



WALES **AUDIT** OFFICE
SWYDDFA **ARCHWILIO** CYMRU

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Consultation Document Contracting Strategy and the Audit of Town and Community Councils

Foreword

In this consultation paper I set out proposals for my future Contracting Strategy and, in part three, I consider arrangements for the audits of town and community councils. I should very much welcome your comments.

My Contracting Strategy is relevant to you as I, and the auditors I appoint in local government, are the statutory external auditors of most of the Welsh public sector and audit most of the public money spent in Wales. I have a local government assessment function to assess their compliance with the Local Government (Wales) Measure 2009 and guidance issued by the Welsh Government, and come to a view on their likelihood and ability to improve. I also have powers and duties to examine the economy, efficiency and effectiveness (together known as value for money) with which other public bodies in Wales use their resources; and to make recommendations to improve value for money. Currently, my Wales Audit Office staff deliver around two thirds of the annual audit work, and private sector accountancy firms perform around one third under contracts first let in 2007 and which are due to end in 2014.

The services I procure and the way those services are delivered must be appropriate to the Welsh context. The Welsh public sector and the requirements placed upon auditors have changed significantly since the current contracts were arranged. My forthcoming procurement needs to respond appropriately to continuing financial constraint, high public expectations of services and changing patterns of service provision. Like everyone in the public sector, I work in the context of severe financial and service pressures and fast-moving change. I am also mindful of the changes to the delivery of public audit in England. I will keep a close eye on the impact of those changes on the independence, accountability, cost and quality of audit as they unfold over the coming years.

External audit is an essential part of public accountability and its independence is paramount. I am committed to audit providing insight and supporting improvement as well as constructive challenge enabling government to be held to account. I will continue to work with the other UK national audit agencies to enhance the efficiency and effectiveness of public audit, to provide a strategic focus on issues cutting across our work and to develop broadly consistent approaches to public audit. And I will continue to deliver a high quality and consistent approach across Wales that provides value for money for the people of Wales. Taken together, my Annual Report and Accounts for 2010-11, my Supplementary Estimate for 2011-12 and my Estimate for 2012-13 show clearly a dramatic overall reduction in the level of resources utilised by the Wales Audit Office. On a cumulative basis between 2009-10 and 2012-13, I will have overseen a real-terms reduction in total annual expenditure of close to 25 per cent.

All of these factors make it timely for me to consult you about options for my future Contracting Strategy. My Code of Audit Practice sets out *how* I and my appointed auditors should carry out our respective audit functions. This consultation is about *who* should deliver that work. Whilst recognising my statutory role to undertake audits and to appoint auditors, I am also interested in exploring the extent to which audited bodies' representatives might contribute to my decisions about procurement.

I look forward to receiving your views on my proposals, by Friday 13 April 2012. A response form is provided on [page 22](#) and on our website at: www.wao.gov.uk/reportsandpublications/currentconsultations.asp.

Huw Vaughan Thomas
Auditor General for Wales
20 February 2012



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Summary

- 1** My staff, in the Wales Audit Office, currently deliver around two-thirds of the audit work available for contestability. For that contestable work, I am able to choose between the Wales Audit Office and at least two firms for the provision of audit services anywhere in Wales. Accountancy firms deliver the majority of the remaining third of contestable work. I buy around £3.4 million of professional services annually, predominantly under audit services contracts that will expire in 2014. As well as providing contestability of individual audits, my current contracting strategy is designed to deliver a high quality service at a low and regulated cost.
 - 2** I wish to refresh my contracting strategy before starting my new procurement exercise. The contracts I let will need to successfully deliver audit work, while accommodating future demands on audited bodies and auditors and changes to the general audit market. I will focus on Welsh needs, competition, maintaining an appropriate balance between quality and price, partnership working and sustainability. I intend to keep downward pressure on costs by promoting a competitive market for audit and related services and using more flexible procurement arrangements. In doing this, I will provide greater transparency on how suppliers are chosen. I also wish to introduce more robust, though still affordable, arrangements for the audit of town and community councils. To do this I am considering:

 - the balance of work done by the Wales Audit Office and other suppliers, including opening up more health and central government work to contestability;
 - the breadth and depth of supply, by using new and additional suppliers (including those based in Wales) and enhancing the skills base for performance audit by widening its supply base beyond the accountancy firms alone;
 - broadening the purchasing approach to include framework agreements and occasional specific tenders as well as new core audit services contracts; and
 - the involvement of audited bodies' representatives in my selection of potential suppliers, while safeguarding my independence.
- My consideration of these issues will continue beyond the period of this consultation in the light of any eventual developments arising from the Wales Audit Office Bill.
- 3** Strengths of the current arrangements will not be lost, however. I will preserve the principle of the independent auditor appointment; the independence of auditors from the bodies they audit; my regulation of the quality and cost of auditors' work; and the principle of 'Post-Office pricing' whereby work of an equal nature is be charged for using the same fee scales across the whole of Wales regardless of the remoteness of the audit's location.

