periodic and annual reports to Audit Committee, Group Auditor Opinion • CIPFA code compliance assessment 	<ul style="list-style-type: none"> • Annual Plan • Annual Governance Report • Annual Audit Letter • Audit Opinion and VFM conclusion

Ongoing assurance on adequacy and effectiveness of control over key risks

Audit Committee – 23rd June 2011

9. Audit Committee Terms of Reference

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham (Finance and Corporate Services)
Lead Officer: Donna Parham, Assistant Director (Finance and Corporate Services)
Contact Details: donna.parham@southsomerset.gov.uk or 01935 462225

Purpose of the Report

This report reviews the current Terms of Reference of the Audit Committee to ensure that its current and future role is clear.

Recommendation

The Audit Committee is asked to recommend the amended Terms of Reference (attached at pages 36-37) to Council.

Report

The Terms of Reference of the Audit Committee were reviewed in April 2011 with members of the committee requesting some further amendments. These amendments have now been incorporated and are attached.

Financial Implications

There are no financial implications in amending the Terms of Reference.

Background Papers: None.

AC

Audit Committee – Terms of Reference

The purpose of the Audit Committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority's financial and non-financial performance, to the extent that it affects the authority's exposure to risk and weakens the control environment and to oversee the financial reporting process.

The Audit Committee should review the Code of Corporate Governance seeking assurance where appropriate from the Executive or referring matters to management on the scrutiny function.

The terms of reference of the Audit Committee are:

Internal Audit Activity

1. To approve the Internal Audit Charter and annual Internal Audit Plan;
2. To receive quarterly summaries of Internal Audit reports and seek assurance from management that action has been taken;
3. To receive an annual summary report and opinion, and consider the level of assurance it provides on the council's governance arrangements;
4. To monitor the action plans for Internal Audit reports assessed as "partial" or "no assurance;"
5. To consider specific internal audit reports as requested by the Head of Internal Audit, and monitor the implementation of agreed management actions;
6. To receive an annual report to review the effectiveness of internal audit to ensure compliance with statutory requirements and the level of assurance it provides on the council's governance arrangements;

External Audit Activity

7. To consider and note the annual external Audit Plan and Fees;
8. To consider the reports of external audit including the Annual Audit Letter and seek assurance from management that action has been taken;

Regulatory Framework

9. To consider the effectiveness of SSDC's risk management arrangements, the control environment and associated anti-fraud and corruption arrangements and seek assurance from management that action is being taken;
10. To review the Annual Governance Statement (AGS) and monitor associated action plans;
11. To review the Local Code of Corporate Governance and ensure it reflects best governance practice. This will include regular reviews of part of the Council's Constitution and an overview of risk management;
12. To receive reports from management on the promotion of good corporate governance;

Financial Management and Accounts

13. To review and approve the annual Statement of Accounts, external auditor's opinion and reports to members and monitor management action in response to issues raised;
14. To provide a scrutiny role in Treasury Management matters including regular monitoring of treasury activity and practices. The committee will also review and recommend the Annual Treasury Management Strategy Statement and Investment Strategy, MRP Strategy, and Prudential Indicators to Council;
15. To review and recommend to Council changes to Financial Procedure Rules and Procurement Procedure Rules;

Overall Governance

16. The Audit Committee can request of the Assistant Director – Finance and Corporate Services (S151 Officer), the Assistant Director – Legal and Corporate Services (the Monitoring Officer), or the Chief Executive (Head of Paid Services) a report (including an independent review) on any matter covered within these Terms of Reference;
17. The Audit Committee will request action through District Executive if any issue remains unresolved;
18. The Audit Committee will report to each full Council a summary of its activities.

Meetings of the Audit Committee are held monthly including at least one meeting with the Council's external auditor.

10. Future of Local Public Audit - Consultation

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham (Finance and Corporate Services)
Lead Officer: Donna Parham, Assistant Director (Finance & Corporate Services)
Contact Details: donna.parham@southsomerset.gov.uk or 01935 462225

Purpose of the Report

This report requests that members of the Audit Committee approve the response to the consultation paper from the Department of Communities and Local Government (DCLG) regarding the future of public audit.

Recommendations

The Audit Committee is asked to approve the attached response (pages 39-45) to the consultation paper.

Introduction

The DCLG announced some time ago that the Audit Commission would in effect be disbanded and removed by April 2012. The inspection regime around Comprehensive Area Assessment and Use of Resources has already been removed but the Commission still provides an assurance framework around the Statement of Accounts, an opinion on Value for Money, a view around the financial resilience of an organisation, grant certification, the Whole of Government Accounts, and the National Fraud Initiative. Last month the DCLG launched its 65-page consultation report with 50 questions regarding the future arrangements for external audit but these include some major changes for local authority Audit Committees.

The Consultation Paper

The consultation paper was initially considered by this committee in April 2011 and the draft response is attached at pages 39-45 taking into account the comments made by the Audit Committee at that meeting.

The deadline for responses is the 30th June 2011.

A copy of the consultation paper is attached as Appendix 2 at the back of this agenda.

Financial Implications

There are no financial implications in responding to this consultation paper.

Background Papers: *Department for Communities & Local Government Consultation Document – Future of Local Public Audit*

Draft Response to DCLG Consultation Paper regarding the future of Local Public Audit

South Somerset District Council welcomes the consultation in terms of the ability in future to appoint our own auditors and to be able to work with our partners in procuring an efficient and cost effective service.

Attached are the updated and currently draft Terms of Reference for South Somerset's Audit Committee. As you can see the Audit Committee has a wider remit than just dealing with external audit for example it has a wider remit in the scrutiny of treasury management. The consultation paper does not take into account the championing role in good governance and risk management that most Audit Committees currently have. The Audit Committee has been instrumental in embedding the improvement and adherence to these important areas for both officers and members. As elected members they also understand the objectives of a local authority in the provision of local services and the equality and diversity of the residents they serve.

Although the consultation outlines that there will be further proposals for grant certification, Whole of Government Accounts, and NFI it would be onerous for local authorities to have these managed through various other means. The management of these areas also currently enables the Audit Commission to take these areas into account when they are preparing the Annual Audit Letter for local authorities. They also produce a report for Audit Committees on grant certification. The Audit Commission also play a part in the combating of fraud through NFI and also alerting authorities and collecting the data on fraud across the country. We would suggest that NFI be moved to the National Audit Office so that there is a national role in combating fraud with grant certification and WGA's approved by the externally appointed auditors.

The Audit Committee has considered the questions asked and I have outlined below their response:

1. Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?

A – The design principles need to include good governance and include more of the best practice within current Audit Committees

2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?

A - No comment

3. Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?

A - yes

4. Do you agree that we should replicate the system for approving and controlling statutory auditors under the Companies Act 2006 for statutory local public auditors?

A - yes

5. Who should be responsible for maintaining and reviewing the register of statutory local public auditors?

AC

A – National Audit Office

6. How can we ensure that the right balance is 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?

A - Suggest a framework agreement where firms are assessed centrally (perhaps through the National Audit Office) to ensure a consistent standard and then Local Authorities can appoint from the list.

7. What additional criteria are required to ensure that auditors have the necessary experience to be able to undertake a robust audit of a local public body, without restricting the market?

A - none

8. What should constitute a public interest entity (i.e. a body for which audits are directly monitored by the overall regulator) for the purposes of local audit regulation? How should these be defined?

A – same as is used now

9. There is an argument that by their very nature all local public bodies could be categorised as ‘public interest entities.’ Does the overall regulator need to undertake any additional regulation or monitoring of these bodies? If so, should these bodies be categorised by the key services they perform, or by their income or expenditure? If the latter, what should the threshold be?

A - No

10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?

A- duties in para 2.22 of the consultation paper.

11. Do you think the arrangements we set out are sufficiently flexible to allow councils to cooperate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?

A – the method outlined involving each Audit Committee and each full Council would make this very difficult. An example would be if all authorities within the South West Audit Partnership were to appoint the same external audit we would have to find agreement within 11 Audit Committees and 11 Councils – this would involve around 550 councillors and possibly up to 50 independent members. It would be much better to follow a normal joint procurement process.

12. Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?

A – difficult to identify the criteria without outlining the full responsibilities of the role. It is too long a time period of five years to exclude previous officers and members – two years would be more than sufficient. You also need to clarify what is meant by “recent and relevant financial experience” for elected members.

13. How do we balance the requirements for independence with the need for skills and experience of independent members? Is it necessary for independent members to have financial expertise?

A - concerned that having a majority of independent members destroys some of the role of the Audit Committee in championing the audit/governance/risk role within the authority. It should be outlined that it is useful but not necessary to have relevant financial experience.

14. Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?

A – yes we already find it difficult to source suitable independent members for our Standards Committee. We have also tried to co-opt an independent member to the Audit Committee in the past with no success. It does seem odd that the public elect members to represent them but then decisions are made by non elected independent members. Remuneration would be expected by those independent members – currently the independent Chair of Standards receives £2,800 and independent members of the Standards Committee receive £400 per annum.

15. Do you think that our proposals for audit committees provide the necessary safeguards to ensure the independence of the auditor appointment? If so, which of the options described in paragraph 3.9 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?

A - the auditor appointment should be a simple procurement under a framework agreement, The approach outlined is not needed.

16. Which option do you consider would strike the best balance between a localist approach and a robust role for the audit committee in ensuring independence of the auditor?

A – as 15. above

17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?

A – as 15. above. It is appropriate for the Audit Committee to be part of the procurement process but to retain their current functions.

18. Should the process for the appointment of an auditor be set out in a statutory code of practice or guidance? If the latter, who should produce and maintain this?

A – no procurement procedures should be used and a framework agreement developed. The framework agreement would ensure that only auditors of sufficient independence, qualification, and experience are included. The National Audit Office could define the minimum requirements for inclusion.

19. Is this a proportionate approach to public involvement in the selection and work of auditors?

A – no this is already in place through the election of councillors. Should be a simple procurement process.

20. How can this process be adapted for bodies without elected members?

AC

A - N/a

21. Which option do you consider provides a sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?

A - Make it a role of one of the statutory officers (probably in this case the S151 Officer) to appoint in the event that the local public body fails to.

22. Should local public bodies be under a duty to inform a body when they have appointed an auditor, or only if they have failed to appoint an auditor by the required date?

A - do not feel that this is necessary.

23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?

24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?

A - yes

25. Do the ethical standards provide sufficient safeguards for the rotation of the engagement lead and the audit team for local public bodies? If not, what additional safeguards are required?

A - yes

26. Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and audited body to build a relationship based on trust whilst ensuring the correct degree of independence?

A - yes

27. Do you think this proposed process provides sufficient safeguard to ensure that auditors are not removed, or resign, without serious consideration, and to maintain independence and audit quality? If not, what additional safeguards should be in place?

A - yes

28. Do you think the new framework should put in place similar provision as that in place in the Companies sector, to prevent auditors from seeking to limit their liability in an unreasonable way?

A - yes

29. Which option would provide the best balance between costs for local public bodies, a robust assessment of value for money for the local taxpayer and provides sufficient assurance and transparency to the electorate? Are there other options?

A - decide the minimum level and let the local public bodies decide if they want anything further.

30. Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?

A – this should be part of the annual accounts. There is no point in the public viewing performance and spend in different documents.

31. Would an annual report be a useful basis for reporting on financial resilience, regularity and propriety, as well as value for money, provided by local public bodies?

A – no should all be part of the annual accounts

32. Should the assurance provided by the auditor on the annual report be ‘limited’ or ‘reasonable’?

A - reasonable

33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?

A - guidance should be included as part of the annual accounts and therefore it should be produced by whoever gives the guidance on the annual accounts.

34. Do these safeguards also allow the auditor to carry out a public interest report without his independence or the quality of the public interest report being compromised?

A - yes but public interest reports need to be published centrally i.e. by the National Audit Office.

35. Do you agree that auditors appointed to a local public body should also be able to provide additional audit-related or other services to that body?

A - no

36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?

A - yes but taken too far in terms of auditor independence.

37. Do you agree that it would be sensible for the auditor and the audit committee of the local public body to be designated prescribed persons under the Public Interest Disclosure Act? If not, who do you think would be best placed to undertake this role?

A - Yes

38. Do you agree that we should modernise the right to object to the accounts? If not, why?

A - yes but you will need to clarify what “increased publicity requirements for audit bodies” means. We produce a summary “Statement of Accounts” and send it to every resident currently but once the accounts have been audited. This still does not create many queries or comments from the public.

AC

39. Is the process set out above the most effective way for modernising the procedures for objections to accounts? If not, what system would you introduce?

A – yes subject to the comments already made in 38.

40. Do you think it is sensible for auditors to be brought within the remit of the Freedom of Information Act to the extent of their functions as public office holders? If not, why?

A - unsure as to why they need to be as the information would be most likely to originate from the public body. Most requests may come from the public body if they are in dispute with their Auditor!

41. What will be the impact on (i) the auditor/audited body relationship, and (ii) audit fees by bringing auditors within the remit of the Freedom of Information Act (to the extent of their functions as public office holders only)?

A - see 40. above. There will be an impact on fees as the auditors will try to estimate as part of the contract the time they may have to spend on FOI requests.

42. Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?

A – option 2 but again would be made much easier through a simple procurement exercise through a framework agreement. We see no need for an Audit Committee in this case and the appointment could be made through their equivalent of full council.

43. Do you think the county or unitary authority should have the role of commissioner for the independent examiners for smaller bodies in their areas? Should this be the section 151 officer, or the full council having regard to advice provided by the audit committee? What additional costs could this mean for county or unitary authorities?

A - No a localism approach should be used and smaller bodies allowed to appoint their own auditors under the framework agreement. District/Unitary Authorities could ensure that each town and parish council had an appointed auditor as part of the annual precepting procedure.

44. What guidance would be required to enable county/unitary authorities to:

- a.) Appoint independent examiners for the smaller bodies in their areas?
- b.) Outline the annual return requirements for independent examiners? Who should produce and maintain this guidance?

A – This is not a practical solution.

45. Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?

A - see answer to 42.

46. Are there other options given the need to ensure independence in the appointment process? How would this work where the smaller body, e.g. a port health authority, straddles more than one county/unitary authority?

A - see answers to 42 and 43 outlined above.

47. Is the four-level approach for the scope of the examination too complex? If so, how would you simplify it? Should the threshold for smaller bodies be not more than £6.5m or £500,000? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?

A - the four-level approach looks reasonable but at level 2,3, and 4 the body should have a right to appoint its own auditor. If they request that the independent examiner is from a local authority, the independent examiner should include an officer of a district council as well as those of county or unitaries. The smaller bodies that may request this would be town and parish councils that already look to Districts to assist in some matters. The smaller bodies threshold should remain at £6.5 million.

Local authorities also in some cases e.g. joint committees have “smaller body” accounts within their administration. It is important that authorities when appointing an auditor for their own body are able to also appoint the same auditor to encompass all accounts that need to be compiled within their administration.

It would be worth exploring a narrower scope of audit for smaller bodies.

48. Does this provide a proportionate, but appropriate method for addressing issues that give cause for concern in the independent examination of smaller bodies? How would this work where the county council is not the precepting authority?

A – No as outlined above the smaller bodies should be empowered to appoint their own auditors. The precepting authorities should be on hand to advise and assist with these issues when they arise. The precepting authorities including the Districts should only check that there is an auditor appointed within the framework agreement and it is only when there is no appointment should any precepts be withheld. A public interest report should be made to the smaller body with recommendations on how those issues should be addressed – it is for the elected members of those bodies to take action.

49. Is the process set out above the most appropriate way to deal with issues raised in relation to accounts for smaller bodies? If not, what system would you propose?

A - they are not acceptable the smaller bodies are and should be responsible for taking action.

50. Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?

A – no the smaller bodies should be allowed to appoint their own auditors from the framework agreement or from District/County/ or Unitary suitably qualified officers should they wish to do so. The District or Unitary would only regulate that an auditor had been appointed as part of the precepting process.



