



The Association of Drainage Authorities

Response to the:

Future of local public audit Consultation

The consultation was issued by the Department for Communities and Local Government.
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<http://www.communities.gov.uk/documents/localgovernment/pdf/1876169.pdf>

This response has been developed by a project team from Internal Drainage Boards with considerable experience in public audit.

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1. The Role of ADA

The Association of Drainage Authorities (ADA) is the association for water level management organisations in the United Kingdom, with over 200 members.

ADA's members include Internal Drainage Boards (IDBs), the Environment Agency, Regional Flood & Coastal Committees (RFCCs), and the Northern Ireland Rivers Agency. ADA was established in 1937 to watch over and support the interests of drainage authorities at a national and parliamentary level, provide a forum for the exchange of ideas and discussions, and disseminate information of common interest.

ADA also has Associate Members who are consultants, contractors or suppliers to the water level management industry or local authorities.

ADA is recognised as the national representative of the 144 Internal Drainage Boards in England and Wales. Internal Drainage Boards (IDBs) are local public bodies established in areas of special drainage need in England and Wales to undertake works to manage flood risk and water levels on behalf of their community.

2. An Introduction to Internal Drainage Boards

Internal Drainage Boards (IDBs) are a type of operating authority established under Act of Parliament to provide a flood risk management and water level management service in areas of special drainage need in England and Wales. The drainage district of an IDB is not determined by local political boundaries, but by hydrological catchments within a given region. There are currently 144 IDBs in England and Wales covering 1.25 million hectares.

IDBs predominantly operate under the Land Drainage Act 1991 using permissive powers to undertake work to manage the drainage and water level management of their districts, significantly reducing the risk of flooding to local communities, property, businesses and infrastructure. Within their districts, IDBs have direct responsibility for works on ordinary watercourses, those watercourses other than main river – which are the responsibility of the Environment Agency.

Much of an IDB's work involves the maintenance of rivers, drainage channels, outfalls and pumping stations, facilitating drainage of new developments and advising on planning applications. They also have statutory duties with regard to the environment and recreation when exercising their permissive powers. The Board of an IDB is composed of land owners, tenants and representatives of from levy paying local authorities.

3. Response Introduction and Key Areas

The Association of Drainage Authorities welcomes the opportunity to comment on the Future of local public audit in light of the plans to disband the Audit Commission. ADA supports the intention to define a new framework for local public audit, following a sound set of design standards. In particular, ADA welcomes the move to align public and private sector audit regimes and our responses to the consultation questions set out below, further advocate this alignment. In particular we would stress the following:

Reporting - IDBs currently have to prepare two returns each year, the Defra form IDB1 which includes several financial datasets, and the Audit Commission Annual Return, for IDBs subject to the limited assurance audit regime (turnover < £6.5M). The Audit Commission return is the same one used for parish councils and the only financial information included is based on cash movements. In order to complete this return, IDBs have to convert information from accounts (usually prepared on an accruals basis), into cash receipts and cash payments which is of little use to any stakeholder or end user.

ADA cannot see the benefit of providing such basic financial information when proper accounts are already prepared and would suggest that one single return is prepared by IDBs that includes summary information from the income and expenditure account and the balance sheet, rather than the present cash movement summary.

Alignment – The private sector audit regime is long established and works. ADA cannot see the benefit of replicating a parallel regime for public sector audits. In particular, the procedures for the appointment and removal of auditors are transparent and a separate set of public sector guidelines are unnecessary.

Regulation – The bodies that currently regulate the private sector audit regime should be encouraged to widen the scope of their role to cover public sector audits. In particular, the Financial Reporting Council (FRC), which already promotes the highest quality of governance for the audit profession.

Levies – An FRC levy is already charged to IDBs. ADA would not wish to see this levy increased as a result of the abolition of the Audit Commission.

The response contained within this paper has been developed to the best of the Association of Drainage Authorities' abilities.



Dr Jean Venables CBE FREng, Chief Executive,
Association of Drainage Authorities

4. Association of Drainage Authorities response to the consultation questions on the future of local public audit

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?**

Yes, the design principles are sound.

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

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?

No. We believe that the Financial Reporting Council should fulfil this role as it does for the accounting profession. There is no logic in creating a new role for another body.

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?

Yes.

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

Consultation paragraph 2.14 states that supervisory bodies should be those recognised under the Companies Act 2006 and we agree with these criteria. As such, the list of such firms already exists being the membership of the relevant professional body, so there is no need to replicate and update a separate list.

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?

Audit planning notes have to include a statement that the firm has the required knowledge and resources to perform an audit engagement, before the audit can commence. This is one of the fundamental principles of audit engagement. This applies regardless of the size of firm performing the work.

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?

As set out in the above response to question 6, no additional criteria are necessary as the profession is already policing firms performing audit work, to ensure that audit engagement is appropriate.

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?