4 I plan to access additional and new sources of supply by broadening my purchasing approach. I will continue to use contracts similar to those I have at present with firms to provide certainty of a sufficient amount of work over a specified term to encourage contractors' investment in their professional infrastructure and to make specialist technical support economically viable. However, such contracts will not be my sole procurement route. I will also explore new framework agreements for purchasing specific project work, and accessing agency staff and specialists. I also wish to have more secondments both into and out of the Wales Audit Office. I will in addition run occasional specific tenders, or mini-procurements, and use other existing public sector arrangements, where appropriate, from time to time to purchase specific pieces of work, or to acquire particular skills.

5 My overall purchasing approach will therefore consist of three broad areas, as explained later in detail in [paragraphs 2.57 and 2.58](#).

6 To help me design my procurement, I would welcome your comments on the three key questions set out on the response form at the end of this consultation:

- What are your views on my proposals to establish a more competitive and open market for the supply of audit and related services, supported by more flexible procurement arrangements?
- Is increased involvement by audited bodies' representatives in the procurement processes desirable?
- Do you think my proposals are likely to support more robust, though affordable, arrangements for town and community councils?

Figure 1: Summary of proposed purchasing approach



Part 1- Current arrangements

My work as the Auditor General for Wales

- 1.7** A summary of my duties and powers in relation to the audit of the Welsh public sector appears in [Appendix 1](#).
- 1.8** Each year, the staff I employ and the auditors I contract with (we) deliver a broad and varied programme of external audit work. This includes audits of accounts, value for money examinations and studies, local government assessments, certification of grant claims and anti-fraud exercises. We are responsible for the annual audit of most of the public money spent in Wales, including the £14 billion of funds voted to Wales annually by the Westminster Parliament. Elements of this funding pass via the Welsh Government to the NHS (over £5 billion) and to local government (nearly £4 billion). An outline of the audit work delivered in 2010-11 is given in my annual report and accounts which highlights some of its impact. In 2010-11, we issued reports on the accounts of approximately 840 public bodies in Wales. Over 700 of these bodies are 'small bodies', predominantly town and community councils.
- 1.9** The work of the Wales Audit Office is funded from a variety of sources, mainly from fees charged to audited bodies and from the Welsh Consolidated Fund (WCF) following approval by the National Assembly. Income for 2010-11 is summarised as follows.

Figure 2: Wales Audit Office income analysis

Income and financing		£ (thousands)
Audit and inspection fees	Local government	£13,391
	NHS	£4,181
	Central government	£1,604
Resources from the Welsh Consolidated Fund		£5,047
Other income		£258
TOTAL		£24,481

Source: *Wales Audit Office Annual report and accounts 2010-11*

Those who help deliver my work

- 1.10** I employ staff and affiliates and I purchase professional services from firms. Most work is done by my staff – the Wales Audit Office. At the 2010-11 year-end, I directly employed 253 staff (222 whole-time equivalents).

1.11 Professional services are bought under my two sets of audit services contracts, one for principal audited bodies and one for small audited bodies. Those contracts began in 2007 and will expire in 2014. Some relevant statistics about the work I contract out are provided in the next paragraph.

1.12 For the audits of large bodies, the Wales Audit Office undertakes around 73 per cent of work (by audit numbers and fee value) and firms undertake around 27 per cent. All of the town and community council audits are with firms. In terms of the type of audit work, some 31 per cent of financial audit and 13 per cent of performance audit (by input time) is outsourced. The amount of work I contract out sits in the middle of the spectrum of other UK audit institutions: from published information, the proportions of contracted out work range from 20 per cent to 48 per cent. I exceed the 25 per cent target recommended (for the National Audit Office) in the Sharman Report.

