

# Strategy for making auditor appointments for 2012/13 and future years

January 2012

**The Audit Commission is a public corporation set up in 1983 to protect the public purse.**

**The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.**

**We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.**

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# Introduction

## Background

- 1 In August 2010 the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission (the Commission). At the same time, he indicated his intention to transfer the Commission's in-house Audit Practice (the Audit Practice) to the private sector and, in due course, to abolish the residual element of the Commission.
- 2 The Commission worked closely with the Department for Communities and Local Government (DCLG) and their external advisors on developing and evaluating the options.
- 3 Ministers subsequently concluded that the option for achieving such a transfer, which offered the best value for money, as well as being the quickest and, in their view, the most straightforward, was to outsource the 70 per cent of audits of principal bodies currently delivered by the Audit Practice from the 2012/13 audit year, by means of a public procurement exercise.
- 4 At its meeting in July 2011, the Commission Board agreed to undertake the procurement exercise.
- 5 The objectives of the procurement exercises are to transfer successfully to the private sector the audit work currently delivered by the Audit Practice, so as to maximise value for money, by:
  - securing the provision of high quality audit services at the best prices possible; and
  - minimising the costs of redundancy that may otherwise fall on DCLG, by maximising the extent to which audit staff in the Audit Practice transfer to successful bidders under Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).
- 6 The procurement was also designed to allow, so far as consistent with these objectives, a range of firms to bid, to support market plurality during the period of transition to new audit arrangements.
- 7 The value of the work being outsourced is c£90 million per annum in ten Lots, ranging in size from £5 million to £12 million, covering all types of audited body in a defined geographical Contract Area.
- 8 The Commission is also procuring limited assurance audit services for all small local public bodies, to a total value of £2.8 million per annum.
- 9 Firms invited to tender were invited to quote prices for contracts of both three and five years' length.

**10** The Commission will decide, in consultation with DCLG, whether to award three or five-year contracts.

**11** Decisions about the length of the contracts to be awarded will be linked to the government's timetable for the introduction of, and transition to, new local public audit arrangements, and for the disbandment of the Commission. In this respect, DCLG has indicated that it will wish to consider the potential trade-off between value for money and the benefits of the proposed new local public audit arrangements (including local auditor appointment).

**12** As a contingency, the Commission will have the right to extend the contracts, once awarded, for up to three further years.

**13** The timetable for the procurements provides for contracts to be let to new providers by 1 April 2012. This will give the Commission time to manage the process of making new statutory auditor appointments for 2012/13 with effect from 1 September.

**14** The Commission envisages that most Audit Practice staff in each lot area will transfer to the successful bidders under the TUPE regulations at midnight on 31 October 2012.

## **Purpose of this document**

**15** This strategy sets out the basis on which the process of developing, consulting on and formally making auditor appointments for 2012/13 and future years will be carried out.

**16** It applies only to the first round of auditor appointments to principal bodies to be made following the completion of the procurement exercise. These appointments will be for either a three or five-year period.

**17** There will be a separate process for developing, consulting on and formally making any changes to auditor appointments that may become necessary in future years, including the appointment of auditors to the new NHS Clinical Commissioning Groups from 2013/14.

**18** There will also be a separate process for appointing auditors to small bodies, for which auditor appointments will be made on a county area basis.

## **Objectives of the appointment process**

**19** The objectives of the appointment process are to ensure that:

- an 'interim' auditor is appointed in accordance with section 3 of the Audit Commission Act 1998 (the Act) by 1 April 2012;
- a 'permanent' auditor is appointed to all principal bodies within the Commission's audit regime from 1 September 2012; and
- there is a smooth and efficient transfer from the outgoing to the incoming auditor.

## Evolution of the strategy

**20** This strategy has been developed in the light of the practical knowledge and experience of the Commission in running previous appointment processes.

**21** The strategy was formally adopted on behalf of the Commission Board by its Appointments Panel at its meeting on 5 January 2012.

# The legal background

## The Audit Commission Act 1998

**22** The appointment of auditors to local public bodies under section 3 of the Act is arguably the Commission's core statutory function. Under the Commission's governance framework, decisions on the appointment of auditors are reserved to the Commission Board.

**23** Section 3(3) of the Act states:

Before appointing an auditor or auditors to audit the accounts of a body other than a health service body the Commission shall consult that body.

**24** In addition, the Commission has always consulted all local public bodies, including health service bodies, on the appointment of their auditor and it will continue to do so.

