

The audit and inspection of local authorities

Memorandum from the Department for Communities and Local Government

1. Summary and introduction

- The Audit Commission was set up in 1983 to audit local authorities, to improve the quality of local audit and to promote and develop value for money studies. This role expanded over time to include audit of other organisations, such as local health bodies, and an increasing amount of inspection activity across the local government sector. In particular, from 2002 (2003 for district councils), the Commission was responsible for the system of Comprehensive Performance Assessment, which itself was replaced from April 2009 by the Comprehensive Area Assessment regime.
- Following its establishment, the Audit Commission increased the professionalism and quality of local government audit, and its in-house audit practice continues to be well-respected. However, the Commission also became overly focused on reporting to central government and supporting Whitehall oversight of local bodies
- The Government is clear that such centralised inspection and supervision is both an unnecessary burden on frontline services and is detrimental to the genuine local accountability that is essential if local services are to be efficient and meet the needs and aspirations of local communities.
- Accordingly, on 25 June 2010, the Government instructed the Audit Commission and five other inspectorates to stop Comprehensive Area Assessments. On 13 August 2010, the Government announced plans to disband the Audit Commission. These decisions are part of a fundamental shift in power away from central government to councils and communities, overturning decades of increasing central government control.
- **This memorandum outlines how the Government is taking forward the establishment of a new, more localist, audit regime for local public bodies, and the underlying principles on which the Government believes any such regime should be based.** Given the terms of reference for this inquiry, the memorandum largely addresses these issues from a local government perspective.
- As Ministers have made clear to Parliament, the Government is developing proposals for a new local audit regime with the Audit Commission, the National Audit Office, the Financial Reporting Council, local government, audit firms and other interested parties. Close involvement of the Audit Commission in this work is essential to secure an effective transition, and the Department is grateful for the Commission's constructive participation.
- The Government will be seeking views widely on the proposals, and will want to have careful regard to the Select Committee's report. A first

consultation on the details of a new audit framework is planned for early in 2011, and the Government envisages that it may subsequently publish a draft Bill for pre-legislative scrutiny, ahead of the final introduction of legislation to Parliament. Following such consultation and scrutiny it is the Government's intention to introduce the necessary legislation at the earliest opportunity.

- As to the underlying principles, local bodies – councils and local health bodies - will continue to be subject to robust and efficient auditing that follows the established principles of public audit. Any new local audit regime will provide full and appropriate accountability, ensuring that local authorities are effectively accountable to local communities for their spending decisions. Local audits would thus continue to have the wide scope of public audit, covering the audit of financial statements, regularity, propriety, and value for money.
- The Government considers that 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. Accordingly, the Government intends to move the work of the Audit Commission's in-house practice into the private sector. It will put in place new arrangements, with stringent safeguards to ensure independence, for councils to appoint their auditors, and for the appointment of auditors to local health bodies.
- For the future, the Government envisages that the National Audit Office, given its role in providing Parliament with assurance on public spending, would have oversight of auditing standards; the professional accountancy bodies, as supervisory bodies under the oversight of the Financial Reporting Council, would maintain a register of firms and auditors that are eligible to undertake local public audit engagements; and quality assurance and monitoring of audits, under the Financial Reporting Council's oversight, would be undertaken by the supervisory bodies and the Council's Audit Inspection Unit (in the case of larger local bodies) .
- The Audit Commission's inspection activities will stop. In future, any central inspection will be focused on the most vulnerable, for example to help maintain high standards in children's services and adult social care. Intervention will focus on cases of serious risk or failure. The Commission's National Fraud Initiative should continue, and this Department is in discussions with a number of bodies that have expressed an interest in taking on the Initiative. The Audit Commission's research activities, including its value for money studies, will cease. The National Audit Office's value for money studies will be able, as they can currently, to cover activities of local bodies.

2. The work of the Audit Commission

1. The Audit Commission was set up in 1983 as a self-funding, independent body to secure the audit of local authorities, promote and undertake value for money studies and to increase both the expertise of government auditors and the impact of external audit.
2. The Audit Commission's role developed under successive governments until, at the time of the last General Election, it encompassed:
 - A) **Audit** of local authorities, NHS Trusts and other local bodies in England. A full list of bodies audited by the Commission is at Annex A.
 - B) **Assessment and inspection** of the performance of councils, fire and rescue services and housing association.
 - C) **Research** (including value for money studies), on a wide range of social and financial issues.
 - D) **Assurance functions**, including data-matching through the National Fraud Initiative and grant certification on behalf of Government Departments.