1.13 Each of the UK audit agencies contracts out work in different ways:

- The National Audit Office (NAO) has a set of framework contracts for financial audit with seven firms. Ministries are divided into specific lots with two or three firms working in each. Firms work in combined teams led by senior NAO staff. A separate framework agreement engages seven 'strategic value for money (VFM) partners' to provide professional services (eg, research, consulting and analytical skills) to support VFM investigations, working with NAO staff in most cases.
- Audit Scotland has framework contracts with eight firms. Audited bodies are classed into five different 'lots' with generally between two and six providers working in them. The audits contracted out include a high proportion of college audits which, if excluded, would make the percentage by number around 39 per cent.

- The Northern Ireland Audit Office contracts with eight firms for financial audit work and/or temporary audit staff. It uses two firms for VFM studies.
- The Audit Commission has framework contracts with five major firms for principal local government and NHS bodies; and four other firms for parish councils. It has a framework agreement with two firms to supply it with staff to cover workload peaks. However, the Audit Commission is undertaking a new contracting round as part of the process towards its planned dissolution which will see all work outsourced.

My current contracting strategy

1.14 My current Contracting Strategy dates from 2006, and provides for:

- a mixed market of supply, aiming to maintain a low cost, high-quality audit regime;
- engagement with a sufficient number of accountancy firms in order to provide contestability (ie, the ability to select from the Wales Audit Office and at least two firms) for providing audit services anywhere in Wales;
- buy-in of specialist services as appropriate, rather than creating a mixed market for inspection services; and
- a total quantum of work to be outsourced of between £3 million and £5 million a year, giving flexibility to expand or contract that quantum depending on the value for money available.

1.15 However in 2009, on reorganisation of the NHS in Wales, the then Auditor General decided to oversee that major change personally and so arranged for Wales Audit Office staff to perform the audits of all of the new local health boards. He did not reallocate other NHS work to replace that lost by the firms through the demise of the bodies they were previously allocated to.

1.16 I have continued with a ‘Single Appointed Auditor’ arrangement across local government. Under this arrangement financial audit delivery teams, whether from the Wales Audit Office or a firm, work to a single Appointed Auditor, who is a senior member of the Wales Audit Office staff. The arrangement promotes consistency and continuity of audit judgement.

Current policy for auditor rotations

1.17 Professional and ethical standards stress the risks to auditors’ independence if they have an overly long-standing relationship with an audited body. My policy is to have independence considered at the start of every year. Rotation becomes increasingly likely after the fifth year of tenure. The maximum engagement period is 10 years.

Timetable for my next procurement

1.18 I am consulting at this early stage to inform the design of my next sets of contracts. My timetable is outlined as follows.

Figure 3: Procurement timetable

	Rest of 2011-12	2012-13	2013-14	2014-15
Current contracts				
Consultation on proposed strategy				
Implement new strategy and launch next procurement(s)				
Conclude procurement(s) and arrange new appointments				
First year of delivery under new contracts				

Part 2 - Options for change

The context in which my contracting strategy needs to work

2.19 Considerations about what parts of my contracting strategy should be kept or changed need to be made in the context of the probable future climate for public services and the resulting expectations for auditors' work. That context is fast-moving and uncertain, but the likely audit market and the economic pressures on public bodies and services, and professional and legal requirements upon auditors – including the draft Wales Audit Office Bill – are all important factors. My contracting approach will need to accommodate any necessary changes to arrangements which result from that Bill.

Future demands on audited bodies and auditors in Wales

2.20 The Welsh public sector has changed significantly since the last procurement. The NHS has been reorganised into a smaller number of larger bodies. Probation services were brought together into the Wales Probation Trust. In local government, the Local Government (Wales) Measure 2009 introduced more standardised assessments of improvement with a greater emphasis on outcomes for citizens; and reforms to the police service are pending. My procurement must respond effectively to new pressures and issues. For public services generally, these include:

- the economic climate of financial pressures from long-term fiscal deficits; the need to reduce debt when there is little or no

economic growth; and the difficulties of raising taxes further;

- higher expectations for citizen value, given increasing citizen demand and the reduced resources available to meet them;
- changing patterns of service provision and collaboration issues;
- a stronger focus on 'outcomes' and the need to 'achieve more but with less' which will bring new business techniques, innovation and efficiency to the fore;
- more open and commercially minded public services, with a diverse range of suppliers;
- the public sector equality duty;
- sustainable development (particularly issues related to climate-change, waste management, energy supply and costs); and
- increasing digital delivery and overcoming the digital divide.