**25** It is important to emphasise that the statutory duty to consult, and the right of local government bodies to be consulted, does not equate to audited bodies having a choice or veto over the appointment of their auditors. The final decision on the appointment of auditors must rest with the Commission. Clearly, however, in proposing auditor appointments, and in responding to representations made by audited bodies following consultation, the Commission must follow due process and act reasonably.

**26** Section 3(1) of the Act enables the Commission to appoint either:

- a. an officer of the Commission – ie a District Auditor or senior audit manager;
- b. an individual who is not an officer of the Commission; or
- c. a firm of individuals who are not officers of the Commission.

**27** Following the outsourcing of the Audit Practice, the Commission proposes only to appoint firms in accordance with section 3(1)(c).

**28** The statutory consultation under section 3 will therefore be on the appointment of the firm, which in law will be the appointed auditor. This is different to the process where we have appointed officers of the Commission, where it is the individual concerned who is the appointed auditor. Once a firm has been appointed, the identity of the engagement lead is a matter for discussion between the firm and the audited body. However, all of a firm's engagement leads have to be approved in advance by the Commission, as having sufficient appropriate experience and expertise.

**29** In the case of strategic health authorities and NHS primary care trusts, we have agreed with the Department of Health that where the current

appointed auditor (District Auditor or senior audit manager) and/or their second in command (audit manager) transfers to a firm under TUPE, the firm will be contractually obliged to nominate those individuals to continue in post until at least the completion of the 2012/13 audit unless specific circumstances prevent this.

**30** The Commission's contractual arrangements with firms are such that there will always be more than one firm that could be appointed as auditor to any individual body. Where an audited body is able to put forward good reasons why the auditor proposed by the Commission should not be appointed, we will consider those representations carefully and, in the light of those representations, decide whether to propose an alternative auditor.

## Future arrangements

**31** In August 2010 the Secretary of State for Communities and Local Government announced plans to disband the Commission and to allow local public bodies to appoint their own auditors. The government consulted on its proposals in March 2011.

**32** In the *Government Response to the Future of Local Audit Consultation*, published by DCLG in January 2012, the government indicated that it proposes to publish a draft Bill for pre-legislative scrutiny in Spring 2012. This will allow for examination and amendments to be made, in advance of the introduction of an Audit Bill as soon as Parliamentary time allows. The government has also confirmed that it intends such future legislation to provide for local public bodies to have a statutory duty to appoint their own auditors.

**33** Subject to the Parliamentary timetable, local public bodies will not be able to appoint their own auditors until 2015/16 at the earliest, or 2017/18 if the Commission decides, following consultation, it should award contracts for five years.

**34** Until the Audit Commission Act 1998 is replaced by new primary legislation, the current legal framework under which the Commission is responsible for making auditor appointments will remain in place.



# The process of making auditor appointments for 2012/13

## Interim appointments

**35** The great majority of current auditor appointments are due to expire upon completion of the audit of the accounts for the 2011/12 financial year. This is the case both where the appointed auditor is a firm and where the appointed auditor is an officer of the Commission from the Audit Practice.

**36** As the contracts arising from the procurement exercise to outsource the work of the Audit Practice will not commence until 1 April 2012, the Commission will not be able to complete the process of developing proposals for, consulting on, and making auditor appointments for 2012/13 until 1 September 2012.

**37** Where a body's current auditor is a firm, we do not expect to have to change the appointment from 2012/13. However, we can only confirm this when the national picture on auditor appointments has been finalised. This is because we may need to change some current firms' existing appointments, either to enable us to manage any independence issues that may be identified in the appointments process or in response to representations from audited bodies.

**38** Because an auditor needs to be in place at the start of the financial year, we will need to make an interim auditor appointment to cover the period from 1 April to 31 August 2012.

**39** We have proposed extending bodies' current auditor appointment to deal with any issues that may arise during that period. Over the period of the interim appointment, the current auditor will be completing the audit of the body's financial statements for 2011/12 and will therefore be monitoring issues that could impact on the 2011/12 opinion and certificate. So to extend the appointment in this way makes most practical sense and will serve to minimise disruption.

**40** We do not expect the interim auditor will need to undertake any substantive audit work relating to 2012/13. Their role will be limited to keeping a watching brief. Provided this is the case, the Commission will meet any costs properly incurred by the interim auditor.

**41** Any issues requiring the interim auditor to do substantive audit work will be of an exceptional nature – for example, a need to exercise their statutory reporting powers. The interim auditor will tell both the audited body and the Commission about the need to do the work. Where appropriate the Commission will determine a variation to the scale audit fee to reflect the

costs of the work. The additional fee will then become payable by the audited body.