Future of local public audit Consultation



Future of local public audit
Consultation

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DCLG Publications
Tel: 030 0123 1124
Fax: 030 0123 1125

Email: product@communities.gsi.gov.uk
Online via the website: www.communities.gov.uk

March 2011

ISBN: 978 1 4098 2933 1

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Ministerial foreword

“...The Audit Commission has lost its way. Rather than being a watchdog that champions taxpayers' interests, it has become the creature of the Whitehall state. We need to redress this balance.”

Secretary of State for Communities and Local Government 13 August 2010

On 13 August, the Secretary of State for Communities and Local Government announced our plans to disband the Audit Commission and re-focus audit on helping local people hold their councils and other local public bodies to account for local spending decisions.

We want to drive power downwards to people. We want local public bodies to be more accountable to their citizens, to you the taxpayer, rather than upwards to Whitehall. That is what localism is all about.

The current arrangements for local audit, whereby a single organisation - the Audit Commission - is the regulator, commissioner and provider of local audit services are inefficient and unnecessarily centralised. The Audit Commission has increased the professionalism and the quality of local government audit, but, it has also become too focused on reporting to central Government and supporting the previous era of a target driven Government.

We are clear that centralised inspection and supervision have no part in localism and that they can be an unnecessary burden on frontline services at a time when they must be tightening their belts and focusing on service delivery; they also drive a culture of compliance rather than initiative and problem solving. If our local services are going to be genuinely responsive, tailored to the needs of local people, then they must be accountable to those same people. This is why we want to put in place a new locally focused audit regime, which is open and transparent but retains the high quality of audit that we expect.

This consultation sets out our vision for the future of local audit. This vision is firmly based on four principles. The first of these is localism. When reforms are complete local public bodies will be free to appoint their own independent external auditors from a more competitive and open market. The second is transparency; local public bodies will become increasingly accountable for their spending decisions to the people who ultimately provide their resources. The third is to remove the overheads charged by the Audit Commission to service the central government machine. At a time when we are taking decisive action to reduce the deficit, we think it is important that we deliver a framework which sees a reduction in the overall cost of audit to local bodies. The fourth principle is high standards of auditing. Make no mistake, we are determined that audit will remain both robust and efficient and that the new framework will follow the established principles of public audit.

To meet these principles, the consultation sets out proposals which would see all local public bodies with a turnover of over £6.5m appointing their own independent auditor. This appointment would be made on the advice of an independent audit committee.

Auditors would be regulated under a system which mirrors that of the audit of companies with a role for the Financial Reporting Council and the professional audit bodies. We envisage that the National Audit Office will set the code of audit practice and we have put forward options for the scope of audit in the new framework. The consultation document also sets out how transparency will be increased in the new framework and our proposals for auditing smaller bodies with a turnover below £6.5m in a proportionate way.

Alongside these proposals, the consultation asks a number of questions, to which I would welcome your responses. Your contribution will help us to further develop the framework before publishing legislation in draft in the autumn.

We look forward to hearing your comments on how we can make the future of local audit robust and efficient while ensuring that local public bodies are truly accountable to those they serve.

A handwritten signature in black ink, appearing to read 'Grant Shapps'.

Rt. Hon Grant Shapps MP

Glossary

Accountancy and Actuarial Disciplinary Board

An independent board which has the ability to investigate and discipline accountants and actuaries who are members of the following professional bodies: the Association of Chartered Certified Accountants; the Chartered Institute of Management Accountants; the Chartered Institute of Public Finance and Accountancy and the Institute of Chartered Accountants in England and Wales; the Institute of Chartered Accountants of Ireland and the Institute of Chartered Accountants of Scotland.

<http://www.frc.org.uk/aadb/>

Charities Act 1993

The Charities Act 1993 sets out the regulatory framework in which charities operate.

http://www.charity-commission.gov.uk/About_us/Regulation/default.aspx

CIPFA

Chartered Institute of Public Finance and Accountancy is the professional body for people in public finance.

www.cipfa.org.uk

Companies Act 2006

The Companies Act 2006 forms the primary source of UK company law.

<http://www.companieshouse.gov.uk/companiesAct/companiesAct.shtml>

Comptroller and Auditor General

Created by the Exchequer and Audit Departments Act 1866 to authorise funding to Government departments and examine departmental accounts, reporting the results to Parliament.

Drainage Boards

An operating authority, established in areas of England and Wales with particular drainage needs. The Board is responsible for work to secure clean water drainage and water level management.

<http://www.ada.org.uk/>

Financial Reporting Council

The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.

They also oversee the regulatory activities of the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

<http://frc.org.uk/>

Freedom of Information Act 2000

Legislation which enables any member of the public to request information from a public body.

Grant Certification

The Audit Commission is required by the Audit Commission Act 1998 to make arrangements for the certification of grant claims when requested to do so by public bodies in receipt of grant funds.

Health and Social Care Bill

The Bill takes forward the areas of Equity and Excellence: *Liberating the NHS* (July 2010) and the subsequent Government response *Liberating the NHS: legislative framework and next steps* (December 2010). It also includes provision to strengthen public health services and reform the Department's arm's length bodies.

International Financial Reporting Standards

IFRS is an independent, not for profit private sector organisation which works on behalf of the public sector to develop standardised financial reporting standards.

<http://www.ifrs.org/>

LASAAC

The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) develops and promotes proper accounting practice for local government in Scotland in line with legislation, International Financial Reporting Standards (overseen by the International Accounting Standards Board) and the work of the Financial Reporting Advisory Board.

<http://www.cipfa.org.uk/pt/cipfalasaac/index.cfm>

Lord Sharman

Liberal Democrat peer, previously the spokesman for Business, Enterprise and Regulatory Reform and former chairman of KMPG. Lord Sharman's review of audit and accountability for central government, *Holding to Account: the Review of Audit and Accountability in Central Government* was published in February 2001.

http://archive.treasury.gov.uk/docs/2001/sharman_1302.html

Management Commentary

A narrative report which provides the context or background to the financial position, performance and cash flow of an authority or public body.

National Fraud Initiative

Since 1996 the Audit Commission has run the National Fraud Initiative (NFI), an exercise that matches electronic data within and between audited bodies to prevent

and detect fraud. This includes police authorities, local probation boards and fire and rescue authorities as well as local councils.

www.audit-commission.gov.uk/nfi

Police Reform and Social Responsibility Bill

The Bill will make the police service more accountable to local people by replacing police authorities with directly elected police and crime commissioners to be introduced from May 2012.

Professional Oversight Board

The Professional Oversight Board (POB), formerly known as the Professional Oversight Board for Accountancy, is a UK regulatory body specialising in the accounting, auditing and actuarial professions.

www.frc.org.uk/pob

Public Audit Forum

The public audit agencies, the National Audit Office, the Northern Ireland Audit Office, the Audit Commission for Local Authorities and the National Health Service in England, the Wales Audit Office and Audit Scotland have established the Public Audit Forum to provide a focus for developmental thinking in relation to public audit.

<http://www.public-audit-forum.gov.uk>

Public Interest Reports

Under Section 8 of the Audit Commission Act 1998, the appointed auditor is required to consider whether to issue a report in the public interest on any significant matter coming to his or her notice in the course of an audit, and to bring it to the attention of the audited body and the public.

Public Interest Disclosure Act 1998

The Public Interest Disclosure Act 1998 is an Act that protects whistleblowers from detrimental treatment by their employer.

Remuneration report

Companies produce a report containing certain information concerning director's remuneration, governed by the Directors' Remuneration Report Regulations 2002,

Section 151 officer

Section 151 of the Local Government Act 1972 requires every local authority to make arrangements for the proper administration of their financial affairs and requires one officer to be nominated to take responsibility for the administration of those affairs.

Special Health Authorities

Special health authorities are health authorities that provide a health service to the whole of England, not just to a local community. They have been set up to provide a national service to the NHS or the public under section 9 of the NHS Act 1977. They are independent, but can be subject to ministerial direction in the same way as other NHS bodies.

Unitary Authority

Since 1996 the two-tier structure of local government has ceased to exist in Scotland and Wales, and in some parts of England, and has been replaced by single-tier unitary authorities, responsible for all local government services.

Whole of Government Accounts

Whole of Government Accounts (WGA) are full accruals based accounts covering the whole public sector and audited by the National Audit Office. WGA is a consolidation of the accounts of about 1500 bodies from central government, devolved administrations, the health service, local government and public corporations.

Section 1

1. Introduction

- 1.1. 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 councils and local health bodies would still be subject to robust auditing.
- 1.2. The Secretary of State was clear that safeguards would be developed to ensure independence, competence and quality, regulated within a statutory framework.
- 1.3. This consultation paper discusses the Government's proposals for how a new local audit framework could work and seeks your views.
- 1.4. This document has been developed by the Department for Communities and Local Government. Our proposals have been discussed with a wide range of partners and bodies which will be affected by the changes. These include 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.

What is audit and why is it important?

- 1.5. An audit is the review of financial statements, resulting in the publication of an independent opinion on whether those statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework and present a true and fair view. A summary of accounting arrangements for local bodies other than those in the health sector is at appendix A.
- 1.6. The audit of public bodies plays a key role in ensuring that those responsible for handling public money are held accountable for the use of that money. Public audit strengthens accountability, both upwards to the elected or appointed members who make decisions about the allocation of resources, and outwards to the consumers and beneficiaries, taxpayers and the wider community. Regular public audit also provides assurance on bodies' arrangements for managing their finances properly, including their arrangements for value for money and to safeguard public money.

Current arrangements for the audit of local public bodies in England

- 1.7. There are approximately 11,000 local public bodies which, together, are responsible for some £200bn of public money. Of these, there are 353 local authorities; 268 NHS bodies (in addition to Special Health Authorities audited by the National Audit Office, and Foundation Trusts); 38 police authorities; and 215 other bodies, including fire and rescue authorities; national park authorities; conservation boards; larger internal drainage boards, joint committees; and probation trusts. The remaining 9,800 bodies, with income or expenditure ranging from £1m down to £1,000 or less, comprise: 9,400 parish and town councils; 150 internal drainage boards; and 250 other bodies (for example, charter trustees and port health authorities). A list of the categories of bodies audited by the Audit Commission is set out in Appendix B.
- 1.8. The current system for the audit of local public bodies is operated and overseen by the Audit Commission under the provisions of the Audit Commission Act 1998 (as amended). Since its inception in 1983, the Audit Commission has acted as the regulator, commissioner and provider of local audit services.
- 1.9. Acting as the overall regulator, the Audit Commission publishes two statutory Codes of audit practice - one for local government bodies and one for health bodies - which are approved by Parliament. These set the standards for audit and require auditors to comply with the auditing and ethical standards issued by the Auditing Practices Board¹ (which is part of the Financial Reporting Council)². The Commission monitors the quality of audit, although the professional accountancy bodies also monitor their members.
- 1.10. Acting as the commissioner, the Audit Commission appoints auditors, either from its in-house practice or from firms contracted to the Commission, to local public bodies.
- 1.11. The Audit Commission also acts as the main provider in the current system, with 70 per cent of local public audits undertaken by its in-house practice.

Proposals for a new audit framework for local public bodies

- 1.12. The Government believes that the current arrangements for local public audit, whereby a single organisation is the regulator, commissioner and provider of local audit services are unnecessarily centralised. There is a lack of transparency and clarity as well as potential conflicts between the roles.
- 1.13. The proposals set out in this consultation build on the statutory arrangements and professional ethical and technical standards that currently apply to companies. However, those arrangements have been adapted to ensure that the principles of public sector audit are maintained.

¹ <http://www.frc.org.uk/apb/>

² <http://www.frc.org.uk/>

- 1.14. The proposed new local audit regime would continue to provide Parliament with the assurances it needs on public spending. The National Audit Office would prepare the Codes of audit practice, which prescribe the way in which auditors are to carry out their functions, and which would continue to be approved by Parliament, and associated guidance. The National Audit Office would also continue to audit Government departments providing funding to local public bodies and will continue to receive Whole of Government Accounts returns. Registration of audit firms and auditors, as well as monitoring and enforcement of audit standards, would be undertaken by the accountancy professional bodies, under the supervision of the Financial Reporting Council (as this builds on their existing role in the regulation of private sector auditors) and its operating bodies.
- 1.15. Principal local authorities would appoint their own auditors, with decisions made by full council, taking into account advice from an independently chaired audit committee. Different arrangements would apply for some other local public bodies and these are explained in section 3.
- 1.16. Localism and decentralisation can only work if central government is prepared to trust local bodies, communities and citizens. We have aimed to design a local audit system which provides the rigour needed for Parliament, but allows local public bodies to take more responsibility in the way they procure audit services. These changes go hand in hand with the Government's actions to increase transparency in local government and will help enable local people and local organisations to hold their local public bodies to account for the way that their money is spent.

Design principles

- 1.17. In proposing a new framework for local public audit, we have followed a set of design principles:
- **localism and decentralisation** – freeing up local public bodies, subject to appropriate safeguards, to appoint their own independent external auditors from a more competitive and open market, while ensuring a proportionate approach for smaller bodies
 - **transparency** – ensuring that the results of audit work are easily accessible to the public, helping local people to hold councils and other local public bodies to account for local spending decisions
 - **lower audit fees** – achieving a reduction in the overall cost of audit
 - **high standards of auditing** – ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit
- 1.18. These principles are not wholly independent. For instance, there is a clear relationship between the quality and scope of the audit and the level of audit fees. We wish to find the right balance to ensure an effective, robust, quality audit for local bodies while keeping fees as low as possible.

1.19. We have also had regard to the principles of local public audit, which were codified in 1998 by the Public Audit Forum, but have deep historical roots. They are:

- **Independence of public sector auditors from the organisations being audited.** Auditors must be independent, to avoid improper influence and allow work to be carried out freely. Independence encompasses the methods of appointment of auditors; the financial relationship between auditor and audited bodies, discretion in the amount of work necessary, the ability to follow up the implementation of recommendations, and the ability to have access to information necessary for audit work.
- **The wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money.** Public audit involves more than an opinion on accounts. It also covers issues such as regularity, propriety and value for money. In this way, it helps to contribute to corporate governance arrangements of public bodies.
- **The ability of public auditors to make the results of their audits available to the public, to democratically elected representatives and other key stakeholders.** To be effective, there must be appropriate reporting arrangements, under which auditors report the results of their work both to the bodies responsible for funding and to the public.

Q1: Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?

What this consultation covers

1.20. This consultation focuses on the audit of local public bodies that currently have auditors appointed by the Audit Commission. It sets out, in sections 2 and 3, our proposals for the regulation and commissioning of audit, including the various elements of the new regulatory framework and the role local public bodies will have when appointing an auditor. Section 4 covers the scope of local public audit and the work of auditors, while section 5 deals with the way that the proposed framework would apply to smaller local bodies, such as parish councils.

LOCAL BODIES COVERED BY THIS CONSULTATION

1.21. This document sets out proposals for a new framework for most bodies currently audited by the Audit Commission and listed in appendix B.

1.22. However, the Police Reform and Social Responsibility Bill, which is currently before Parliament, aims to make a number of significant reforms to the policing system. This includes provisions to abolish police authorities (excluding the City of London) and replace them with directly elected Police and Crime Commissioners for each police force outside London, and the Mayor's Office for Policing and Crime for the Metropolitan Police.

- 1.23. Police and Crime Commissioners (and Mayor's Office for Policing and Crime) will be responsible for holding the Chief Constable (and Commissioner for London) of their police force to account for the full range of their responsibilities.
- 1.24. Probation services, which used to be part of Local Government's remit, have been a responsibility of central government since consolidation into the Home Office in 2000-01. The financial results of probation trusts have been consolidated into the National Offender Management Service accounts, which are audited by the Comptroller and Auditor General. We believe, therefore, that probation trusts should in future be audited by the Comptroller and Auditor General.

Q2: Do you agree that the audit of probation trusts should fall within the Comptroller and Auditor General's regime?