2.21 In the specific Welsh context, issues include:

- new law-making powers and further extensions in devolution and funding;
- the Welsh Government's desire for a new and distinct 'Welsh public service';
- new models of service for priority areas such as children and families with complex needs; support for people to live well and independently; and public protection;

- decisions on which services are best delivered locally, or through regional or national collaboration;
- bedding-down of the NHS reorganisation, which has increased differences to the service in England; and
- the need for economic development; improved skills and educational attainment and more and better homes.

2.22 All of these issues will mean changes in the expectations for auditors' work. I expect to see:

- the focus of regulation moving towards public value and efficiency – maintaining the need for well-grounded performance evaluation;
- auditing across boundaries and shared services rather than by traditional sectors – making following the public pound, and accountabilities, more complicated;
- proactive engagement with emerging issues (for insight and improvement) rather than only retrospective auditing (assurance) – increasing the currency of audit; and
- sharper focus on strong governance and risk management and increasing transparency and accountability.

2.23 Against this context, I will now turn to the arrangements I propose to retain or change.

Changes to the general audit market

2.24 It is unclear how the new market for audit in the public sector in England will emerge but whatever happens in England, there are likely to be market consequences in Wales. I will keep a close and watchful eye on the impact of the changes, particularly in relation to the independence, accountability, cost, consistency and quality of audit.

2.25 There is also potential reform of the audit market generally. This includes the Competition Commission's investigation into the market for statutory audit services and the European Union's publication on audit policy and the obstacles to competition.

Legalities

2.26 Certain aspects of how I arrange to deliver audit work in the Welsh public sector are based in legislation and cover:

- what I and other auditors must do under current and new legislative requirements, particularly:
 - a the Public Audit (Wales) Act 2004;
 - b the Government of Wales Act 2006;
 - c legislation for specific individual Welsh Government sponsored bodies;
 - d the Accounts and Audit (Wales) Regulations 2005; and
- how I must go about procuring services, as set out under the Public Contracts Regulations 2006, European Commission Directives and the Transfer of Undertakings (Protection of Employment) Regulations.

I must also have regard to any new or differing requirements which come in with the forthcoming Wales Audit Office Bill.

2.27 To ensure constant provision I also require an effective 'auditor of last resort', which in practice means the Wales Audit Office. To fulfil this role, the Wales Audit Office must be a centre of excellence and of a size and capability that is able to simultaneously deploy resources anywhere in Wales. I want it to be the 'engine room' for public service improvement and a valuable partner for audited bodies. To support me and audited bodies, the Wales Audit Office must also be

a holder of corporate knowledge. Having the Wales Audit Office continue to deliver a significant volume of audit work gives me a practitioner's perspective into audit processes and of the services I buy from other suppliers. The Wales Audit Office gives me a benchmark of cost and quality and helps me promote important product values.

2.28 I am also committed to the principles of public audit.

The principles of public audit

2.29 Public audit is essential for effective accountability in the distinctive area of public services. Welsh Ministers, elected members, governing bodies and service managers are responsible for ensuring that public money is handled with integrity and that it delivers value for money. High standards of accountability are particularly required because:

- there is an element of compulsion in how public money is raised, typically through national and local taxation;
- public money can only be used for purposes intended and authorised by law;
- those dealing with public money must be able to show they have done so in accordance with the standards expected by the public and their elected representatives; and
- independent scrutiny can help drive improvement in areas of public service where there is no competition.

2.30 I recognise three fundamental principles which underpin public audit. They are tried and tested:

- the independence of public sector auditors from the organisations being audited;
- the wide scope of public audit covering the audit of financial statements, regularity (or legality), propriety (or probity) and value for money; and

- the ability of public auditors to make the results of their audits available to the public, and to democratically elected representatives.

2.31 I also fully intend that I – and the Wales Audit Office – shall uphold a fourth principle:

- public auditors must show the highest standards of governance, performance and accountability for their own use of resources.

Practicalities

Appointments to local government bodies being determined by the Auditor General

2.32 Independent appointment is one of the main safeguards to audit independence, and it is in the public interest. Those responsible for spending and accounting for public money should not decide who audits them. Independent appointment provides essential safeguards so that auditors can carry out their roles as set out in the Code of Audit Practice, freely and without influence from the audited body. Without the safeguard of independent appointment, auditors would face increased pressure to undertake or not undertake certain work, and to report privately – or not at all – rather than publicly as they do now.