3. Audit of expenditure by local public bodies

The current local audit regime

3. The Audit Commission currently combines within one body the regulation and commissioning of public audit, as well as providing auditors for 70% of local bodies. The Government is committed to strengthening democratic accountability and decentralisation of decision making. As part of that, it is committed to developing a decentralised approach to the external audit of public bodies.

The Commission as Regulator

4. As regulator of the current local audit regime, the Commission sits alongside and partially overlaps the more extensive audit regulatory regime of the Companies Act audit sector. The Government considers that having a specific regulator for the local government sector and the local health sector is inefficient and risks duplication.
5. The Government therefore believes there should be a single regulatory regime for audit, covering the private sector and the local government and local health sectors. This single regime can be more readily tailored to local accountability – in the way that the commercial sector is tailored to shareholders – rather than accountability to central government, as is the case with the Commission.
6. However, the local audit regime cannot entirely replicate the private sector regime because of the need for accountability to Parliament and Government

and the nature of the activities required to provide those assurances. It is also necessary for the audit of public bodies to follow the principles of public audit.

The Commission as Commissioner of Services

7. The Audit Commission currently appoints all auditors of the local bodies listed in Schedule 2 of the Audit Commission Act 1998 (as amended). However, the Government believes that, in the case of elected local bodies, centralised commissioning of audit services is fundamentally inconsistent with the concept of accountability to the electorate. Under the Government's proposals, authorities would appoint their own auditors. However, the principle of auditor independence will be retained as a cornerstone of the new regime. In this respect, independence encompasses the methods of appointment of auditors, the financial relationship between auditors and audited body, discretion in the amount of work necessary, the ability to follow up recommendations, and free access to information.

The Commission as Audit Provider

8. The Audit Commission's in-house audit practice provides auditors to 70% of local public bodies, with the remaining 30% of auditors employed by accountancy firms under contract to the Commission. The Commission sets fees for auditing work on a 'post office pricing' basis, whereby all principal authorities pay the same rates, which include a surcharge of around 20% to cover the costs of the Commission's work. The direct commissioning of audit services by the local bodies should therefore reduce fees by removing the Commission's overheads.
9. The in-house audit practice is well respected and has consistently done a good job. However, the Government does not believe that there is a rationale for the audit practice - the fifth largest provider of audit services in the UK – remaining in the public sector. The Government expects that the commissioning of audit services directly, and through a genuinely competitive process will be more efficient, effective and locally accountable than the current arrangements.

The proposed new audit regime

10. Subject to consultation and Parliamentary approval, the new regime will consist of:
 - **Regulation** – The Government expects regulation, monitoring and quality control to be undertaken one or more of the accountancy professional bodies, with independent oversight provided by the Financial Reporting Council and its operating bodies. The Financial Reporting Council would have direct responsibility for certain matters: for example its Audit Inspection Unit would carry out the monitoring of the largest public interest audits. The National Audit Office would provide the necessary oversight of auditing standards, including responsibility for developing and maintaining the audit codes and supporting guidance.

- **Commissioning** – auditors would be appointed by local bodies with appropriate stringent safeguards built into the audit framework to ensure audit independence is maintained. Competitive appointment will be from those licensed in accordance with the regulatory regime, bringing an end to centralised commissioning.
- **Provision** - audit would be undertaken by private sector commercial firms, licensed by the regulator and appointed through a competitive process, charging commercial market rates.

11. The design principles underpinning the new local audit regime include maintaining audit standards and ensuring independence, competence and quality.

12. The Government expects that the scope of audit will cover:

- regularity and propriety – the auditor would need to be satisfied regarding compliance with legal requirements and control mechanisms
- financial statements – the auditor would give an opinion as to the whether accounting statements give a true and fair view of the financial position and of income and expenditure
- value for money - the auditor would need to be satisfied as to whether there have been effective arrangements to secure economy, efficiency and effectiveness
- financial resilience – the auditor would need to be satisfied as to whether there are any risks to the future financial sustainability and whether mitigation action taken.

The scope of audit would be set out in the audit codes and supporting guidance that would be developed and maintained by the National Audit Office.

13. Auditors would still consider matters in the public interest through public interest reports. They would be able to undertake, possibly as part of a wider team, further inspections, such as corporate governance inspections, where they considered this necessary to meet their public interest responsibilities. They could also carry out such inspections if requested to do so by the audited body, one of the continuing inspectorates or the Secretary of State. More generally, auditors would be able to undertake audit-related value for money investigations, with the agreement of the body.