- 1.25. Pension funds are not statutorily subject to a full audit separate from that of the local authority. However, the Audit Commission has used its regulatory powers to require pension funds to be audited separately. We propose to include pension funds on the list of local public bodies subject to the new local audit framework.
- 1.26. We consider that Joint Committees should remain subject to audit, but it will be for the constituent authorities making up the Joint Committee to decide whether the Joint Committee is audited separately or as part of one of the authorities' own audits.
- 1.27. The abolition of the Audit Commission will also impact on the audit arrangements for local health bodies. Currently, the Strategic Health Authorities, Primary Care Trusts and NHS Trusts are audited under the Audit Commission framework. The Health and Social Care Bill, currently before Parliament, aims to abolish Strategic Health Authorities and Primary Care Trusts and provides for all NHS Trusts to become Foundation Trusts by 2014. The Department of Health is considering the governance and accountability arrangements for the new health landscape and these will help determine the appropriate audit arrangements. The local public bodies referred to in this consultation paper do not therefore include local health bodies. However, health bodies will be included in draft legislation on the proposals for the new local audit framework. The Department of Health will publish a paper summarising its proposals at the same time.

Audit Commission functions excluded from this consultation

- 1.28. There are a number of functions that are or have been carried out by the Audit Commission that are not considered as part of this consultation. The Secretary of State has announced that the Commission's inspection and research activities would cease. In general, local government and others outside of central Government are well-placed to decide when and where research should

be undertaken. In addition, the National Audit Office, following confirmation of its existing powers, will be able, when reporting to Parliament on the activities of central Government departments, to examine the impact of policies administered by local bodies. As well as contributing to parliamentary accountability, this will provide useful insights for local communities by drawing out examples of what works successfully in different circumstances and how barriers to good value for money are being overcome.

1.29. It will also be possible for an auditor to undertake value for money studies connected to audit work, with the agreement of the audited body. In addition, the National Audit Office would be able to identify and report on wider issues of concern about local bodies' use of resources or common themes of interest, should such issues be identified by the audit process. They could do this, in part, by drawing upon the work of local auditors.

1.30. Other functions, such as grant certification, operation of the National Fraud Initiative and the auditor function of reporting on Whole of Government Accounts returns will continue in some form, but are not considered in detail here. These issues will be covered in the forthcoming draft bill and accompanying consultation.

1.31. The Audit Commission appoints auditors to all local public bodies in England. It appoints its own auditors from the in-house practice to 70 per cent of local public bodies, with the remaining 30 per cent of auditors employed by accountancy firms under contract to the Commission. We are considering a range of options for transferring the Commission's in-house audit practice into the private sector. We expect that an announcement on our preferred option for privatisation of the Commission's audit work will be made ahead of publication of a draft audit bill.

Timing and how to get involved

1.32. This initial consultation will run for 12 weeks with responses invited by 30 June. Following this period, we will consider the responses we receive and will publish a summary and a Government response.

1.33. We then propose to publish draft legislation on the proposals for a new local audit framework which will be subject to pre-legislative scrutiny by Parliament and other interested parties. As part of this process, we will consult again on our proposals, and will publish a consultation stage impact assessment. Following pre-legislative scrutiny, we will prepare for final legislation to be introduced at the earliest opportunity.

Costs

1.34. We are developing an impact assessment which will be published alongside the draft Bill. We would therefore be interested in your views on the costs and benefits of the proposals and options set out in this consultation. This evidence will inform the draft bill proposals and help refine the impact assessment.

Who are we consulting?

1.35. We would welcome comments from organisations affected by the change to the audit of local public bodies, and any other bodies or individuals. This document is available on the Department for Communities and Local Government website (www.communities.gov.uk) and we will be drawing it to the attention of all public bodies currently audited by the Audit Commission, to professional bodies and those involved in regulating audit in England. It is open to all to make representations on the proposed new system of local audit and all submissions will be carefully considered.

How to respond

1.36. Your response must be received by 30 June 2011 to:

foia@communities.gsi.gov.uk

Or to:

Luke Scofield
The Department for Communities and Local Government
Zone 3/G6
Eland House
Bressenden Place
London SW1E 5DU

1.37. Please use the title 'Response to future of local audit consultation'.

1.38. It would be helpful if you could make clear in your response whether you represent an organisation or group, and in what capacity you are responding.

Publication of responses – confidentiality and data protection

1.39. Information provided in response to this consultation, including personal information, may be published, or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

1.40. If you want any information you provide to be treated as confidential you should be aware that under the Freedom of Information Act, there is a statutory Code of Practice with which public authorities must comply, and which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential.

1.41. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give any assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer

generated by your IT system will not, of itself, be regarded as binding on the Department.

- 1.42. The Department will process your personal data in accordance with the Data Protection Act and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Section 2

2. Regulation of local public audit

2.1. Audit systems in the UK for both the public and private sector follow the International Standards on Auditing. These include the following common elements of regulation:

- **standards** – setting out what comprises the audit and the quality standards that apply
- **registration** – determining who can audit and ensuring that auditors have the necessary skills, expertise and qualifications in order that there can be confidence in the auditors' work
- **monitoring and enforcement** – ensuring that standards are met and that appropriate action is taken in the case of failure

2.2. The Government believes that having a specific regulator for the local government and the local health sectors in England - less than 10% of the audit market – risks duplication. 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 local health sectors. This local public audit regime should be focused on local accountability, in the way that the commercial sector is tailored to accountability to shareholders.

Standards and codes of practice

CURRENT SYSTEM

2.3. Under the current system the Audit Commission sets audit standards through Codes of audit practice for the local government and health sectors, which are approved by Parliament. These Codes build on the ethical, auditing and other standards issued by the Auditing Practices Board and are therefore broadly consistent with audit standards applied in other sectors.

2.4. However, the Commission's Codes contain additional standards to reflect the principles of public audit and its wider scope, particularly in terms of regularity and propriety and value for money. They specify the approach to audit for areas not already covered by professional audit standards (such as the 'value for money' conclusion). The Commission also publishes guidance and statements of responsibilities of auditors and audited bodies.

OTHER SECTORS

2.5. Standards for the audit of companies are set by the Auditing Practices Board (part of the Financial Reporting Council), which sets standards and issues guidance for the performance of external audit and in relation to the independence, objectivity and integrity of external auditors. The Auditing Practices Board is also responsible for setting ethical standards for auditors in the private and public sectors.

The Audit Commission's Codes of audit practice

The Commission has a statutory duty to prepare, keep under review and publish statutory Codes of audit practice. There are currently two Codes: one for local government bodies and one for health bodies. The Codes, which are approved by Parliament and must be reviewed at least every five years, set out best professional practice with respect to the standards, procedures and techniques to be adopted by auditors. The latest versions of the Codes of practice were published in 2010.

The Codes are high level documents, which focus on the Audit Commission's core requirements and aspects of audit specific to its regime. Each Code:

- sets out the general principles to be followed by auditors in delivering their objectives
- outlines auditors' responsibilities regarding the audit of financial statements and use of resources and
- sets out the range of outputs through which the results of audit are reported

OUR PROPOSALS

2.6. Under our proposals, auditors of local public bodies would continue to follow the auditing and ethical standards set by the Auditing Practices Board. We have considered which body would be best placed to produce the audit Codes of practice and supporting guidance. While this is a role that could possibly be undertaken by the Financial Reporting Council or the profession, we believe that the National Audit Office, given its role in providing Parliament with assurance on public spending, would be best placed to develop and maintain the audit Codes, which would continue to be approved by Parliament. The National Audit Office would also produce any supporting guidance.

Q3: Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?

Registration of auditors

CURRENT SYSTEM

2.7. The Audit Commission Act 1998 stipulates that for an individual or a firm to be appointed as an auditor, the person/s conducting the audit must be a member of one of the specified professional bodies and has such qualifications as may be approved by the Secretary of State (none have been so approved). The Audit Commission regulates the quality of the work of auditors by setting minimum qualifications a public sector auditor must have in conjunction with standards set by the professional bodies for membership.

OTHER SECTORS

- 2.8. As part of the statutory framework for the audit of companies under the Companies Act 2006, the Professional Oversight Board (part of the Financial Reporting Council), essentially acts as the main regulator, with statutory powers delegated to it by Government for the recognition and supervision of those professional accountancy bodies responsible for supervising the work of auditors or offering an audit qualification – recognised qualifying body and recognised supervisory body e.g. Institute of Chartered Accountants in England and Wales.
- 2.9. Recognised supervisory bodies are responsible for putting rules and arrangements in place which their members must fulfil before they can be registered auditors, both as regards eligibility for appointment as a statutory auditor and the conduct of statutory audit work. A list of recognised supervisory bodies and recognised qualifying bodies for the purposes of the Companies Act is at annex C. The Institute of Chartered Accountants for Scotland maintains the list of registered auditors for the whole of the UK on behalf of the recognised supervisory bodies.
- 2.10. People with responsibility for company audit work at the firm must also hold a recognised qualification, awarded by a recognised qualifying body.
- 2.11. Looking elsewhere, in Finland, auditors who are eligible to audit municipal authorities are included in a register of eligible auditors maintained by the Finnish Board of Chartered Public Finance Auditing. In Italy, auditors who can carry out local public audit are included on a register of auditors managed by the Ministry of Justice.

OUR PROPOSALS

- 2.12. We propose that, as under the Companies Act 2006 (“the Companies Act”), an overall regulator would have responsibility for authorising professional accountancy bodies to act as recognised supervisory bodies for local public audit. Any such body would need to comply with the statutory requirements set out in the proposed primary legislation. It would have the roles of registration, monitoring, and discipline in relation to local public audit.
- 2.13. The Financial Reporting Council is the regulator for Companies Act audit and we propose that it takes on a similar role for the local public audit regulatory regime in England, provided that it can assure the Government that it has both the resources and the expertise to undertake the role, and wishes to do so. It is likely that setting up a separate regulator for local public audit would lead to duplication of work as entirely new systems and procedures would need to be developed.
- 2.14. Recognised supervisory bodies for local public audit could include supervisory bodies recognised under the Companies Act 2006 and any other bodies with sufficient expertise and capacity.
- 2.15. A recognised supervisory body for local public audit could have rules and practices covering:

- the eligibility of firms to be appointed as local public auditors and
- the qualifications, experience and other criteria individuals must reach before being permitted to lead a local public audit engagement and/or sign off an audit report

2.16. We propose to set out, in primary legislation, certain high level criteria that specify that the auditor must be:

- a member of a recognised supervisory body and
- eligible for appointment under the rules of that body

2.17. The legislation will include provisions enabling the supervisory body to develop appropriate detailed rules and practices on other criteria.

2.18. The eligibility criteria will be based on those for the audit of companies as we would like to ensure enough flexibility in the criteria to enable new firms to enter the local public audit market. However, there will need to be additional criteria to ensure that auditors have the necessary experience to be able to undertake a robust audit of a local public body.

2.19. We propose that all eligible local public auditors would be placed on a public register. This register could be kept by the recognised supervisory bodies for local public audit, or it could be kept by another body.

Q4: Do you agree that we should replicate the system for approving and controlling statutory auditors under the Companies Act 2006 for statutory local public auditors?

Q5: Who should be responsible for maintaining and reviewing the register of statutory local public auditors?

Q6: How can we ensure that the right balance is 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?

Q7: What additional criteria are required to ensure that auditors have the necessary experience to be able to undertake a robust audit of a local public body, without restricting the market?

Monitoring and enforcement

CURRENT SYSTEM

2.20. The Audit Commission currently monitors the quality of auditors' performance through its annual quality review programme. The Audit Inspection Unit of the Financial Reporting Council reviews the quality of the financial statements audits carried out by the Commission's own audit practice and by private firms on behalf of the Commission.

OTHER SECTORS

2.21. Under the Companies Act, the recognised supervisory bodies are responsible for monitoring the quality of the statutory audits undertaken by their members and for disciplining their members where this is appropriate.

2.22. Some companies that are of public significance because of the nature of their business, their size, or their number of employees can be designated as "public interest entities". In the case of these bodies, the Professional Oversight Board has an additional role in monitoring the quality of the auditing function and the Accountancy and Actuarial Disciplinary Board has a role in investigating significant public interest disciplinary cases and imposing sanctions to those found guilty of misconduct.

OUR PROPOSALS

2.23. We propose that recognised supervisory bodies for local public audit would have responsibility for monitoring the quality of audits undertaken by their members, as they do in the private sector. This work would fall under the monitoring units of these bodies, and would 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

2.24. The recognised supervisory bodies for local public audit would 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 and remove them from the register of eligible local public auditors.

2.25. We are considering whether the overall regulator (i.e. the body that authorises the recognised supervisory bodies) should have a role in assuring the quality, and undertaking independent investigation of the audit of local public bodies that might be considered analogous to public interest entities for the public sector. The overall regulator would have powers to investigate and discipline in these cases. The process undertaken would be similar to that above, but would provide an additional level of assurance in respect of those bodies.

However, the costs that would fall on the Financial Reporting Council from undertaking this role would be passed on to the audit firms and therefore could be reflected in fees.

Q8: What should constitute a public interest entity (i.e. a body for which audits are directly monitored by the overall regulator) for the purposes of local audit regulation? How should these be defined?

Q9: There is an argument that by their very nature all local public bodies could be categorised as 'public interest entities.' Does the overall regulator need to undertake any additional regulation or monitoring of these bodies? If so, should these bodies be categorised by the key services they perform, or by their income or expenditure? If the latter, what should the threshold be?

Q10: What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?

Section 3

3. Commissioning local public audit services

- 3.1. The Government believes that a localist approach, without an independent central body having a role in appointing an auditor, is an important element of driving accountability to local people rather than to central government. However, maintaining the independence of the auditor in the new system is central to the principles of public audit. Our proposals therefore need to include measures to safeguard the independence of the auditor.

Duty to appoint an auditor

CURRENT SYSTEM

- 3.2. Under the current system, all auditors of local public bodies included in Schedule 2 of the Audit Commission Act are appointed by the Audit Commission. Before making appointments of auditors to local government bodies, the Commission has a statutory duty to consult the body. The Commission has voluntarily extended this practice to health bodies.

OTHER SECTORS

- 3.3. Commissioning takes different forms in different sectors. Under the Companies Act the annual general meeting must agree a resolution on the appointment of the auditor, although this will be based on a recommendation from directors and input from an audit committee.
- 3.4. Looking elsewhere, it is clear that there are different systems for commissioning audit services. However, in the USA local authorities procure their own auditors: an audit committee often appoints 'internal auditors' for their local authority, who then procure the external auditor.

OUR PROPOSALS

- 3.5. We propose that all larger local public bodies (those with income/expenditure over £6.5m) will 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.
- 3.6. It is equally important as it is in other sectors that those to whom audit is directed have influence but that the independence of the auditor remains paramount. Therefore, for larger public bodies, we propose an approach whereby appointment is made by full council or equivalent, on the advice of an audit committee with opportunities for the electorate to make an input.
- 3.7. We consider that local public bodies will wish to co-operate to ensure that there is wide competition for external audit contracts, and that local public bodies will want to work together to procure an external auditor. We propose to ensure that legislation provides for both joint procurement and joint audit committees.

Q11: Do you think the arrangements we set out are sufficiently flexible to allow councils to cooperate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?

- 3.8. Lord Sharman, in his report, *Holding to Account: the Review of Audit and Accountability in Central Government*, was clear that, to maintain confidence, auditors must be independent to avoid improper influence and allow work to be carried out freely. Independence includes the way auditors are appointed. We consider that, as part of a new local audit regime, each larger local public body should have an audit committee with a majority of members independent of the local public body and, with some elected members to strike a balance between objectivity and in-depth understanding of the issues.
- 3.9. A possible structure is set out below. However, there could be alternative arrangements, for example:
- a) only the chair and perhaps a minority of members are independent of the local public body
 - b) a chair and a majority of members independent of the local public body, as described below
 - c) as for (b), but with independent selection of the members independent of the local authorities
- 3.10. We are keen to ensure that local public bodies have flexibility in the way that they constitute and run audit committees. But we need to balance this with ensuring that the minimum requirements for an audit committee set out in legislation provide for an independent audit appointment. We set out below a possible structure and role for the audit committee, some of which may be prescribed in legislation and some of which we would put forward as best practice.