We believe that this should apply to ALL public bodies.

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?

No comment.

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

No comment.

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?

Yes, however, there should not be a stipulation regarding the appointments based on a geographical area.

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

No comment.

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?

No comment.

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

No comment.

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?

No comment.

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?

No comment.

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

No comment.

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?

No comment.

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

No comment.

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

No comment.

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?

We believe that option 1 should be followed in such circumstances.

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?

Yes but only when appointed.

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

The FRC should be notified.

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

We believe that the rules regarding appointment should mirror the requirements of the profession. The ICAEW Ethical Standard 3 gives guidance on issues arising out of a long association with the audit client. Dealing with non-listed audits, there is a requirement that where audit principals and staff in senior positions have a long association with the audit, the firm should assess the threats to its objectivity and independence as auditors and, where the threats are other than clearly insignificant, the firm should apply safeguards to reduce the threats to an acceptable level. Where appropriate safeguards cannot be applied, then the firm must either resign as auditors or not stand for reappointment, as appropriate.

Appropriate safeguards may include:-

- *Removing (rotating) the audit principal and the other senior members of the engagement team after a pre-determined number of years in that role.*
- *Involving an additional principal, who is not and has not recently been a member of the engagement team, to review the work done by the audit principal and the other senior members of the engagement team and to advise as necessary.*
- *Applying independent internal or external quality reviews to the engagement in question.*

Once the principal has been the audit principal for a period of ten continuous years or more, the standards require the firm to consider carefully whether a reasonable and informed third party would consider its objectivity and independence to be impaired. If the audit principal is not rotated then either alternative safeguards, such as those outlined above, must be applied, or the firm must document its reasons and communicate them to the directors or those charged with governance in accordance with Ethical Standard 1.

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?

Response as for question 24.

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?

Response as for question 24.

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?

Yes we agree with the steps set out in the consultation at 3.59 to 3.62. Again, the profession already has guidance relating to an Auditor's removal from office:

In certain circumstances, Company Law requires the firm to notify the ICAEW or the oversight body if it ceases to hold an audit appointment. If the firm ceases, for any reason, to act as auditors to a major audit client, it is required to inform the oversight body of the reasons for the cessation at the time of cessation. In the UK, the Professional Oversight Board defines what a major audit is for the purposes of these resignation statements. The current list can be viewed at www.frc.org.uk/pob. For appointments that are not in respect of a major audit client, notification is only required if the audit appointment ceases before the normal time the auditor's term of office is to end, as set out in law. Notification to the ICAEW of the reasons for the cessation; this can be either at the time the cessation takes effect or as part of the Annual Return.

The above notifications are in addition to any other notifications that are required to be made to the client and registering bodies, such as Companies House. For information, an example of an Audit Resignation Checklist is included as a separate attachment.

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?

The FRC have published guidance on the limitation of liability by auditors, however, the majority have not agreed any limitation of liability in respect of audit work under Section 534 to 536 of the Companies Act 2006. As such, we would not expect firms performing public sector audit to change their view on this.

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?

In our opinion, Option 1 would give the best balance.

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

No.

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?

No.

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

No.

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

An FRC template with standard headings would be possible and added to the criteria set out in paragraph 4.14.

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?

Yes.

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?

The ICAEW Ethical Standard 5 deals with non-audit services provided to audit clients. Where safeguards can eliminate or reduce the threat to an acceptable level, the non-audit services may be provided to the client. We believe that this principle should be followed for public audit assignments.

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

Yes.

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?

No comment.

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

Yes.

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?

Yes.

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?

No. We are not aware that auditors are currently within the remit of The Freedom of Information Act and would expect this to be strongly resisted.

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)?

No comment.

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

We believe that option 2 is preferable to option 1 as Boards should be free to appoint their own auditors.

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?

No

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

a.) Appoint independent examiners for the smaller bodies in their areas?

The Authority should simply ensure that there are a number of auditors listed on their Preferred Supplier List and Boards would then be free to appoint from that list

b.) Outline the annual return requirements for independent examiners?

Who should produce and maintain this guidance?

This would increase the burden on the Authority and could lead to differences between Authorities. We would prefer the FRC to maintain any such guidance.

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

Yes.

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?

Should option 2 not be the preferred option, the EA or RFCC would be better placed to appoint auditors as IDBs straddle more than one Authority, which would lead to duplication.

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?

Yes. Combining 3 and 4 would be simpler. The £6.5M audit threshold should remain in place and track any changes to this limit in the Companies Act.

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?

No, we believe that reports should go to the FRC in those circumstances

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?

Yes and IDBs already pay a levy to the FRC. We would not wish to see any increase in levy which must be proportionate to the income level of individual Boards, where the costs of dealing with representation are incurred.

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?

Yes but should any Board be unable or unwilling to self-appoint, the power to appoint auditors should rest with the EA or the RFCC rather than the relevant Authority.