14. To help ensure independence, the Government envisages that councils would be able to appoint the same audit firm for a fixed number of years, but they would not be able to reappoint the same responsible individual for successive periods. The new regime would ensure that members of public could still make representations to auditors.

15. The Government is considering very carefully how to treat parish and town councils and other small bodies under the new framework, to ensure that a proportionate approach is adopted, perhaps similar to that which applies to small companies and charities.

Consultation

16. The Government intends to consult on the detail of the new local audit framework early in 2011. It also envisages that it may publish a draft bill to allow full scrutiny of the proposed legislative framework, ahead of final introduction of legislation in Parliament.

Transferring in-house audit work to the private sector

17. The Government is working with the Commission and other partners to develop and assess a range of options for the transfer the work of the Commission's in-house audit practice to the private sector. In assessing options, it will seek to secure strong value for money for taxpayers, including local taxpayers. The Government would be happy to see a mutual set up by existing Audit Commission staff, if this proves to be appropriate and practical.

Timetable

18. The Government has stated that reforms to the local audit regime are likely to take effect from 2012/13. However, it will take account of the views expressed by the Select Committee and responses to the planned consultation on the new local audit framework and will review the implementation timetable in the light of these views.

4. Oversight and inspection of local authority performance

Background

19. Inspection and assessment have played an increasing role in the governance of public bodies, including local authorities. From April 2009, the main programme of inspection and assessment for local authorities was the Comprehensive Area Assessment, which attempted to provide an overall picture of how councils and their partners were delivering services and outcomes for local people.
20. However, inspection and assessment placed costly burdens on local service providers and made them focus on reporting to central government rather than delivering the services their citizens wanted. For this reason, the Comprehensive Area Assessment was abolished in June 2010.
21. The Government is decentralising power in many areas of local authorities' work, including education, health, and housing. In November 2010, this Department announced the end to the strategic housing inspections previously carried out by the Audit Commission. The Department of Health also announced the ending of annual performance assessments of councils under

the Care Quality Commission's current framework, while Ofsted announced, in December 2010, the phasing out of the annual children's services assessment.

Increasing local accountability

22. Local government performance has improved over a number of years, and local authorities are well placed to deliver services that local people want, independent of central control. The Government wants to free up local authorities to enable them to be innovative in the delivery of services, rather than merely seeking to raise performance against centrally established criteria to achieve good inspection results. Local authorities will have the freedom to deliver services in ways that meet local needs, and will be accountable for those services to their electorates. These principles are key elements of localism.
23. The Government is committed to increasing transparency across Whitehall and local authorities and will make data more readily available to the citizen to allow them to hold politicians and public bodies to account. The Secretary of State has called upon councils to increase transparency and openness by publishing information on senior salaries, councillor allowances and all spending over £500. These are first steps, but the Government is considering other types of data that should be more accessible, such as council minutes and papers, performance data, food hygiene reports and licensing applications. Greater transparency will help root out overspending and waste in local government.
24. A key part of the change will be putting information into the public domain in an accessible and readily comparable format so people have access to the information they need to judge the performance of their local service providers, and hold them to account. National government will still have a role to play in aggregating data of national importance, or to allow accountability to Parliament, but it is for local authorities to provide local residents with the data they need.
25. This Department is putting together the single data list of all the data that central government requires from local government. The principal aim is to reduce the burden of data collection on local government, but all of the data is being assessed to ensure that it needs to be aggregated at the national level. The exercise will provide a transparent catalogue of all data that central government collects from local government.
26. The Government is also committed to creating a new 'right to data' to empower citizens to request access to government-held datasets if they feel they need more information. The Government fully supports the work being done by local government as part of the Place Based Productivity Programme to develop effective benchmarking tools to allow citizens to compare their local council's performance against others.

Future of inspection and the role of Inspectorates

27. Approaches to inspection and assessment of local authorities are being developed across Government in the light of the decentralisation and localism agenda. Key principles include independence from the service providers and accountability for the most vulnerable. The benefits of inspection must outweigh the costs, including those of the inspected body. Those local service inspectorates that remain must provide credible judgements for the public and have a clearly defined purpose which focuses on public protection. The sharing of information by inspectorates can help identify where service failures in one part of an authority are linked to broader questions about the authority's capacity to manage its overall corporate responsibilities effectively.
28. The Department for Education is working with Ofsted, which is making changes to its inspection arrangements to reduce costs and burdens, re-focus on key priorities and ensure they are proportionate. The statutory duty on Ofsted to publish an annual rating for children's services will be repealed as soon as a suitable legislative slot is identified. Details of future changes to safeguarding and children's social care inspection, and early years and childcare inspection reforms will be informed by the results of the reviews carried out by Professor Eileen Munro and Dame Clare Tickell. Extensive reforms to schools inspection are already underway.
29. The Department of Health has agreed a new approach to the assessment and inspection of councils. The annual assessment of councils as commissioners of adult social care has been discontinued, and the Care Quality Commission will no longer publish information about council performance. This new approach will see a shift towards more sector-led assessment, with councils taking greater responsibility for driving improvement. The Care Quality Commission will retain the ability to respond to concerns about council services by carrying out inspections. The Department of Health will continue to work with the Care Quality Commission and local government organisations to develop the detail of the new approach.