Structure of audit committees

We envisage 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

Q12: Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?

Q13: How do we balance the requirements for independence with the need for skills and experience of independent members? Is it necessary for independent members to have financial expertise?

Q14: Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?

Role of the Audit Committee

CURRENT SYSTEM

3.11. 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 an 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.

3.12. 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.

OTHER SECTORS

3.13. The Financial Reporting Council currently produces guidance for the establishment of audit committees for companies, stating that they should be made up of at least three, or in the case of smaller companies two, independent non-executive directors.

3.14. The main role and responsibilities of a company's audit committee are set out in written terms of reference and can include a number of roles, including:

- providing advice to the board in relation to the appointment of external auditors
- approving the remuneration and terms of engagement of the external auditor
- reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process
- developing and implementing policy on the engagement of the external auditor to supply non-audit services

3.15. Looking elsewhere, audit committees are statutory bodies in each municipality in Finland. Their remit includes preparing the choice and appointment of external auditors. In Canada, the local authority's audit committee also commissions audit services.

OUR PROPOSALS

3.16. 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 its role.

3.17. 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 or equivalent on the selection process and may, if they wish, indicate which auditor, in their view, presents the best choice.

- 3.18. The full council or equivalent 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.
- 3.19. Advice provided by the audit committee to the full council or equivalent would be published, although consideration will need to be given to the treatment of commercially confidential material.
- 3.20. If the full council or equivalent 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

- 3.21. We could specify only one mandatory duty for the local public body's audit committee, i.e. to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.
- 3.22. 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 other issues, e.g. 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.
- 3.23. This 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

- 3.24. 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 auditors' 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

3.25. This option would provide more assurance about the independence of the relationship between the audited body and its auditor, it would also ensure that the audit committee had a wider role in reviewing the financial arrangements of the local public body.

Q15: Do you think that our proposals for audit committees provide the necessary safeguards to ensure the independence of the auditor appointment? If so, which of the options described in paragraph 3.9 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?

Q16: Which option do you consider would strike the best balance between a localist approach and a robust role for the audit committee in ensuring independence of the auditor?

Q17: Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?

Q18: Should the process for the appointment of an auditor be set out in a statutory code of practice or guidance? If the latter, who should produce and maintain this?

Involvement of the public in the appointment of an auditor

CURRENT SYSTEM

3.26. There is no involvement of the public in the appointment of auditors by the Audit Commission to audited bodies.

OUR PROPOSALS

3.27. We envisage that the appointment of an auditor by the local public body should be as transparent as possible so that local people are able to hold their local public bodies to account for the appointment.

Pre-appointment

3.28. The audited body could ask for expressions of interest from audit firms for the audit contract one month prior to the publication of the invitation to tender. The list of those firms that have expressed an interest would then be published on the audited body's website. The public would then be able to make representations to the audited body's audit committee about any of these firms. The audit committee would consider these representations when providing advice to the full council or equivalent.

Post - appointment

3.29. The public would be able to make representations at any time to the local public body's audit committee. If a representation identified a significant, or potentially significant, issue relating to the auditor, then the audit committee would be able to provide advice to the audited body on that issue and investigate as appropriate. If the issue identified was material to the ongoing work of the auditor (such as an undisclosed material conflict of interest) then the audited body would need to take such steps as appeared necessary, in accordance with the terms of the contract with the auditor, to address that issue. We may also wish to specify in legislation some statutory requirements relating to conflicts of interest.

Q19: Is this a proportionate approach to public involvement in the selection and work of auditors?

Applicability to other sectors

3.30. The policy of audit committees acting as a safeguard to independent appointment is applicable to all larger local public bodies covered by this framework. The approach may differ depending on the constitution and governance arrangements of those bodies.

3.31. For Police and Crime Commissioners (and Mayor's Office for Policing and Crime) and Chief Constables (and Commissioner for London) we are considering whether the Police and Crime Panel should have a role similar to that of the audit committee. Arrangements for the audit of these policing bodies will be finalised once the Police Reform and Social Responsibility Bill has completed its passage.

Q20: How can this process be adapted for bodies without elected members?

Failure to appoint an auditor

CURRENT SYSTEM

3.32. As the Audit Commission is responsible for appointing the auditors for all audited bodies specified in the Audit Commission Act 1998, the situation where an audited body fails to appoint an auditor does not arise.

OTHER SECTORS

3.33. The Companies Act 2006 provides a default power for the Secretary of State, so that if a private company fails to appoint an auditor or auditors, the Secretary of State may appoint one or more persons to fill the vacancy. If the company fails to make the necessary appointment, the company is required to give notice to the Secretary of State that his power has become exercisable and if the

company fails to give this notice then the company has committed an offence and can be liable for a fine.

OUR PROPOSALS

3.34. The audited body would be under a duty to appoint an auditor. However, there could be some instances under the new system where a body does not fulfil this duty.

Option 1

3.35. In these circumstances we propose that the Secretary of State would be able to direct the local public body to appoint an auditor.

Option 2

3.36. 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.

Q21: Which option do you consider provides a sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?

3.37. It would clearly be against our design principles for the new local audit framework for the Secretary of State to make the auditor appointment for local public bodies. However, some form of assurance will be required that local public bodies have fulfilled their duty to appoint an auditor.

Q22: Should local public bodies be under a duty to inform a body when they have appointed an auditor, or only if they have failed to appoint an auditor by the required date?

3.38. Given that we envisage that the Recognised Supervisory Bodies will hold the register of eligible local public auditors there is an argument that they should be notified if a local public body has appointed or failed to appoint an auditor. However, this could involve a significant cost.

3.39. As the Secretary of State would be able to direct the local public body to appoint an auditor, or could be provided with the power to make the auditor appointment where a local public body does not fulfil its duty to appoint an auditor, an alternative option would be for the local public body to notify the appropriate government department, or a body that the government department specifies, of the auditor appointment. The cost of doing this could be met by the appropriate department, and would provide an effective route for the Secretary of State to exercise his powers to direct the local public body to appoint an auditor, or to make the auditor appointment where the body did not fulfil its duty to appoint an auditor.

Q23: If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?

Rotation of audit firms and audit staff

CURRENT SYSTEM

3.40. The Auditing Practices Board's ethical standards, which apply to the audit of both private and public entities, require an audit firm to establish policies and procedures to monitor the length of time that audit engagement partners and other key staff serve as members of the engagement team for each audit. These procedures are in place to help ensure the independence and objectivity of auditors.

3.41. The Audit Commission appoints audit firms or its own staff for an initial period of five years. The audit engagement partner can then be appointed for an additional period of up to two years in accordance with the Auditing Practices Board's Ethical Standards (i.e. a maximum of seven years, provided there are no threats to the auditor's independence). The audit manager (the second in command to the audit engagement partner) can be appointed for a maximum of ten years. After this period individuals should then have no further direct relationship with or involvement in work relating to the body concerned until a further period of five years has elapsed.

OTHER SYSTEMS

3.42. In the case of listed companies, the audit firm must have policies and procedures so that:

- no-one shall act as audit engagement partner for more than seven years and
- anyone who has acted as the audit engagement partner for a particular entity for a period of seven years, shall not subsequently participate in the audit engagement with that entity until a further period of five years has elapsed

3.43. The audit committee of a company assesses the independence and objectivity of the external auditor annually, taking into consideration regulatory and professional requirements. This assessment involves a consideration of all relationships between the company and the audit firm (including the provision of non-audit services) and any safeguards established by the external auditor. The audit committee seeks from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners and staff.

OUR PROPOSALS

3.44. We envisage that the new audit framework would be in line with the current ethical standards regarding the rotation of staff within the audit firm.

3.45. The audited body's audit committee would have a role in monitoring the independence and objectivity of the body's external auditor.

- 3.46. In relation to the rotation of the firm, an audit firm would be reappointed annually by the full council on the advice of the audit committee (who may want to provide advice on the quality of service received in the previous year) but the audited body could 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 second consecutive five year period, following competition.
- 3.47. To preserve independence, we propose that the audited body would need to procure a different audit firm at the end of the second five year period. This will help to ensure that in carrying out their responsibilities auditors are not influenced by their desire to secure re-appointment.

Q24: Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?

Q25: Do the ethical standards provide sufficient safeguards for the rotation of the engagement lead and the audit team for local public bodies? If not, what additional safeguards are required?

Q26: Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and audited body to build a relationship based on trust whilst ensuring the correct degree of independence?

Resignation or removal of an auditor

CURRENT SYSTEM

- 3.48. In the current situation there is not a direct contractual relationship between the auditor and the audited body - the relationship is with the Audit Commission. It is therefore not possible for the audited body to remove the auditor and the auditor does not need to resign because of issues arising with the audit.
- 3.49. In the event that there was a breakdown in the relationship between the auditor and audited body the Audit Commission can consider rotating suppliers.
- 3.50. The audit engagement partner or audit team may change during the appointment and the Audit Commission can and does rotate between firms and its in-house practice undertaking the audit, including if the audited body requests it.

OTHER SECTORS

Resignation

3.51. In the companies sector, if an auditor ceases for any reason to hold office, he must deposit a statement at the company's registered office which will usually set out the circumstances connected with his ceasing to hold office. If the circumstances are set out in the statement (in the case of a quoted company), the company must send a copy of the statement to all members of the company unless it makes a successful application to the court to stop this.

3.52. If (in the case of an unquoted company) the circumstances are not set out in the statement, the auditor must deposit a statement with the company to that effect but the company does not have to circulate this statement to its members.

3.53. When an external auditor resigns, the audit committee of the company will investigate the issues giving rise to such resignation and consider whether any action is required.

Removal

3.54. The members of a company may remove an auditor from office at any time during their term of office. They, or the directors, must give 28 days notice of their intention to put to a general meeting a resolution to remove the auditor. The company must send a copy of the notice to the auditor, who then sends it to the company's members. The auditor may speak at the meeting where the resolution is to be considered. Although a company may remove an auditor from office at any time, the auditor may be entitled to compensation or damages for termination of appointment.

OUR PROPOSALS

3.55. We envisage 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.

3.56. However, we recognise 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. These safeguards would broadly mirror those in the Companies Act, 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.

Resignation

3.57. We envisage that in the first instance, the audited body and the auditor should discuss and seek to resolve any concerns. If the auditor still wished to resign he should give 28 days written notice of his intention to the audit committee and the audited body, setting out his intention to resign. The audited body should then make a written response, which it should send with the auditor's written notice, to its members and the audit committee. The auditor will then be required to deposit a statement at the audited body's main office and with the audit committee, which should be published on its website. The statement

would set out the circumstances connected with the resignation of the office that are relevant to the business of the audited body.

3.58. The audited body would need to notify the body responsible for maintaining the register of appointed auditors, and the auditor will need to notify the appropriate regulatory supervisory body. We envisage a role for the audit committee and the regulatory supervisory body in investigating the issues that have led to the resignation and considering whether any action is required.

Removal

3.59. Again, we envisage that in the first instance, the audited body and the auditor should discuss and seek to resolve any concerns. If the audited body still wished to remove its auditor, it should give 28 days written notice of its intention to the audit committee and to the auditor. The audited body should put to a public meeting, or full council meeting, a resolution to remove the auditor. The audited body would also send a copy of this notice to the auditor.

3.60. The auditor would then have the right to make a written response, which the body would need to send to its members and the audit committee, and to speak at the meeting where the resolution is to be considered. A representative from the audit committee should also be able to speak at the meeting. The auditor would be required to deposit a statement at the audited body's main office and with the audit committee, which would need to be published on its website. This statement would set out the circumstances connected with the cessation of their office that are relevant to the business of the audited body.

3.61. The audited body would need to notify the appropriate regulatory supervisory body. We envisage a role for the audit committee and the regulatory supervisory body in investigating the issues that have led to the removal and considering whether any action is required.

3.62. A right of access to the previous auditor's audit working papers (from the previous year and/or current) should be provided to incoming auditors in cases of resignation or removal or any other instances where the audit firm changes. This right should extend to all aspects of the previous auditor's responsibilities and not just to work on the audit of the financial statements.

Q27: Do you think this proposed process provides sufficient safeguard to ensure that auditors are not removed, or resign, without serious consideration, and to maintain independence and audit quality? If not, what additional safeguards should be in place?

Auditor liability

3.63. In the private sector, auditors are concerned about the consequences of the risks of litigation, as a result of actual or perceived failing by auditors. These concerns have been fuelled by legal judgments about the extent of auditors' duty of care to third parties, such as potential investors and the banks. They have increasingly caused auditors to caveat their audit opinions by explicitly limiting their duty of care and by seeking to limit their liability. Case law has established that the duty of care of auditors appointed by the Commission is to the audited body itself and not to third parties. Public authorities can sue their auditor for breach of duty.

CURRENT SYSTEM

3.64. There are particular issues in the public sector where auditors may exercise special powers. The Audit Commission currently indemnifies auditors for the costs they incur where they are engaged in litigation arising from the exercise of such powers. This ensures that auditors are able to exercise their functions with the certainty that their costs will be met.

OTHER SECTORS

3.65. In the companies sector, the Companies Act provides that general provisions that protect auditors from liability for negligence, default, breach of duty or breach of trust in relation to the company, or provide an indemnity against 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 favour or in the granting of relief by the court in the case of honest and reasonable conduct
- 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

OUR PROPOSALS

3.66. 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. Without a liability agreement, audit firms may increase their fees to match the increased risk they face in undertaking their work.

Q28: Do you think the new framework should put in place similar provision as that in place in the companies sector, to prevent auditors from seeking to limit their liability in an unreasonable way?

Section 4

4. Scope of audit and the work of auditors

4.1. In this chapter, we look at the scope of the audit and the options for the elements of local public bodies' finance and the arrangements that auditors should assess. The duty for the auditor to issue a report in the public interest is also considered. This section asks whether auditors should be able to carry out additional, non-audit, work for the audited body, and considers the various safeguards that could be introduced to ensure that auditor independence is not compromised.

Scope of local public audit

4.2. The starting point is the principles of public audit, in particular the wide scope of the audit covering the audit of financial statements, regularity and propriety and value for money.

CURRENT SYSTEM

4.3. Public sector accounting in the UK has recently moved to adopt International Financial Reporting Standards adapted as necessary for the public sector (for local government audits from 2010-11).

4.4. Currently, the auditor of larger local public bodies is required to:

- give an opinion on whether the accounting statements give a true and fair view of the audited body's financial position and of its income and expenditure
- provide a conclusion as to whether the body has proper arrangements for securing value for money, having regard to specified criteria (such as financial resilience and to regularity and propriety) and in accordance with guidance issued by the Commission
- review and report on as appropriate, other information published with the financial statements, including the statement on internal control/annual governance statement and the remuneration report and
- (for local government) review and report on the Whole of Government Accounts return

4.5. Smaller local public bodies are currently subject to a limited assurance regime. We believe that it is important for smaller bodies to continue to be dealt with proportionately under the new framework and discuss this in more detail at Section 5.

OTHER SECTORS

Companies

4.6. The scope of audit for companies is based around the financial statements produced by the company and a report that the directors are required to produce which must describe the company's principal activities, a review of the business and an indication of future developments.

4.7. Statutory auditors of companies include in their report, statements as to whether, in their opinion:

- the accounts have been prepared in accordance with the Companies Act 2006
- the accounts give a “true and fair “ view of the company’s financial statements
- the director’s report is consistent with the accounts
- the remuneration report is properly prepared

Charities

4.8. Any charity which has income above the audit threshold in the financial year must have an audit of its financial statements undertaken by a registered auditor. This is in line with the treatment of companies.

4.9. The Charities Act 1993 also requires all registered charities to prepare a Trustees’ Annual Report. The length of the report and the amount of detail included in it can be in proportion to the charity’s size so for small charities it can be a very simple report.

Central government

4.10. The Comptroller and Auditor General, with the support of the National Audit Office, is responsible for auditing the financial statements of all central Government departments, executive agencies and a wide range of other public sector bodies.