2.33 There are other advantages for audited bodies from my role in making independent appointments. Hundreds of bodies across Wales save the considerable effort and expense of running their own procurement and appointments processes. Bodies can be assured as to the minimum quality standards and the independent regulation and monitoring of the performance of auditors. Bidders save similar costs which they would otherwise need to recoup from audited bodies. Bulk purchasing produces more economically advantageous tenders, which in turn helps to keep fees lower than would otherwise be the case in a fragmented market.

2.34 However, and recognising my statutory duty to audit and appoint auditors, I am attracted to the concept of involving audited bodies' representatives in assisting me with the contracting processes. I should welcome views on whether, and how, representatives of audited bodies might become more involved in assisting me with the selection of those I contract with¹.

The Single Appointed Auditor arrangements for principal local government bodies and the Liaison Director arrangement for central government and National Health Service bodies

2.35 These arrangements² promote the continuity and consistent application of audit judgement across audited bodies. They promote flexibility in the supply of audit services across local government bodies, and for all of the central government and NHS bodies as I am their statutory auditor. As all principal local government bodies are now within the Single Appointed Auditor arrangement, I intend to refer simply to the Appointed Auditor in the local government context.

Indemnity for auditors provided they have not acted negligently

2.36 Working under contract to me, rather than independently, helps to reduce audit costs as my indemnity reduces the overall level of risk to auditors (as long as they have not acted negligently) from the work done for me. My focus on the quality of supply in the contracting process, my provision of guidance to auditors, and my regulation and monitoring of public sector audit reduces the risk of that indemnity being called upon.

Control of fees by the Auditor General and the principle of 'Post-Office' pricing

2.37 My regulation of fees ensures that auditors' local audit work will be sufficiently resourced to properly discharge their audit duties. I am able to challenge and, if necessary, reduce proposals for excessive fees (or increase fees where they are not sufficient to cover the work required). Work of an equal nature will be charged for using the same fee scales across the whole of Wales where applicable. Bodies in more remote locations thus avoid excessive costs.

The high quality of audit work and auditors' working relationships

2.38 High quality audit work is vital to provide assurance to the public and hold government to account. Public sector audits are highly specialised, reflecting the complex legal, governance and financial control framework in which the audited bodies operate, and the nature of the audit itself. Auditors must be able to work effectively in this environment, and cope effectively whenever an extreme situation arises. Current financial audit work within my regime is recognised as a real strength. It meets increasingly ambitious timescales and exacting standards, and that is something I want to continue.

2.39 Wales Audit Office national study reports are of a consistently high quality. Even where reports have been very critical of particular organisations, their senior managers have often expressed positive feedback about the conduct and impact of this sensitive and high-profile work. This success is something I also want to continue, whilst broadening the supply base to bring in new skills and techniques to further improve the quality of our work.

¹ Please see paragraph 2.64, later.

² The Single Appointed Auditor arrangement covers the responsibilities vested in the appointed auditor. It does not include local government improvement assessment work, as that performance audit work is the responsibility of the Auditor General.

2.40 Successful audit also depends on good, professional, working relationships, with investment of time and effort in understanding the audited body's business needs. The Wales Audit Office's and firms' working relationships with audited bodies are generally positive, but not overly familiar. My current suppliers stress the satisfaction and experience they gain from working in the public sector. They also welcome our effective processes for contract letting and monitoring and their good working relationships with my staff. Audited bodies appreciate the service they have from the Wales Audit Office and the firms contracted to me.

Effective procurement focussing on Welsh needs, competition, the right balance between quality and price, partnership working and sustainability

2.41 Organisations who wish to work for me need to maintain a current and thorough knowledge of the Welsh public sector and the legislation covering it. They must understand the challenges faced here, and be able to offer appropriate skills and solutions. Audited bodies need a service which responds effectively to particular local factors, especially use of the Welsh language and the number of remote locations to be covered.

2.42 I wish to maintain a vibrant, accessible and affordable supply of auditors, enabling a good choice of auditor regardless of the location of an audited body. This helps me arrange rotations between the Wales Audit Office and the firms for financial audit work, especially if an unexpected need to rotate auditors arises. Additionally, I wish to build the supplier capacity for Wales to prevent over-reliance on one or two suppliers and the subsequent risks of market dominance or the loss of service should any major supplier reduce the scale of, or withdraw, its operations here.