5. Research

30. The Audit Commission has undertaken research (including value for money studies) and produced national reports on a range of issues of interest to its customers. In 2008-2009 it produced twenty-three national reports including *Tougher at the Top*, about the role of local authority Chief Executives, *Well Disposed*, about how councils are responding to the challenge of reducing the amount of waste sent to landfill and *Risk and Return*, about how the collapse of banks in Iceland affected English local authorities.
31. However, local government and others outside of central Government are well-placed to decide when and where research should be undertaken. The Government expects that value for money will remain an important component of local audit. The National Audit Office, using its existing powers, will be able, when reporting to Parliament on the activities of central government

departments, to directly examine the impact of policies administered by local bodies. This will contribute to parliamentary accountability, as well as providing useful insights for local communities.

32. 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 wider issues of concern about local bodies' use of resources in general, should such issues be identified by the audit process.

6. Assurance functions

National Fraud Initiative

33. The National Fraud Initiative (NFI) is a data matching exercise, which is run under the Audit Commission's statutory data matching powers. The NFI works within a strong legal framework, including the Data Protection Act 1998, which is designed to protect individuals' personal data.
34. The NFI plays an important role in protecting the public purse against fraud. For example, fraudsters often target different organisations at the same time, using the same fraudulent identities. The NFI combats this threat by comparing or 'matching' information held by different organisations and within organisations to identify anomalies that indicate potentially fraudulent claims and overpayments.
35. A key strength of the NFI is that it brings together a wide range of bodies in tackling fraud. It helps individual organisations go beyond what they could do acting alone. The last NFI exercise in 2008/09 processed some 8,000 datasets from 1,300 organisations, including 100 from the private sector; It helped trace £215m in fraud, error and overpayments bringing the total detected since it started in 1996 to £664m
36. The Government is currently considering how the function might be delivered in the new audit environment and is discussing this with other bodies that have an interest in ensuring its future. In the meantime the 2010-11 exercise is continuing as normal.

Grant certification

37. Under section 28 of the Audit Commission Act 1998, the Audit Commission makes arrangements for certifying claims and returns in respect of grants or subsidies from Government Departments. Auditors also certify other financial returns such contributions payable to the national non domestic rating pool, and the Commission provides significant technical guidance, advice, tools and system support for auditors.
38. Certification work is separate from audit and is a form of assurance engagement designed to provide assurance for the accounting officers of the

grant paying bodies and contribute to the assurance sought by the National Audit Office when auditing grant-paying bodies.

39. It is the Commission, rather than its appointed auditors, that has the responsibility for making certification arrangements. In discharging this function the Commission works with each of the grant paying bodies to develop certification instructions specific to each grant scheme, and which must be followed by auditors appointed by the Commission. It also provides technical guidance, advice and tools to auditors and the grant paying bodies to ensure a consistent approach.
40. In future, the Government envisages that grant certification will be undertaken by the external auditor. The certification arrangements will continue to be proportionate to the amount of the claim and the auditors' assessment of the control environment involved.

7. Conclusion

41. In conclusion, the Government has already removed burdens on local authorities and is committed to reducing further central Government control and monitoring. It is disbanding the Audit Commission and refocusing audit on helping local people to hold councils and local public bodies to account for local spending decisions.
42. The Government is working with a wide range of partners to design a new local audit regime, and prepare the in-house practice for transfer to the private sector, wind down the Commission and transfer any residual functions that are to be retained. The primary legislation necessary to make these changes will be introduced at the earliest opportunity. In the meantime, the Government will consult on its proposals for a new audit regime and will consider whether a draft bill would be helpful as a means of achieving early scrutiny of legislation.

Annex A

List of bodies to which the Audit Commission appoints auditors

A local authority
A joint authority
The Greater London Authority
A functional body
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
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
A probation trust (other than a Welsh probation trust as defined in paragraph 13(6) of Schedule 1 to the Offender Management Act 2007
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
Passenger Transport Executive