4.11. When certifying the accounts of central government departments, the Comptroller and Auditor General states whether, in his opinion:

- the financial statements give a “true and fair” view of the financial position of the body
- the financial statements have been properly prepared in accordance with underpinning legislation
- in all material respects the transactions recorded in the financial statements are in accordance with Parliamentary or other authority (regularity)
- information given in the Management Commentary/Annual Report is consistent with the financial statements
- the audited part of the Remuneration Report has been properly prepared in accordance with relevant guidance

4.12. The Comptroller and Auditor General also has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

OUR PROPOSALS

4.13. When looking at the future scope of audit for local public bodies we have considered whether we should move to a more transparent model, such as that followed by companies and charities which must produce a director or trustee’s report. Central Government departments are also required to prepare an Annual Report along similar lines. However, we recognise that public money

must be accounted for in a certain way, including assuring regularity and propriety and with the necessary focus on value for money. With this in mind, for larger public bodies we have identified the following three options to deliver effective audit that conforms to the principles of public audit.

Option 1

4.14. The scope of audit could be reduced to be more in line with that for companies, with no assessment of value for money. The auditor would:

- give an **opinion** on whether the financial statements give a true and fair view of the audited body's financial position and of its income and expenditure and
- review, and report on as appropriate, other information published with the financial statements, including the statement on internal control/annual governance statement, the remuneration report and the whole of government accounting summarisation schedules

4.15. This option would reduce the information available to local citizens on how local bodies are spending their money or on whether bodies are securing value for money.

Option 2

4.16. As under the current system, the auditor would:

- give an **opinion** on whether the financial statements give a true and fair view of the audited body's financial position and of its income and expenditure; and
- provide a **conclusion** as to whether it has the proper arrangements in place to secure value for money (based on locally defined policy priorities) having regard to specified criteria (including financial resilience and regulatory and propriety)
- review, and report on as appropriate, other information published with the financial statements, including the statement on internal control/annual governance statement, the remuneration report and the whole of government accounting summarisation schedules

4.17. This option would maintain the current scope of audit. However, this option would not provide any additional information to local citizens on how local public bodies are spending their money or on whether bodies are securing value for money.

Option 3

4.18. New arrangements could provide stronger assurances on the way local public bodies spend money. Under this option, the auditor would still give an **opinion** on the financial statements, but would provide **conclusions** on:

- regularity and propriety – a conclusion on compliance with relevant laws and regulations and the audited body's governance and control regime

- financial resilience – a conclusion about the future financial sustainability of the audited body and
- value for money – in addition to proper arrangements in place to secure value for money, a conclusion about the achievement of economy, efficiency and effectiveness within the audited body

4.19. We will need to consider carefully how a stronger value for money element to the audit would fit with other sectors, such as policing, who already have alternative systems for examining and reporting value for money publicly.

4.20. We believe that, compared to option 1 and 2, option 3 could lead to greater transparency for local citizens, and would help deliver the wide scope of public audit. It would also require a separate conclusion on regularity and propriety and financial resilience, rather than having regard to these aspects within a conclusion on value for money (as in option 2). However, the volume of work undertaken by the auditor would be significantly greater than for option 1. It is also possible that auditors would have difficulties in reaching a robust conclusion on value for money, regularity and propriety. We expect that reaching a conclusion on the achievement for value for money would involve more work for auditors, particularly in the case of complex organisations such as principal local authorities.

Option 4

4.21. Local public spending should be transparent so that citizens can hold bodies to account. Companies are required, by law, to produce and publish an annual report, including the principal activities of the company during the year, and a business review which includes risks and uncertainties. Most public bodies also produce such a report, although local authorities are not currently required to do so.

4.22. Under this option, all local public bodies would be required to produce an annual report and to publish this report on their website. The report would set out the arrangements the audited body had put in place to secure value for money, whether they had achieved economy, efficiency and effectiveness, regularity and propriety and financial resilience.

4.23. The auditor would be required to:

- give an opinion on the financial statements
- review the audited body's annual report and
- provide reasonable assurance on the annual report

4.24. The annual report could be written in an accessible way and would be published. This option could therefore substantially increase the transparency of the local public bodies, compared to options 1 and 2. Citizens' increased knowledge of the local public body's financial performance could help drive greater local accountability. We would need to consider whether producing an annual report in an appropriate format would be a new burden for local authorities that do not currently produce an annual report in an appropriate format.

4.25. Another possible benefit of this option, is that it brings the format of audit for local public bodies (financial statements and reviewing a report) more in-line with that of other sectors.

Q29: Which option would provide the best balance between costs for local public bodies, a robust assessment of value for money for the local taxpayer and provide sufficient assurance and transparency to the electorate? Are there other options?

Q30: Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?

Q31: Would an annual report be a useful basis for reporting on financial resilience, regularity and propriety, as well as value for money, provided by local public bodies?

Q32: Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?

Q33: What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?

Public interest reporting

CURRENT SYSTEM

4.26. Under Section 8 of the Audit Commission Act 1998, the auditor is currently required to consider whether to issue a report in the public interest on any significant matter coming to his or her notice in the course of an audit, and to bring it to the attention of the audited body and the public. The auditor can also make written recommendations to the audited body as part of this report. The audited body has a corresponding duty to consider and respond to these reports and any recommendations that might be made. The costs of the report fall on the audited body.

4.27. Appointed auditors have issued 131 public interest reports since 2002, of which 13 have related to principal local authorities, 85 to parish councils, 30 to health bodies and one each to a passenger transport authority (now an integrated transport authority), a passenger transport executive, and an internal drainage board.

4.28. In addition to the auditor's duties to report in the public interest, they also have the power to make a recommendation requiring a public response and can issue an advisory notice to the body if they have reason to believe the body is about to or has made a decision involving the unlawful incurring of expenditure.

OTHER SECTORS

4.29. Although public interest reporting is a consequence of the principles of public audit, there are some similarities with processes in place in other sectors.

4.30. The auditor of a regulated entity generally has special reporting responsibilities in addition to the responsibility to report on financial statements. One of these special reporting responsibilities is a statutory duty to report certain information, relevant to the regulators' functions that come to the auditor's attention in the course of the audit work. This form of report is derivative in nature and is initiated by the auditor on discovery of a reportable matter.

OUR PROPOSALS

4.31. We consider it is important that the duty on an auditor to consider whether to make a report in the public interest should be retained. Public interest reports are a key part of the current audit system and provide a vehicle through which the public are made aware of issues of significant interest to them. This is consistent with the design principles of localism and transparency.

4.32. We envisage that the current publication requirements for public interest reports would be retained, as would the audited body's responsibilities to consider the report at a meeting within one month of receipt and to publish a summary of the meeting's decision.

4.33. The costs of public interest reports will fall on the audited body. It has been suggested that the new direct contractual relationship between the audited bodies and their auditors could have, if unchecked, an impact on the ability or willingness of the auditor to issue a public interest report. However, we believe that if suitable safeguards are put in place for the resignation or removal of auditors, this will mitigate the risk.

4.34. We also propose to retain the power of an auditor to make a recommendation requiring a public response and to issue an advisory notice to the body if they have reason to believe the body is about to or has made a decision involving the unlawful incurring of expenditure.

<p>Q34: Do these safeguards also allow the auditor to carry out a public interest report without his independence or the quality of the public interest report being compromised?</p>
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Provision of non-audit services

CURRENT SYSTEM

4.35. The auditor may be best placed to carry out certain types of additional work for the audited body. Therefore, the Audit Commission allows additional work to be undertaken without prior approval from the Commission, if the auditor is satisfied that:

- performance of such work will not compromise, nor be reasonably perceived by the public to compromise, his independence and
- the value of the work in total, in any audit year, does not exceed a de minimis amount (set by the Audit Commission as the higher of £30,000 or 20 per cent of the total audit fee, excluding fees for the certification of grant claims and returns)

4.36. Auditors are required to establish procedures to identify and address any potential breaches of these requirements.

4.37. All such work must be:

- agreed in advance with the audited body, on the understanding that such work is discretionary and is not required to meet the auditors' statutory responsibilities and
- billed separately from the audit work

The Commission requires applications for approval to carry out work exceeding the de minimis threshold at least ten days before the start of the work.

OTHER SECTORS

4.38. In other sectors, such as the companies sector, statutory auditors are allowed to provide other non-audit services to the company.

4.39. However, the audit committee of the company has a role in considering all relationships between the company and the audit firm, including the provision of non-audit services and whether, taken as a whole and having regard to the views, as appropriate, of the external auditor, management and internal audit, those relationships appear to impair the auditor's independence and objectivity.

4.40. The audit committee should also develop and recommend to the board the company's policy in relation to the provision of non-audit services by the auditor, and keep the policy under review. The audit committee's objective should be to ensure that the provision of such services does not impair the external auditor's independence or objectivity.

OUR PROPOSALS

4.41. We propose that auditors will be able to provide non-audit services to the audited body, but safeguards will be built into the system to prevent any actual or perceived threats to the auditor's independence. We recognise that by adding a number of safeguards into the system we could reduce the number of auditors eligible for appointment to an audited body, which would in turn affect competition.

4.42. We propose that auditors should continue to adhere to the ethical standards produced by the Auditing Practices Board 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.

Q35: Do you agree that auditors appointed to a local public body should also be able to provide additional audit-related or other services to that body?

Q36: Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?

Public interest disclosure

CURRENT SYSTEM

4.43. Under the current framework, the Audit Commission and appointed auditors are prescribed persons under the Public Interest Disclosure Act 1998 for disclosures relating to “the proper conduct of public business, value for money, fraud and corruption in local government and health service bodies”. The Audit Commission and appointed auditors consider information they receive as a result of a disclosure and determine what action, if any, to take in the context of their existing statutory and professional powers and duties.

4.44. We recognise the importance of the roles undertaken by prescribed persons including the Audit Commission and appointed auditors. It provides reassurance to workers that it is safe and acceptable for them to raise concerns internally and sets out the circumstances where the disclosure of the malpractice outside of the organisation is in the public interest and should be protected.

The Audit Commission’s role in public interest disclosure

The Audit Commission is a ‘prescribed person’ as set out in the Schedule to the Public Interest Disclosure Act. It exercises this role by:

- receiving the facts of a disclosure
- supporting the discloser by referring them to Public Concern at Work for further advice and guidance if subjected to victimisation or harassment;
- acknowledging receipt of the disclosure and stating in general terms what the procedures are
- forwarding information to the auditor and inform the discloser

The current role of the appointed auditor

The auditor’s role includes:

- evaluating the information provided by the Commission
- acknowledging receipt to the discloser, and providing an indication of the likely response, with an explanation for the decision
- undertaking appropriate audit work in response to the disclosure
- reporting the outcome of any work to the discloser and the Commission

OTHER SECTORS

4.45. The Financial Reporting Council's guidance for the audit committees of companies sets out a role for the audit committee in reviewing arrangements under which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective is to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

OUR PROPOSALS

4.46. We believe it is important that a similar system operates in the new framework. We propose that the Audit Commission's role (receiving, acknowledging receipt of and forwarding the facts of disclosure) should be broadly transferred to the audit committee of the local public body. The audit committee may choose to designate one of its independent members as a point of contact. As this role is an administrative role, which involves no need to consider the issue they are transferring, we do not see this as an additional burden on audit committees.

4.47. We envisage that the statutory auditor of the local public body would continue to be a prescribed person and would continue with his/her role with no change from the current system.

Q37: Do you agree that it would be sensible for the auditor and the audit committee of the local public body to be designated prescribed persons under the Public Interest Disclosure Act? If not, who do you think would be best placed to undertake this role?

Transparency

CURRENT SYSTEM

4.48. Members of the public currently have rights to question the auditor of an audited body about its accounts and raise objections, if the audited body is not a health body, in respect of unlawful items of account or matters on which the auditor can make a report in the public interest. The auditor may also apply for a declaration to the Court. Objectors have the right to appeal to the Courts about an auditor's decision.

4.49. Auditors have only limited discretion to refuse to investigate objections, but the costs of investigating objections, which are recovered from the local public body and, therefore, funded by council taxpayers, can be disproportionate to the sums involved in the complaint, or to the normal audit costs of the local public body.

4.50. The right to object to the accounts was first introduced more than 150 years ago, at a time when the auditor was the only individual to whom an elector could raise issues of concern.

OUR PROPOSALS

- 4.51. The public can now raise concerns through a wide variety of appropriate avenues for redress, including the Local Government Ombudsman (in relation to maladministration) and the Information Commissioner (on matters concerning the rights that individuals have under the Freedom of Information and Data Protection Acts). Publication of all expenditure over £500 also makes spending more transparent and more readily available to the public.
- 4.52. With this in mind, we consider that the rights for local government electors to object to the accounts are both outdated and over-burdensome on auditors, local public bodies and council tax payers.
- 4.53. Under the new local audit framework, members of the public would retain the right to make representations to the auditor, raise issues with the auditor and to ask the auditor questions about the accounts.
- 4.54. While the right to make formal objections would be removed, the local public body would still be required to advertise that its accounts had been prepared and there will be increased publicity requirements for audited bodies. The auditor would still be open and transparent about the audit, and would consider any relevant representations from the public. The auditor would have discretion to decide whether to follow-up any issues raised by local citizens, having regard to the significance of the issue, the amounts of public money involved and the wider public interest. If the auditor decided not to consider a representation further, the decision would be amenable to judicial review, should the citizen who made the representation be dissatisfied with the decision.
- 4.55. We propose that auditors should also 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. Therefore, only information in connection with a public audit would be within the remit of a freedom of information request. However, we recognise that there are costs associated with responding to freedom of information requests which could have an impact on audit fees. We would also need to consider whether this could be detrimental to the auditor and audited body's relationship.
- 4.56. We also envisage that local public bodies should be required to publish their accounts and the auditor's report on the website.
- 4.57. We consider that these proposals would provide a balance between transparency and disproportionate cost.

Q38: Do you agree that we should modernise the right to object to the accounts? If not, why?

Q39: Is the process set out above the most effective way for modernising the procedures for objections to accounts? If not, what system would you introduce?

Q40: Do you think it is sensible for auditors to be brought within the remit of the Freedom of Information Act to the extent of their functions as public office holders? If not, why?

Q41: What will be the impact on (i) the auditor/audited body relationship, and (ii) audit fees by bringing auditors within the remit of the Freedom of Information Act (to the extent of their functions as public office holders only)?

Section 5

5. Arrangements for smaller bodies

Current system

The limited assurance audit regime

The limited assurance audit regime was first introduced in 2001-02 for local councils (parish meetings and parish and town councils) where neither income nor expenditure exceeded £500,000. This threshold was increased to £1m in 2006.

The regime is designed specifically to minimise the audit requirement upon, and cost to, these small bodies. The audits are based on the submission by the body to the auditor of an annual return that is subject to a desk review. The audit report provides a limited level of assurance to the body commensurate with the amount of work undertaken.

The basic audit approach is common to all smaller bodies. However, for those bodies with annual income or expenditure over £200,000, auditors are required to carry out additional testing as part of their audit approach to reflect the higher risk to public funds; this is referred to as the intermediate audit. In addition, on a random sample basis, 5 per cent of those bodies operating below the £200,000 threshold will also be selected annually for intermediate audit at no extra cost.

- 5.1. Under the current legislation, the statutory audit requirements for smaller bodies are the same as those for larger bodies. However, since 2002, the Audit Commission has ensured that these are met proportionately through a separate “limited assurance” framework for bodies with an income or expenditure less than £1m. The smallest bodies currently do not pay any fees for their annual audit.
- 5.2. To bring this into line with the framework under the Companies Act the £1m threshold for local public bodies is being increased to not more than £6.5m.

OTHER SECTORS

- 5.3. The companies and charities sector, both have arrangements in place to ensure a more proportionate level of audit for smaller bodies.

Charities

- 5.4. The Charities Act 1993 put in place a system by which some small charities could be subject to independent examination rather than a full audit.