2.43 I will continue to seek to contract with organisations willing and able to invest in Welsh public sector audit and to work in effective partnership with me and my staff. Their technical innovations and development of leading-edge technologies should help me maintain high standards across the Welsh public sector. I wish to exploit organisations' extensive technical resources, and the wider knowledge acquired through their global networks and private sector work, to benefit public bodies here.

2.44 I wish to support the Welsh Government in its duty to promote sustainable development, and public procurements are one of the more powerful levers to assist with this.

2.45 I will seek to achieve this high quality by applying the following selection criteria, while maintaining a downward pressure on audit costs.

Figure 4: Proposed tender selection criteria
(not in rank order)

Proposed tender selection criteria
<ul style="list-style-type: none"> • Understanding of the nature and purposes of the Auditor General for Wales and Welsh audited bodies, and an ability to address the issues facing them. • Skills, knowledge and experience of the proposed Engagement Leads and the members of the audit team (along with team composition). • Specialist skills, tools and techniques. • Commitment to, and investment in, public sector audit (for example, by providing dedicated teams and a centre of technical expertise and support). • Ability to address language issues and cover the whole of Wales. • Other technical and developmental capacity, including innovation. • Working relationships and communication, including responding to correspondence from local electors, and local/national representatives. • Effective internal quality assurance and control arrangements. • Effectively addressing environmental issues. • Compliance with legal requirements, including Welsh legislation and especially the specified 'public sector equalities duties'. • Price.

Areas I particularly welcome comments on

2.46 My intention is to maintain a high standard of audit while having:

- a more competitive and open market for the supply of audit and related services, supported by more flexible procurement arrangements;
- increased transparency about how suppliers are selected; and
- more robust, though affordable, arrangements for town and community councils.

2.47 Changes to workloads, the sources of supply, the means of procurement and an increased involvement by audited body representatives should all bring benefits. I should particularly welcome your comments on the following matters.

(1) The balance of work done by the Wales Audit Office and other suppliers

2.48 While I believe the overall level of financial audit work identified for contestability is about right, I am willing to look at how the accountancy firms are deployed on this work across the local government, NHS and central government sectors. Currently the balance is skewed towards local government. Public bodies will benefit from my maintaining plurality of supply such that I can deploy an effective combination of resources to deliver financial audit work across all sectors.

2.49 Given the current demands and the changing future expectations upon auditors, I wish to bring additional skills and capacity from a variety of sources to support the delivery of performance audit work. Bringing in additional experience and skills should increase future audit capacity, strengthen the pool of expertise I can call upon, and help with timely reporting.

2.50 As my next contracts will run well towards the end of the decade, they will need to cope with potential uncertainties. Having a broader base of supply will better enable me to accommodate fluctuations in workload and skill needs over time.

(2) Opening up more of the National Health Service sector

2.51 Until the Welsh NHS was reorganised two years ago, accountancy firms provided around 30 per cent of the audit work. Currently, only the audit of the Ambulance Trust is supplied by a firm. I propose to re-open the NHS market in Wales to supply from outside the Wales Audit Office, either wholly, or, at very large bodies, as joint audit teams.

(3) Opening up more of the Central Government sector

2.52 Relevant legislation for the Welsh Government's sponsored and related bodies, and for the independent devolved government bodies, requires me to audit their annual accounts. However, as I am able to have assistance from others, I can arrange for contractors to help me deliver these financial audits. I am considering whether to increase the extent to which I do this.

(4) Finding new suppliers

2.53 All principal audit bodies are large and complex and require their auditor to have a sound knowledge of the public sector generally, the sector the body is in, and the body specifically. These requirements tend to act as high entry levels for new contractors in terms of technical knowledge and expertise. While essential to maintain quality, these entry requirements might deter some new suppliers from entering the market.

2.54 I will attempt to overcome these difficulties, and broaden the supplier base to build audit capacity, aid competitive supply and keep downward pressure on costs in the following ways.

- I will explore additional sources of supply. For financial audit this could involve specialist skills, or supply for specific topic work such as the certification of certain grant claims. For performance audit this could include services such as specialist skills, study work, analysis, survey or international comparison work.
- I will look to encourage bids from new suppliers, including small and regional suppliers, who would work with support and supervision from Wales Audit Office staff or other larger and more experienced suppliers.
- I will also offer appropriate technical support to new suppliers, as befits the expectation that professional bodies, and public audit bodies and regulators, will disseminate their specialist public sector knowledge.