**42** The process for consulting audited bodies on interim appointments will be managed in the normal way.

**43** We wrote to all relevant audited bodies to consult them formally on the interim auditor appointment in December 2011.

**44** The Commission Board will be asked to approve all interim auditor appointments for 2012/13 at its meeting on 22 March.

## **The process of consulting on permanent 2012/13 auditor appointments**

**45** The process of developing and consulting on permanent auditor appointments for 2012/13 will follow the four-stage process outlined below.

### **Stage 1**

**46** The Commission will begin the process of consulting audited bodies on auditor appointments for either three or five years from 2012/13 at the end of April 2012.

**47** Initial proposals on auditor appointments will be made by the Commission's Director of Audit Policy and Regulation (APR).

**48** Where a body is currently audited by a firm, we expect to extend the current auditor's appointment from 2012/13. However, we can only confirm this when the initial proposals on auditor appointments have been finalised.

**49** This is because, under the terms of our contracts with the firms, we may need to change some firms' current appointments, to enable us to manage any independence issues that may be identified as a result of the appointment process. A firm may have a prior or current business relationship with an audited body – such as providing consultancy services directly relevant to auditors' responsibilities (for example in relation to a PFI scheme or the provision of internal audit services) – which would preclude the Commission appointing the firm, or the firm accepting appointment, as the auditor to that body. We may also need to make changes in response to representations from audited bodies. But, in practice, we envisage that any changes to firms' current appointments will be exceptional.

**50** Where a body is currently audited by the Commission's Audit Practice, we will propose the winning firm in each Contract Area as the appointed auditor, unless there are good reasons that prevent this. This reflects the fact that, through the competitive process run by the Commission, the firm will have demonstrated it is the best provider in that geographical area. This process included a rigorous assessment of the ability of the firm to deliver high-quality audits, so we will be confident of their skills, competence and resources to perform the audit to our required standards. The Commission

has published the evaluation methodology it applied in evaluating firms' bids on its [website](#).

**51** However, our contract strategy ensures the Commission will have the option of appointing a different firm to an audited body should this be appropriate.

**52** In developing our initial proposals for auditor appointments we will also consider whether certain types of local public body should be audited by a limited number of firms nationally, to enable those firms to develop appropriate specialisation in the audit of those bodies. Historically, the Commission has applied this policy to such single-purpose bodies as police authorities and national parks authorities.

**53** We will also consult, at the same time, on the appointment of the auditor proposed for 2012/13 and future years to complete any work relating to the 2011/12 or prior years' audits that remains outstanding at 31 October 2012.

**54** The incoming auditor will also be required by the Commission to complete all grant certification work that has not been completed by that date. This includes the housing benefit and council tax subsidy claim which is due to be completed by 30 November 2012.

**55** To support the consultation, the Commission will provide all audited bodies in a Contract Area with the opportunity to meet the Commission and a senior partner from the firm we have proposed to appoint to bodies in that area. This will provide an opportunity for all audited bodies to meet the firm and understand how it proposes to deliver the audits. It will also allow any audited bodies that object to the proposed appointment to have a face-to-face discussion with Commission staff.

**56** We will also need to make similar arrangements for those audited bodies where we are not proposing to appoint the winning firm. This will arise only in a limited number of cases as Tenderers are required to confirm they are able to audit the great majority of audited bodies in a Contract Area (90 per cent by number and 80 per cent by value).

**57** It is expected that most auditor appointments held by firms under the existing (2006 and 2007) contracts will be extended, so that all appointments will end at the same time. The process for consulting those audited bodies will be managed in the normal way as far as practicable. Where it is necessary to propose not extending an appointment of a firm, we will deal with that audited body in the same way as other bodies at which we are proposing a change of auditor.

**58** We expect the great majority of audited bodies will be content to accept whichever firm the Commission decides is appropriate. Nevertheless we recognise that in some instances there could be good reason why the winning firm in an area should not be appointed to an individual body or bodies.

**59** Audited bodies will have the opportunity to make representations to the Commission on the proposed auditor appointments.

**60** If the body does not object to the proposed appointment, the Commission's Managing Director (MD), Audit Policy will recommend the appointment to the Commission Board at its meeting on 26 July.

**61** If a body's objection to a proposed appointment is upheld at any subsequent stage, Stage 1 will be repeated.

## **Stage 2**

**62** Where an audited body objects to the proposed appointment, it should set out in writing good reasons why the proposed appointment should not be made.