Independent Examination v Audit (Charity Sector)

The two main differences between independent examination and audit relate to:

- Who can act
- The nature of the report.

	Who can act	The nature of the Report
Independent Examination	An independent person who is reasonably believed by the body to have the requisite knowledge and practical experience to carry out a competent examination of the accounts. No specific qualification is necessarily required but the person must have a good understanding of accounts.	Provides a "negative assurance" on the accounts. The independent examiner declares that no evidence was found of lack of accounting records, of accounts failing to comply with the records, nor of other matters that need to be disclosed.
Audit	Must be a registered auditor	An audit report will need to provide an opinion on the financial statements

5.5. The level of independent examination is dictated by the level of gross income of the charity.

Level of Gross Income	External scrutiny	Annual Report
Not exceeding £10,000	There is no requirement to have the accounts independently examined or audited	The trustees must prepare an annual report but it may be simplified.
Over £10,000 but not exceeding £100,000	Accounts must be subject to outside scrutiny but trustees may choose either independent examination or audit by a registered auditor	An Annual Report must be prepared but it may be simplified
Over £100,000 but not exceeding £500,000 (total assets not exceeding £2.8m)	Accounts must be subject to outside scrutiny but trustees may choose either independent examination or audit by a registered auditor. If an independent examination is chosen and gross income exceeds £250,000 then the independent examiner appointed must be a member of a body specified under the 2006 Act.	An Annual Report must be prepared but it may be simplified
Exceeds £500,000 (or a charity whose gross assets exceed £2.8m and gross income exceeds £100,000)	A statutory audit is required (subject to specified exceptions) and the accounts must be audited by a registered auditor.	A full Annual Report must be prepared

- 5.6. Company charities used to be dealt with under the Companies Act 2006 system. However, from the financial year beginning on or after 1 April 2008 all charities (including company charities) are subject to the Charities Act 1993 system. The purpose of this change was to ensure that the scrutiny of small company charities was consistent with charity law requirements and in particular allowed for the independent examination of eligible small company charities.
- 5.7. Company charities which meet the Companies Act definition of a small company may elect for exemption from audit under the Companies Act and opt to have their accounts audited or independently examined under the Charities Act 1993.
- 5.8. Independent examination offers a lower cost alternative to charities that do not require the higher level of assurance that audit can provide. Changes effective from this date also result in new requirements for the audit of small groups when their accounts are prepared by parent company charities.

Companies

- 5.9. The Companies Act 2006 sets out the thresholds which must be met for a company to be deemed a small company. These are, at least two of the following three conditions:
- annual income or expenditure (gross income for charities) not exceeding - £6,500,000
 - balance sheet total not exceeding - £3,260,000
 - average numbers of employers not exceeding – 50
- 5.10. These thresholds are subject to periodic amendment.
- 5.11. There is exemption from audit for **certain** small companies if they are eligible and wish to take advantage of it. To qualify for audit exemption, a company must:
- qualify as small (per paragraph 5.9) **and**
 - have an income or expenditure of not more than £6.5m **and**
 - have a balance sheet total of not more than £3.26m
- 5.12. Even if a small company meets these criteria, it must still have its accounts audited if this is demanded by a member or members holding at least 10 per cent of the nominal value of issued share capital or holding 10 per cent of any class of shares. Public companies are not eligible for exemption.

OUR PROPOSALS

- 5.13. Both the limited assurance and independent examination regimes outlined above provide a simpler, more proportionate, form of external scrutiny than a full audit, but still provide assurance that the accounts of the bodies involved have been reviewed by an independent person.

- 5.14. We aim to bring arrangements for smaller local public bodies into line with other sectors. We are therefore considering a process under which the income and expenditure of a body determines what 'level' of audit or scrutiny is required; the greater the income/expenditure, the more scrutiny is required.
- 5.15. We propose that the 1,200 or so bodies with income or expenditure less than £1,000 would not be subject to an external examination or audit, as the risk to public funds is low and any external examination or audit fees would be disproportionate to their income or expenditure. These bodies do not currently pay a fee for an audit or examination, and requiring them to now do so would clearly increase their costs.
- 5.16. Bodies with an income or expenditure between £1,000 and the upper threshold of £6.5m would be subject to an independent examination rather than a full audit.
- 5.17. Examiners of small bodies should act for a maximum period of 10 years (which is in line with the current practices of the Audit Commission).
- 5.18. We propose that the independent examination of smaller bodies should be similar to that followed in the charities sector. As we have set out above, the charities sector provides for a reduced audit for bodies with income or expenditure below £500,000. However, the Audit Commission has provided limited assurance to all bodies with income or expenditure under £1m recently raised to not more than £6.5m. We are keen to ensure that smaller bodies are not disproportionately affected by our proposals. Therefore we propose a staged model such as the model followed in the charities sector, where the level of examination and the qualifications that the independent examiner must have are based on the income or expenditure of the body. However, this staged model would reflect the current £6.5m threshold used by the Audit Commission for their limited assurance regime. The independent examination of smaller bodies might therefore look as follows:

	Number	% small bodies market	Income/Expenditure	Scrutiny
Level 1	1,200	12%	Public bodies with expenditure less than £1,000	<ul style="list-style-type: none"> Existing governance and accounting arrangements Annual accounts published Positive confirmation that annual accounts have been produced and published via the precept request (or equivalent) No external audit/scrutiny
Level 2	Approx 6,400 bodies	64%	Public bodies with expenditure between £1,000 and £50,000	<p>As level 1, but</p> <ul style="list-style-type: none"> (Under option 1 below) the county or unitary council to appoint an independent examiner (no specific qualifications needed, but County or unitary council should assure itself that the relevant person has the requisite experience and expertise) to assess its accounts. In practice the Section 151 officer or full council, having regard to advice provided by the audit committee, would make this appointment. The independent examiner might be an officer of the county or unitary council. The body must also publish the details of the examiner.
Level 3	Approx 1,625 bodies	16%	Public bodies with expenditure between £50,000 and £250,000	<p>As level 2, but:</p> <ul style="list-style-type: none"> Existing internal audit arrangements Independent examiner must hold a professional qualification to assess its accounts.
Level 4	Approx 675 bodies	7%	Public bodies with expenditure between £250,000 and £6.5m	<p>As level 3, but</p> <ul style="list-style-type: none"> Independent examiner must hold a professional qualification and be registered as a public auditor.

Appointing the examiner

OPTION 1

5.19. We consider that the appointment process for the independent examiner should be proportionate. An audit committee could be a significant cost for a smaller body. Instead, where an independent examiner is required, we propose that the county or unitary authority should be responsible for appointing the independent examiner (see table above). If smaller bodies were responsible for appointing their own examiner in the absence of an audit committee there would be a lack of independence in the appointment process. In addition, they may not achieve a good price for this service.

5.20. If the county or unitary authority was responsible for the appointment this would provide a degree of independence to the appointment process for smaller bodies, and they would have the ability to appoint independent examiners for all of the smaller bodies in their areas, providing the opportunity to make savings through economies of scale.

OPTION 2

5.21. The small body would be required to make arrangements for the appointment of the independent examiner, **including** the involvement of an audit committee. This would give the body the freedom to make the necessary arrangements which might include joining up with other small bodies, either locally or providing similar services. The smaller bodies would be able to arrange a joint audit committee, with safeguards to provide for independence. Alternatively, the small body would be able to join with a larger local public body and utilise their audit committee. Under this option the scope of the examination would still be as set out in the table above.

Q42: Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?

Q43: Do you think the county or unitary authority should have the role of commissioner for the independent examiners for smaller bodies in their areas? Should this be the section 151 officer, or the full council having regard to advice provided by the audit committee? What additional costs could this mean for county or unitary authorities?

Q44: What guidance would be required to enable county/unitary authorities to:

- a.) Appoint independent examiners for the smaller bodies in their areas?**
- b.) Outline the annual return requirements for independent examiners?**

Who should produce and maintain this guidance?

Q45: Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?

Q46: Are there other options given the need to ensure independence in the appointment process? How would this work where the smaller body, e.g. a port health authority, straddles more than one county/unitary authority?

Q47: Is the four-level approach for the scope of the examination too complex? If so, how would you simplify it? Should the threshold for smaller bodies be not more than £6.5m or £500,000? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?

Public interest reporting for smaller bodies

5.22. There would be no auditor to receive queries or objections from the public, and there would be no public interest reporting. However, if the examiner identified issues giving cause for concern we propose that these could be raised with the audited body, or the county or unitary authority. The county or unitary authority could be given the power to appoint an auditor to then carry out a public interest report on the matters raised with the audited body. Sanctions could include a power to make the next precept (partly or wholly) conditional on the matters raised being addressed.

Q48: Does this provide a proportionate, but appropriate method for addressing issues that give cause for concern in the independent examination of smaller bodies? How would this work where the county council is not the precepting authority?

Objections to accounts of smaller bodies

5.23. For bodies with an income or expenditure greater than £6.5 million we are proposing to modernise the system for dealing with objections to accounts.

5.24. In the case of smaller bodies, we propose that the independent examiner would be able to consider whether to refer issues raised by citizens to the proper officer (possibly the s151 officer) of the county or unitary authority. That authority would be provided with powers to take action, which might include appointing an auditor to consider those issues and report in public to the examined body. The costs for dealing with the representation would fall to the smaller body.

Q49: Is the process set out above the most appropriate way to deal with issues raised in relation to accounts for smaller bodies? If not, what system would you propose?

Regulatory regime for smaller bodies

5.25. For smaller bodies the more proportionate approach described of independent examination would not give rise to the same level of scrutiny as an external audit.

5.26. However, if appointing the independent examiner to the smaller body, or if provided with powers to take action, which might include appointing an auditor to carry out a public interest report, the county or unitary council would, essentially, be the regulator for this sector.

Q50: Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?

Section 6

6. List of consultation questions

1. Have we identified the correct design principles? If not what other principles should be considered? Do the proposals in this document meet these design principles?
2. Do you agree that the audit probation trusts should fall within the Comptroller and Auditor General's regime?
3. Do you think that the National Audit Office would be best placed to produce the Code of audit practice and the supporting guidance?
4. Do you agree that we should replicate the system for approving and controlling statutory auditors under the Companies Act 2006 for statutory local public auditors?
5. Who should be responsible for maintaining and reviewing the register of statutory local public auditors?
6. How can we ensure that the right balance is 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?
7. What additional criteria are required to ensure that auditors have the necessary experience to be able to undertake a robust audit of a local public body, without restricting the market?
8. What should constitute a public interest entity (i.e. a body for which audits are directly monitored by the overall regulator) for the purposes of local audit regulation? How should these be defined?
9. There is an argument that by their very nature all local public bodies could be categorised as 'public interest entities.' Does the overall regulator need to undertake any additional regulation or monitoring of these bodies? If so, should these bodies be categorised by the key services they perform, or by their income or expenditure? If the latter, what should the threshold be?
10. What should the role of the regulator be in relation to any local bodies treated in a manner similar to public interest entities?
11. Do you think the arrangements we set out are sufficiently flexible to allow councils to cooperate and jointly appoint auditors? If not, how would you make the appointment process more flexible, whilst ensuring independence?
12. Do you think we have identified the correct criteria to ensure the quality of independent members? If not, what criteria would you suggest?

13. How do we balance the requirements for independence with the need for skills and experience of independent members? Is it necessary for independent members to have financial expertise?
14. Do you think that sourcing suitable independent members will be difficult? Will remuneration be necessary and, if so, at what level?
15. Do you think that our proposals for audit committees provide the necessary safeguards to ensure the independence of the auditor appointment? If so, which of the options described in paragraph 3.9 seems most appropriate and proportionate? If not, how would you ensure independence while also ensuring a decentralised approach?
16. Which option do you consider would strike the best balance between a localist approach and a robust role for the audit committee in ensuring independence of the auditor?
17. Are these appropriate roles and responsibilities for the Audit Committee? To what extent should the role be specified in legislation?
18. Should the process for the appointment of an auditor be set out in a statutory code of practice or guidance? If the latter, who should produce and maintain this?
19. Is this a proportionate approach to public involvement in the selection and work of auditors?
20. How can this process be adapted for bodies without elected members?
21. Which option do you consider provides a sufficient safeguard to ensure that local public bodies appoint an auditor? How would you ensure that the audited body fulfils its duty?
22. Should local public bodies be under a duty to inform a body when they have appointed an auditor, or only if they have failed to appoint an auditor by the required date?
23. If notification of auditor appointment is required, which body should be notified of the auditor appointment/failure to appoint an auditor?
24. Should any firm's term of appointment be limited to a maximum of two consecutive five-year periods?
25. Do the ethical standards provide sufficient safeguards for the rotation of the engagement lead and the audit team for local public bodies? If not, what additional safeguards are required?

26. Do the proposals regarding the reappointment of an audit firm strike the right balance between allowing the auditor and audited body to build a relationship based on trust whilst ensuring the correct degree of independence?
27. Do you think this proposed process provides sufficient safeguard to ensure that auditors are not removed, or resign, without serious consideration, and to maintain independence and audit quality? If not, what additional safeguards should be in place?
28. Do you think the new framework should put in place similar provision as that in place in the Companies sector, to prevent auditors from seeking to limit their liability in an unreasonable way?
29. Which option would provide the best balance between costs for local public bodies, a robust assessment of value for money for the local taxpayer and provides sufficient assurance and transparency to the electorate? Are there other options?
30. Do you think local public bodies should be required to set out their performance and plans in an annual report? If so, why?
31. Would an annual report be a useful basis for reporting on financial resilience, regularity and propriety, as well as value for money, provided by local public bodies?
32. Should the assurance provided by the auditor on the annual report be 'limited' or 'reasonable'?
33. What guidance would be required for local public bodies to produce an annual report? Who should produce and maintain the guidance?
34. Do these safeguards also allow the auditor to carry out a public interest report without his independence or the quality of the public interest report being compromised?
35. Do you agree that auditors appointed to a local public body should also be able to provide additional audit-related or other services to that body?
36. Have we identified the correct balance between safeguarding auditor independence and increasing competition? If not, what safeguards do you think would be appropriate?
37. Do you agree that it would be sensible for the auditor and the audit committee of the local public body to be designated prescribed persons under the Public Interest Disclosure Act? If not, who do you think would be best placed to undertake this role?
38. Do you agree that we should modernise the right to object to the accounts? If not, why?

39. Is the process set out above the most effective way for modernising the procedures for objections to accounts? If not, what system would you introduce?
40. Do you think it is sensible for auditors to be brought within the remit of the Freedom of Information Act to the extent of their functions as public office holders? If not, why?
41. What will be the impact on (i) the auditor/audited body relationship, and (ii) audit fees by bringing auditors within the remit of the Freedom of Information Act (to the extent of their functions as public office holders only)?
42. Which option provides the most proportionate approach for smaller bodies? What could happen to the fees for smaller bodies under our proposals?
43. Do you think the county or unitary authority should have the role of commissioner for the independent examiners for smaller bodies in their areas? Should this be the section 151 officer, or the full council having regard to advice provided by the audit committee? What additional costs could this mean for county or unitary authorities?
44. What guidance would be required to enable county/unitary authorities to:
- a.) Appoint independent examiners for the smaller bodies in their areas?
 - b.) Outline the annual return requirements for independent examiners?
- Who should produce and maintain this guidance?
45. Would option 2 ensure that smaller bodies appoint an external examiner, whilst maintaining independence in the appointment?
46. Are there other options given the need to ensure independence in the appointment process? How would this work where the smaller body, e.g. a port health authority, straddles more than one county/unitary authority?
47. Is the four-level approach for the scope of the examination too complex? If so, how would you simplify it? Should the threshold for smaller bodies be not more than £6.5m or £500,000? Are there other ways of dealing with small bodies, e.g. a narrower scope of audit?
48. Does this provide a proportionate, but appropriate method for addressing issues that give cause for concern in the independent examination of smaller bodies? How would this work where the county council is not the precepting authority?
49. Is the process set out above the most appropriate way to deal with issues raised in relation to accounts for smaller bodies? If not, what system would you propose?
50. Does this provide a proportionate but appropriate system of regulation for smaller bodies? If not, how should the audit for this market be regulated?

Appendix A

Audited bodies' published accounts – current arrangements

The annual accounting statements that audited bodies, other than NHS bodies and probation bodies, are currently required to publish are prescribed in Accounts and Audit Regulations made under section 27 of the Audit Commission Act 1998. A new consolidated set of the regulations has recently been issued. The accounting statements for all the bodies must cover the year ending on 31 March.

The larger bodies (broadly those with annual income or expenditure of more than £6.5m) must produce a “statement of accounts”, based, as from the 2010-11 financial year, on International Financial Reporting Standards as those standards are applied by the *Code of Practice on Local Authority Accounting in the United Kingdom*, published by CIPFA/LASAAC. The statement must also conform to specific requirements set out in the Accounts and Audit Regulations and other legislation. A statement of accounts includes all the elements that would be expected in a comprehensive set of accounts, including:

- movement in reserves statement
- comprehensive income and expenditure account
- balance sheet
- cash flow statement, and
- supporting notes, including a summary of significant accounting policies

Where the body has significant subsidiaries or associates Group Accounts must also be included. The statement of accounts is accompanied by a statement of internal control or annual governance statement, setting out the body's annual assessment of how it is managing and controlling the risks it faces in achieving its aims and legal obligations.

The smaller bodies are given a choice on the form of their annual accounting statements. They can prepare either:

- a statement of accounts on the same basis as a larger body or
- an income and expenditure account and statement of balances or
- where the body's annual income or expenditure is no more than £200,000, a record of receipts and payments

For the second and third options the requirements are specified in an Annual Return that the body is required to present to the auditor and publish. The form of the Annual Return is laid out in *Governance and Accountability for Local Councils, a Practitioners' Guide*, available from the National Association of Local Councils.

The accounting statements for both the larger and smaller bodies must be audited (for smaller bodies the audit is a ‘limited assurance’ - a simpler, more proportionate, form of external scrutiny than a full audit). The statements, together with the auditor's opinion on them, must then be published, and this should be done by 30 September following the financial year end. The larger bodies are required to publish the statements on their websites, and the smaller bodies by displaying them within their area, though both are free to use other means of publication in addition.

Appendix B

List of bodies to which the Audit Commission appoints auditors in England

The audit bodies which are specified in primary legislation are³:

- A local authority (meaning a county council, district council, London borough council and a parish council).
- A joint authority (which means an authority established by Part 4 of the Local Government Act 1985, includes metropolitan county fire and rescue authorities).
- The Greater London Authority.
- Passenger Transport Executive.
- A functional body (meaning Transport for London, the London Development Agency, the Metropolitan Police Authority and the London Fire and Emergency Planning Authority).
- The London Pensions Fund Authority.
- The London Waste and Recycling Board.
- A parish meeting of a parish not having a separate parish council.
- A committee of a local authority, including a joint committee of two or more such authorities.
- The Council of the Isles of Scilly.
- Any Charter Trustees constituted under section 246 of the Local Government Act 1972.
- A Health Service Body prepared under paragraph 3(1) of Schedule 15 to the National Health Service Act 2006.
- A Port Health Authority constituted under section 2 of the Public Health (Control of Disease) Act 1984.
- The Broads Authority.
- A national park authority.
- A conservation board established by order under section 86 of the Countryside and Rights of Way Act 2000.
- A police authority established under section 3 of the Police Act 1996.
- A fire and rescue authority constituted by a scheme under Section 2 of the Fire and Rescue Services Act 2004 or a scheme to which section 4 of that Act applies.
- 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).
- A licensing planning committee.
- An internal drainage board.
- A local probation board established under section 4 of the Criminal Justice and Court Services Act.

³ It is proposed through the Police Reform and Social Responsibility Bill that police and crime commissioners and chief constables will be added to schedule 2 of the Audit Commission Act 1998 and thereby become a body for which the Audit Commission will appoint auditors to. In addition, the Health Bill refers to GP Consortia being brought within the Audit Commission Act 1998.

- A probation trust.
- An economic prosperity board established under section 88 of the Local Democracy, Economic Development and Construction Act 2009.
- A combined authority established under section 103 of that Act.
- The accounts of the collection fund of the Common Council and the accounts of the City fund.
- The accounts relating to the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme Regulations 1995.

Appendix C

Recognised supervisory bodies and recognised qualifying bodies in England

In the companies sector, audit firms must be registered with, and subject to supervision by a recognised supervisory body and persons responsible for company audit work at a firm must hold a recognised qualification awarded by a recognised qualifying body.

There are currently five recognised supervisory bodies:

- Association of Authorised Public Accountants
- Association of Chartered Certified Accountants
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants in Ireland
- Institute of Chartered Accountants in Scotland

and six recognised qualifying bodies:

- Association of Chartered Certified Accountants
- Association of International Accountants
- Chartered Institute of Public Finance and Accountancy
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants in Ireland
- Institute of Chartered Accountants in Scotland

11. **Audit Committee Request for a Review of Severance Payment Made to Former Chief Executive of SSDC**

Strategic Director: Mark Williams, Chief Executive
Lead Officer: Mark Williams, Chief Executive
Contact Details: mwilliams@southsomerset.gov.uk or 01935 462101

Purpose of the Report

This report has been prepared for the Audit Committee in response to a request for a review of the process and decision in the redundancy of the former Chief Executive of South Somerset District Council.

Recommendation

To note the finding of both SWAP (Internal Audit), and the District Auditor on behalf of the Audit Commission (External Audit).

Background

As a result of articles in the local and national press approximately 24 members of the public complained or requested further scrutiny of the redundancy payment made to the Chief Executive of South Somerset District Council in March 2010. The Audit Committee requested that an internal examination of the process and decision was made through SWAP who provide Internal Audit services to this authority. As Chief Executive I requested that an external review was also completed to ensure the committee and the public had assurance that due process had been followed and the decision had been made with the full information provided, and that, the decision made was lawful.

The Reviews

Both reviews are attached as an appendix to this report at pages 48-52. The main findings were as follows:

- All payments made to the previous Chief Executive were fully in accordance with SSDC's policy;
- No ex gratia payments of any kind were made to him;
- The report to the District Executive meeting outlined clearly all aspects of the severance proposal;
- The accounts for 2009/10 properly reflected the severance expenditure and fully disclosed all information required (note these were available to the public in June 2010);
- The severance expenditure complied with appropriate legal provisions;
- The expenditure was properly authorised and all relevant information was presented when the decision was made;

All members of the public that requested a review of the payment and decision making process will be sent a copy of both reviews.

Financial Implications

The cost of the review of SWAP has been found from within resources in the Audit Plan.

Background Papers: None

Special Review Final Report



- ▶ Redundancy of the former Chief Executive

Issued To: Mark Williams
Chief Executive

Working in partnership with:



Date of Report: 25th March 2011

Issued by: Gerry Cox
Head of Internal Audit Partnership

Ian Baker
Group Audit Manager

Redundancy of the former Chief Executive

Background

Following headline reports in the Daily Telegraph and Western Gazette, regarding the various payments made to the former Chief Executive, Phil Dolan, in relation to his redundancy last year, the SWAP website received a number of complaints and requests to investigate the veracity and appropriateness of the payments.

In normal circumstances any such investigation would only be launched with the acquiescence of the Assistant Director, Finance and Corporate Services, as Section 151 Officer. In this instance, however, this officer was closely involved in formulating the former Chief Executive's severance package and was the joint author, with the Monitoring Officer, of the definitive report presented to District Executive for approval. In these circumstances I exercised my option, under the Internal Audit Charter, to raise the issue with the Chairman of the Audit Committee, Derek Yeomans, and with the Deputy Leader, Ric Pallister (in the absence of the Leader). Mr Yeomans agreed that, under the circumstances, an investigation was warranted and I agreed to report my findings back directly to him.

Subsequent to my meetings with Mr Yeomans and Mr Pallister, a meeting took place between the Chief Executive, Mark Williams, the Deputy Director, Finance and Corporate Service, Donna Parham, the Deputy Director, Legal and Corporate Services, Ian Clarke, the Group Audit Manager, Ian Baker and the Head of Internal Audit Partnership, Gerry Cox. At this meeting it was agreed that the results of the investigation would be presented to the Chief Executive, who would commission an external review by the Audit Commission to verify the conclusions of this report. Whilst recognising the independence and objectivity of Internal Audit, the Chief Executive considered it essential that the findings and conclusions by Internal Audit be reviewed by the External Auditors so as to ensure complete transparency.

The investigation was undertaken by Ian Baker and Gerry Cox and focussed on these key areas:

1. The establishment as to whether the payments made to Mr Dolan were in accordance with South Somerset District Council's severance policy.
2. That the payments made to Mr Dolan did not include any *ex gratia* amounts outside of the severance policy, except where specifically approved by the Council.
3. That the members of the District Executive were provided with comprehensive information, including any available alternative severance arrangements and a full risk appraisal.
4. That the District Executive received full disclosure on all matters pertinent to the severance arrangements and could make a fully informed decision.

It was originally our intention to interview a number of officers in respect of the investigation. We discovered, however, that the documentary evidence was explicit and complete. As a result we were able to arrive at a clear conclusion without recourse to interviewing staff.

Conclusion

Following our review we have concluded that:

1. All payments made to Mr Dolan were fully in accordance with Council Policy, including the rules pertaining to redundancy payments, pension enhancements and severance pay. In the case of the enhancement to Mr Dolan's pension fund, the amount paid was in accordance with the requirements of the Local Government Pension Scheme and therefore cannot be revised or changed by the Council.

2. No *ex gratia* payments of any kind were made to Mr Dolan. He only received severance remuneration under the scheme that would be applicable to any employee.
3. The report by the Section 151 Officer and the Monitoring Officer, to the District Executive Committee meeting of 4th February, 2010 clearly sets out all aspects of the severance proposal including:
 - a. Alternatives in relation to the timing of Mr Dolan's redundancy, whereby no pension enhancement would be necessary but where alternatively costs to the Council would greatly exceed any pension payments made.
 - b. The calculations as to how the severance and redundancy payments were arrived at.
 - c. A full risk assessment, regarding alternative options, clearly setting out the consequences of following one or more courses of action.
4. The District Executive Committee was provided with complete and comprehensive information, sufficient to come to a fully informed conclusion.

In summary, we are satisfied that, although the 'headline figures' seem high, payments made were fully in accordance with council policy, national agreements and pension regulations. In addition, we found that the figures published in the press were, in part at least, inaccurate and misleading. From that, we concluded that the complaints we had received via our whistleblowing area of the SWAP website, though understandable based on the press coverage, were nonetheless unsubstantiated.

9 May 2011

Mark Williams
Joint Chief Executive
South Somerset & East Devon District Councils
Brympton Way
Yeovil
Somerset
BA20 2HT

Direct line 0844 798 8736

— Dear Mark

Internal Audit report on redundancy payment

In our telephone discussion at end of March, you asked me to review and comment on the report then being finalised by Internal Audit (the South West Audit Partnership) on the redundancy of the former Chief Executive, Phil Dolan. This followed the Audit Committee on 24 February which requested that, in view of the amount of public interest and concern, Internal Audit should independently review the severance package.

The Internal Audit review has since been completed and the report concluded that the “payments made were fully in accordance with council policy, national agreements and pension regulations.”

I can confirm that this conclusion, and the detailed findings in the report, is consistent with the results of our own review carried out as part of the 2009-10 audit. The severance expenditure was incurred during 2009-10 and was examined as part of our audit that year. We reported our findings to the Audit Committee on 23 September 2010 and issued an unqualified audit opinion on the accounts shortly afterwards.

I can confirm that the work we carried out as part of the 2009-10 audit is broadly similar to that undertaken by Internal Audit. In reviewing the expenditure, we confirmed that:

- The accounts properly reflected the severance expenditure and that there was full disclosure of all required information
- The severance expenditure complied with appropriate legal provisions
- The expenditure was properly authorised and all relevant information was presented to the Executive when the redundancy decision was approved

Based on our earlier work and the detail set out in the Internal Audit report, I can therefore confirm that the Internal Audit report findings are accurate and consistent with our own conclusions.

Yours sincerely

A handwritten signature in black ink that reads "B. Bethell". The signature is written in a cursive style with a large, looped initial "B".

Brian Bethell
District Auditor

Audit Committee – 23rd June 2011

12. 2010/11 Treasury Management Activity Report

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham (Finance and Corporate Services)
Service Manager: Amanda Card, Finance Manager
Lead Officer: Karen Gubbins, Principal Accountant - Exchequer
Contact Details: karen.gubbins@southsomerset.gov.uk or 01935 462456

Purpose of the Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the 2010/11 financial year as prescribed by the revised CIPFA Code of Practice and in accordance with the Council's Treasury Strategy and Annual Investment Policy and Treasury Management Practices.

Recommendations

2. The Audit Committee are asked to:
 - Note the Treasury Management Activity for the 2010/11 financial year;
 - Note the position of the individual prudential indicators for the 2010/11 financial year;
 - Note the outlook for the investment performance in 2011/12
 - Recommend the 2010/11 Treasury Management Activity Report to full Council

Background

3. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. The Council reports six monthly to Full Council against the strategy approved for the year. The scrutiny of treasury management policy, strategy and activity is delegated to the Audit Committee.
4. Treasury management in this context is defined as:

"The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".
5. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

Summary of Investment Strategy for 2010/11

6. The Council's strategy for investments is based upon minimising risk and safeguarding the capital sum. There is a reliance on the investment income receivable in maintaining a balanced revenue budget and therefore the long-term

strategy is to maintain stability by having a significant amount invested in fixed rate of return investment instruments.

7. Our minimum rating is A+ long term (or equivalent). Following the guidance from our advisors, Arlingclose we are keeping investments to a rolling programme of 12 months where cash flow permits.
8. The sum invested in longer dated securities at fixed rates of interest at the end of March 2011 represented 32.87% of the total portfolio. The sum invested in longer dated securities at variable rates of interest at the end of March 2011 represented 15.49% of the total portfolio. Investments made in longer dated securities comprise EuroSterling bonds and a Corporate bond; these investments have all been made following advice from our treasury advisers.
9. The Treasury Management Strategy Statement and Annual Investment Policy were both approved by Council on 18th March 2010. The strategy identified that the overall investment portfolio should, subject to current economic conditions, include investments in the following ranges:-

	%
Fund Managers and pooled managed funds.	0% - 25%
Term deposits (up to 2 years).	0% - 75%
3 – 5 year cash deposits.	0% - 25%
1 – 5 year callable deposits.	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	10% - 75%

10. The table below compares the investment portfolio at 31st March 2011 to the investment strategy:-

	£'m	%	Strategic aim
Pooled Managed Funds and business reserve accounts	4.00	10.3	0% - 25%
Term deposits (up to 2 year)	16.00	41.3	0% - 75%
3 – 5 year cash deposits.	0	0	0% - 25%
1 – 5 year callable deposits.	0	0	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	18.73	48.4	10% - 75%
	38.73	100.0	

The above table shows that the current investment portfolio broadly reflects the strategy.

Interest Rates 2010/11

11. Base rate began the financial year at 0.5% and has maintained this throughout 2010/11
12. Our advisors are forecasting that rates will continue at 0.5% during the remainder of this financial year with a likelihood of increasing by 0.25% in August 2011.