**63** We have identified the following grounds that may amount to good reasons.

- There is an independence issue, of which the Commission and/or the firm was previously unaware, which would preclude the Commission appointing the firm – or the firm accepting appointment – as the auditor to a particular body.
- Other than for SHAs and PCTs (which will no longer exist after 31 March 2013), the audited body is involved in formal and on-going joint working arrangements (for example, joint management team or shared back office functions or joint provision of major services with neighbouring bodies), which means it would be more appropriate for those bodies to have the same auditor.
- There is another specific good reason – for example, a body can demonstrate a history of inadequate services from a particular firm.

**64** The MD, Audit Policy will consider carefully all representations made and respond to audited bodies by 8 June 2012. The MD, Audit Policy will either reject the representations and confirm the original proposed auditor appointment, or ask the Director of APR to consult on an alternative proposal. Where an alternative proposal is made, Stage 2 may be repeated.

**65** If the body does not continue to object to the proposed appointment, the MD, Audit Policy will recommend the appointment to the Commission Board at its meeting on 26 July.

## **Stage 3**

**66** If the audited body still objects to the proposed auditor appointment, after completion of Stages 1 and 2, it will have a further opportunity to submit its case in writing to a subcommittee of the Commission Board (the Board's Appointments Panel). The terms and reference and membership of the Panel are attached as Appendix 1

**67** The Appointments Panel will consider the representations made and the MD, Audit Policy's grounds for rejecting the body's initial representations. It will then either endorse the proposed auditor appointment or ask the

Director, APR to consult on an alternative proposal. Where an alternative proposal is made, Stage 3 may be repeated.

**68** Where the Panel endorses the proposed appointment it will make a formal recommendation to the Board at its meeting on 26 July.

#### **Stage 4**

**69** The Board will consider the recommendations of the MD, Audit Policy and the Appointments Panel and either accept the recommendations and formally appoint the proposed auditor, or ask the Director of APR to consult on an alternative proposal. Where an alternative proposal is made, Stage 4 will be repeated.

**70** The Board's decision on the appointment of auditors will be final, subject only to judicial review.

### **Making the appointment**

**71** Once the Board has appointed the auditor, the Commission will formally write to the audited body to confirm the appointment.

**72** Where the firm is also to be appointed to complete any outstanding work relating to the 2011/12 or prior years' audits, we will specify the auditor's terms of appointment for this work.

**73** The auditor appointment process set out above is summarised in a diagram in Appendix 2.

# Timetable

74 The key milestones in the project plan are set out below:

Communication with audited bodies on the procurement process and implications for auditor appointments	Ongoing
Consultation with audited bodies on interim auditor appointments ends	17 February 2012
Commission Board approves interim auditor appointments for 2012/13	22 March
Consultation with audited bodies on permanent auditor appointments begins	w/c 23 April
Regional introductory events	30 April – 18 May
Last date for representations to MD, Audit Policy	25 May
MD, Audit Policy considers representations by audited bodies	30 May – 8 June
Further consultation with audited bodies	18 June – 6 July
Board Appointments Panel considers further representations from audited bodies	w/c 9 July
Commission Board approves appointments	26 July
Letters sent to audited bodies to confirm appointments	By 10 August
Appointments begin	From 1 September

# Appendix 1: The Appointments Panel

## Terms of reference

The Board Appointments Panel will:

- a) determine the strategic policy framework, produced by the Project Board, for the appointment of auditors from 2012/13;
- b) consider and determine significant issues arising during the project, reported by the Project Board;
- c) review the project risk register;
- d) consider final representations from principal audited bodies where they object to the auditor proposed by the Commission, following consideration of initial representations by the Managing Director, Audit Policy; and,
- e) having considered all representations in those cases, recommend auditor appointments for approval by the Commission Board.

The Panel will meet as necessary, timed around key milestones and decision points in the draft appointments timetable. The Panel may meet 'virtually' with papers being circulated, and decisions made, by email.

At any meeting of the Panel the quorum shall be three voting members present. Members may attend meetings of the Board by telephone or videoconferencing facility. Members attending a meeting by these means shall be deemed to be present in person at that meeting. The responsible officer shall record the circumstances of any member attending a meeting by telephone or videoconferencing facility.

## Membership

The membership of the Panel will be:

### Commission Board members

- Bharat Shah (Chair);
- Jennifer Dixon;
- Councillor Steve Houghton;
- Councillor Robert Light; and
- Councillor Sir David Williams.

### Independent non-voting members

- Mike More, Chief Executive, Westminster City Council; and

- Sean Nolan, Deputy Chief Executive and Director of Corporate Resources, East Sussex County Council.

Secretariat support to the Panel will be provided by the Commission Board Secretariat.

## Reporting arrangements

The Panel will report to the Commission's Board.



## Appendix 2: The auditor appointment process