	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Official Bank Rate												
Upside risk	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75	2.75	3.00	3.00	3.00
Downside risk	0.00	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Investment Portfolio

13. The table below shows the Council's portfolio of investments at the start and end of the 2010/11 financial year;

	Value of Investments at 01.04.10 £	Value of Investments at 31.03.11 £	Fixed/ Variable Rate
Investments advised by Arlingclose			
Euro Sterling Bonds	9,850,072	7,537,881	Fixed
Corporate Bonds	5,336,559	5,194,979	Fixed
Euro Sterling Bonds	2,000,630	6,000,000	Variable
Total	17,187,261	18,732,860	
Internal Investments			
Short Term Deposits	19,000,000	16,000,000	Variable
Money Market Funds & Business Reserve Accounts	2,960,000	4,000,000	Variable
Total	21,960,000	20,000,000	
TOTAL INVESTMENTS	39,147,261	38,732,860	

Returns for 2010/11

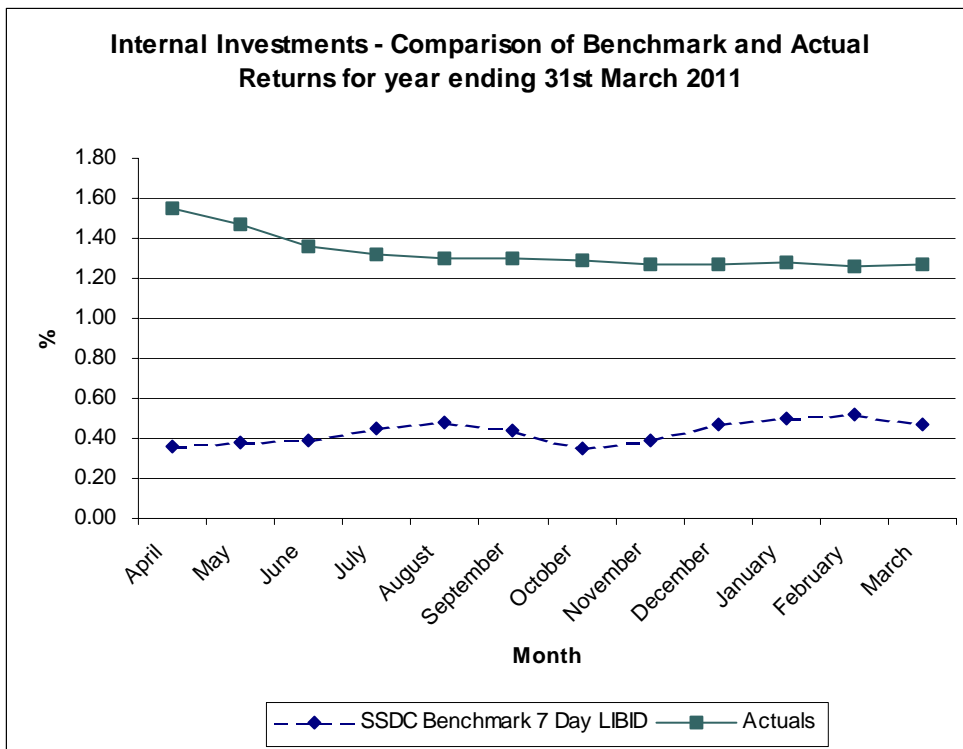
14. The returns to 31st March 2011 are shown in the table below:

	Actual Income £'000	% Rate of Return
Investments advised by Arlingclose		
Euro Sterling Bonds (Fixed)	484	
Corporate Bonds	234	
Euro Sterling Bonds (Variable)	46	
Total	764	3.76%
Internal Investments		
Short Term Deposits	314	
Money Market Funds & Business Reserve Accounts	48	
Total	362	1.27%
Other Interest		
Miscellaneous Loans	150	
Total	150	
TOTAL	1,276	2.23%
PROFILED BUDGETED INCOME	1,348	
SHORTFALL	72	
BENCHMARK RATE OF RETURN		0.43%

- 15. The table above shows investment income for the year compared to the profiled budget. The figures show a shortfall under budget of £72,000.
- 16. The outturn position is affected by both the amount of cash we have available to invest and the interest base rate set by the Bank of England. Balances are affected by the timing of capital expenditure and council tax and business rate collection.
- 17. The original Treasury Management budget of £1,347,620 was derived by forecasting an average rate of return of 2.74%. The actual interest rate received for the year was 2.23%.

Internal Investments (Short Term)

- 18. The graph below shows the In-house performance in respect of short-term investments as at 31st March 2011.



- 19. The current benchmark set for the in house team is the 7-day LIBID (London Interbank Bid) rate which is the rate used for quick benchmarking by the CIPFA benchmarking club.
- 20. The above graph shows that the internal investments returns are consistently outperforming the benchmark by around 80 basis points. This is due to maintaining a rolling programme of 12 month term deposits where cash flow permits. There is a large amount of our investment portfolio in longer dated securities such as Eurobonds and Corporate Bonds which have been secured at attractive rates (in comparison to what is currently achievable on these financial instruments) increasing our overall return even further.

Borrowing

- 21. An actual overall borrowing requirement (CFR) of £9.5 million was identified at the beginning of 2010/11. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st March 2011, the Council had no external borrowing.

Breakdown of investments as at 31st March 2011

Date Lent	Counterparty	Amount	Rate	Maturity Date
10-Jan-11	Bank of Scotland	2,000,000	1.95%	10-Jan-12
14-Oct-10	Bank of Scotland	2,000,000	1.85%	14-Oct-11
1-Mar-11	Bank of Scotland	1,000,000	2.05%	1-Mar-12
15-Apr-10	Nationwide Building Society	1,000,000	1.25%	14-Apr-11
7-Jun-10	Nationwide Building Society	1,000,000	1.36%	7-Jun-11
6-Aug-10	Nationwide Building Society	1,000,000	1.36%	5-Aug-11
25-Aug-10	Barclays Bank Plc	1,000,000	1.47%	25-Aug-11
1-Sep-10	Barclays Bank Plc	1,000,000	1.47%	1-Sep-11
14-Jan-11	Nationwide Building Society	1,000,000	0.76%	27-May-11
4-Nov-10	Barclays Bank Plc	1,000,000	1.45%	4-Nov-11
17-Nov-10	Barclays Bank Plc	1,000,000	1.47%	17-Nov-11
23-Mar-11	Bank of Scotland	1,000,000	2.05%	23-Mar-12
31-Mar-11	Barclays Bank Plc	2,000,000	1.58%	30-Mar-12
	Blackrock Money Market Fund	2,000,000	0.670%	
	Prime Rate Money Market Fund	2,000,000	0.767%	
	Eurobond Fixed Rate	7,537,881		
	Corporate Bond Fixed Rate	5,194,979		
	Eurobond Floating Rate Note	6,000,000		
		38,732,860		

Prudential Indicators – 2010/11**Background:**

22. In March 2010, Full Council approved the indicators for 2010/11, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allows local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

Prudential Indicator 1 - Capital Expenditure:

23. The actual capital expenditure incurred for 2010/11 compared to the original estimate is:

	2009/10 Outturn £'000	2010/11 Original Estimate £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Approved capital schemes	6,259	9,301	5,812	(3,489)	Decrease arises from the reprofiling of estimated expenditure in 2010/11 to future years
Total Expenditure	6,259	9,301	5,812	(3,489)	

The figures in brackets reflect that actual expenditure was less than budgeted.

AC

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

24. A comparison needs to be made between financing capital costs and the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

Portfolio	2009/10 Outturn £'000	2010/11 Original Estimate £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Financing Costs	(2,159)	(1,368)	(1,084)	284	Interest rates have stayed lower for longer than anticipated. Minimum Revenue Provision and related interest charges have been charged to the General Fund as a consequence of reclassifying some operating leases to finance leases
Net Revenue Stream	19,765	20,310	20,716	406	The budget has increased due to the approval of the carry forwards from 2009/10
%	(11.2)	(6.7)	(5.2)		

25. The financing costs include interest payable and notional amounts set aside to repay debt less interest on investment income. The figure in brackets is due to investment income outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement:

26. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The year-end capital financing requirement for the council is shown below:

	2009/10 Outturn Restated £'000	2010/11 Original Estimate Restated £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Opening CFR	9,642	9,461	9,461	(96)	
Capital Expenditure	6,259	9,301	5,812	(3,489)	See explanations for indicator 1 above
Capital Receipts*	(4,270)	(7,116)	(2,734)	4,382	Reduced requirement to draw on Capital receipts due to extra grants being received as well as reprofiling of expenditure to future years
Grants/Contributions*	(1,989)	(2,185)	(3,078)	(893)	Extra income received for gypsy sites and from the Regional Housing Pot
Minimum Revenue Position (MRP)	(181)	(206)	(208)	(2)	
Additional Leases taken on during the year			161	161	
Closing CFR	9,461	9,255	9,414	136	

*Figures in brackets denote income through receipts or reserves.

AC

Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:

27. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

	2009/10 Outturn Restated	2010/11 Original Estimate Restated £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Net Borrowing	(38,188)	(34,802)	(37,936)	(3,134)	More investments than predicted due to the reduced draw on capital receipts
CFR	9,461	9,255	9,414	136	See explanations for indicator 3 above

28. The figures above in brackets described as net borrowing actually represent net investments. Our net borrowing is forecast to remain as net investment for the foreseeable future and therefore will not at any time be in excess of the capital financing requirement.

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

29. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

	2009/10 Actual %	2010/11 % Limit	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Fixed	38.7	80	32.9	(47.1)	Within limit
Variable	61.3	100	67.1	(32.9)	Within limit

30. The Council must also set limits to reflect any borrowing we may undertake.

	2009/10 Actual %	2010/11 % Limit	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Fixed	0	100	0	100	SSDC currently has no borrowing
Variable	0	100	0	100	SSDC currently has no borrowing

31. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

32. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSDC, at any time, has sufficient liquidity to meet all of its financial commitments. The following table summarises the position:

Upper Limit for total principal sums invested over 364 days	2009/10 Actual £'000	2010/11 Maximum Limit £'000	2010/11 Actual £'000	Variance £'000	Reason for Variance
Between 1-2 years	8,604	25,000	3,218	(21,782)	Within limit
Between 2-3 years	3,296	20,000	6,000	(14,000)	Within limit
Between 3-4 years	2,001	10,000	1,174	(8,826)	Within limit
Between 4-5 years	1,160	10,000	0	(10,000)	Within limit
Over 5 years	0	5,000	0	(5,000)	Within limit

33. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

Prudential Indicator 7 - Actual External Debt:

34. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities (this represents our finance leases). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2011	£'000
Borrowing	0
Other Long-term Liabilities	301
Total	301

Prudential Indicator 8 - Authorised Limit for External Debt:

35. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set for each year.

	2009/10 Actual Restated £'000	2010/11 Estimate £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Borrowing	0	11,450	0	(11,450)	SSDC currently has no borrowing
Other Long-term Liabilities	348	550	301	(249)	Within limit
Total	348	12,000	301	(11,699)	

AC

Prudential Indicator 9 – Operational Boundary for External Debt:

36. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million for each of the next three years was set.

	2009/10 Actual Restated £'000	2010/11 Estimate £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Borrowing	0	9,500	0	(9,500)	SSDC currently has no borrowing
Other Long-term Liabilities	348	500	301	(199)	Within limit
Total	348	10,000	301	(9,699)	

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

37. This indicator is relevant when we borrow, then we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

Maturity structure of fixed rate borrowing	2010/11 Upper Limit %	2010/11 Lower Limit %	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Under 12 months	100	0	0	Not applicable	
12 months and within 24 months	100	0	0	Not applicable	
24 months and within 5 years	100	0	0	Not applicable	
5 years and within 10 years	100	0	0	Not applicable	
10 years and within 20 years	100	0	0	Not applicable	
20 years and within 30 years	100	0	0	Not applicable	
30 years and within 40 years	100	0	0	Not applicable	
40 years and within 50 years	100	0	0	Not applicable	
50 years and above	100	0	0	Not applicable	

Prudential Indicator 11 - Incremental Impact of Capital Investment Decisions:

38. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

Incremental Impact of Capital Investment Decisions	2009/10 Actual £	2010/11 Original Estimate £	2010/11 Actual £	2010/11 Variance £
Decrease in Band D Council Tax	0.35	0.20	0.11	(0.09)

Prudential Indicator 12 - Adoption of the CIPFA Treasury Management Code:

39. This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management

The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18th April 2002.

Conclusion

40. The council is currently within all of the Prudential Indicators and is not forecast to exceed them.

Background Papers: *Prudential Indicators Working Paper, Treasury Management Strategy Statement 2010/11*

13. Forward Plan and Programme of Meetings

Strategic Director: Mark Williams, Chief Executive
Assistant Director: Donna Parham, Finance and Corporate Services
Agenda Co-ordinator: Andrew Blackburn, Committee Administrator
Contact Details: andrew.blackburn@southsomerset.gov.uk or 01460 260441

Purpose of the Report

This report outlines the forward plan for the Audit Committee for 2011/12, which has been drawn up in consultation with the Chairman, and is attached at pages 65-66.

The report also sets out the programme of meetings for the municipal year. The meetings commence at 10.00 a.m. on the following dates (all Thursdays):-

2011	2012
23rd June	26th January
28th July	23rd February
25th August	22nd March
22nd September	26th April
27th October	24th May
24th November	
22nd December	

Recommendation

It is recommended that the Committee:-

- (1) approves the forward plan for 2011/12;
- (2) notes the programme of meetings for 2011/12 as set out above.

Background Papers: None.

AUDIT COMMITTEE – FORWARD PLAN 2011/12

Committee Date	Lead Officer
May 2011	
<ul style="list-style-type: none"> Member Training 	Donna Parham
June 2011	
<ul style="list-style-type: none"> Internal Audit Plan – Review of 2010/11 Approve Annual Treasury Management Activity Report Approve Annual Governance Statement Review of Internal Audit Audit Committee Terms of Reference Future of Local Public Audit – Consultation Request from Audit Committee for report regarding Redundancy Payments 	Ian Baker/ Andrew Ellins Karen Gubbins Donna Parham Donna Parham Donna Parham Donna Parham Donna Parham
July 2011	
<ul style="list-style-type: none"> Data and Communications Centre Facilities Management – Audit Review Action Plan Review of Local Code of Corporate Governance Review Exemptions given through Procurement Procedure Rules in 2010/11 Register of Interests – Staff – Audit Review Action Plan 	Roger Brown Donna Parham Gary Russ Ian Clarke
August 2011	
<ul style="list-style-type: none"> Internal Audit – First Quarter Update Treasury Management - First Quarterly Monitoring Report Annual Governance Statement Action Plan Summary Statement of Accounts 	Ian Baker/ Andrew Ellins Karen Gubbins Donna Parham Donna Parham
September 2011	
<ul style="list-style-type: none"> Approval of Statement of Accounts 2010/11 Audit Commission Annual Governance Report Section 106 Obligations and Commuted Sums Update 	Donna Parham Donna Parham Neil Waddleton
October 2011	
<ul style="list-style-type: none"> Approve Treasury Management Practices Risk Management Update including Partnering (suppliers, other agencies, etc.) Use of Resources Judgement Report 	Karen Gubbins Gary Russ Donna Parham

November 2011

- Internal Audit – Second Quarter and Half Year Update Ian Baker/
Andrew Ellins
- Treasury Management - Second Quarterly Monitoring Report and mid year Review of Strategy Karen Gubbins
- Receive and Comment on External Auditors' Management Letter Donna Parham
- Annual Governance Statement Annual Report Donna Parham

December 2011

- Health, Safety and Welfare – Annual Report Pam Harvey
- Markets Audit Action Plan Kim Close

January 2012**February 2012**

- Internal Audit – Third Quarter Update Ian Baker/
Andrew Ellins
- Internal Audit Plan – Approve 2012/2013 Plan Ian Baker/
Andrew Ellins
- Review of Internal Audit Charter Ian Baker/
Andrew Ellins
- Annual Governance Statement Action Plan Donna Parham
- Treasury Management - Third Quarterly Monitoring Report Karen Gubbins
- Treasury Management Strategy and Prudential Indicators Karen Gubbins
- Audit Commission Audit Plan Donna Parham

March 2012

- General Risk Management Update Gary Russ

April 2012

- Review of Local Code of Corporate Governance Donna Parham

14. Date of Next Meeting

The next meeting of the Audit Committee is scheduled to take place on Thursday, 28th July 2011 at 10.00 a.m. in Committee Room 3/4, Council Offices, Brympton Way, Yeovil.