2.55 While my current contractors have much capacity and capability in VFM audit work, I wish to be able to access additional sources for these services. It is not practical or economic for the Wales Audit Office to permanently employ specialists in every subject and I will seek to purchase supply from consultancies, academia, think-tanks and the voluntary sector, as well as expert individuals. New suppliers will help ensure continuity of service should any existing suppliers decide to withdraw from this type of work as a result of the changes to the audit market in England. As at present, contractors and suppliers would always be used with due regard to all ethical issues and in ways which do not impair the independence and objectivity of my audit work.

(5) New arrangements for buying audit work

- 2.56** Currently, I purchase the great majority of outsourced work using established supply contracts or by hiring individual auditors for a short period as affiliates. Occasionally, a consultancy is engaged for a specific piece of work. To date, I have made limited use of secondments.
- 2.57** I will continue to use **audit supply contracts** to provide certainty of a sufficient amount of work over a specified term to encourage contractors' investment in their professional infrastructure and to make specialist technical support economically viable. However, such contracts will not be my sole procurement route. I will also explore separate **framework agreements** for purchasing specific project work, agency staff and specialists. I also wish to have more secondments both into and out of the Wales Audit Office. I will also run **occasional specific tenders**, or mini-procurements, and use other existing public sector arrangements where appropriate, from time to time, to purchase specific pieces of work, or to acquire particular skills.
- 2.58** My overall purchasing approach will therefore consist of three broad areas.

- **Audit supply contracts – a commitment to purchase a specified £ range of annual supply.** Comprises the financial audit of annual accounts in all areas of the Welsh public sector; certification of grant claims and returns; and the financial aspects of Local Government Measure work.
- **Framework agreements – a commitment to purchase a specified £ range of other generic audit work (financial audit, value for money and national studies).** Comprises undertaking routine studies and Value for Money (VFM) work; the supply of additional auditors to help the Wales Audit Office manage its workload peaks; other support for my performance audit teams in the local government and health sectors and for my programme of value for money studies. Such work could include, for example, survey, data analysis and international comparison work.
- **Occasional specific tenders – an unspecified £ value of ad hoc and specialist projects.** Comprises substantial specialist input into occasional performance audit projects which would be led by senior managers from the Wales Audit Office.

Figure 5: Summary of proposed purchasing approach



(6) Affordability of audit

- 2.59** The Wales Audit Office should lead the drive for efficiency in the public service by example. The overall level of savings over planned expenditure that we achieved in 2010-11 through cost reduction and greater efficiency was well over £1 million. Savings covered a very wide range of areas including training, publishing, deferred spending on ICT, and voluntary severance.
- 2.60** The Wales Audit Office has achieved significant year-on-year reductions in the fees charged to audited bodies, through efficiency improvements, by making cost savings and

by taking a more proportionate approach to our work. The total reduction in fees for local government, NHS and central government audits, and for local government grant work between 2009 and 2011 was, in cash terms, £1.27 million or 8.0 per cent. On a cumulative basis between 2009-10 and 2012-13, I will have overseen a real terms reduction in total annual expenditure of close to 25 per cent.

2.61 Every year, I review, set and publish scales of fees for the audit of local government bodies which are also applicable to the majority of audits of NHS bodies. My fee scales are underpinned by a zero-based approach to audit planning and are benchmarked against the fees charged by other UK audit agencies, where appropriate.

2.62 We are continuing to develop ways in which high levels of public assurance can be secured by placing reliance on robust review by others. Last year, with other external review bodies in Wales, we explained how collaboration between us is improving and how this can work to best effect in future³.

(7) Additional involvement of audited bodies' representatives in the procurement processes

2.63 Statutorily, I am the auditor of NHS and central government bodies, and I am required to consult local government bodies before making appointments. I also check when making appointments that there are no known problems that might prevent a new Engagement Lead from undertaking audit work on my behalf (or on behalf of the Appointed Auditor in local government).

2.64 Without prejudicing my independence, I am considering how to involve representative bodies, such as the Welsh NHS Confederation, Welsh Local Government Association, One Voice Wales, and the Society of Local Council Clerks in the process of selecting the organisations I contract with.

³ *Developing our work together in a climate of change. A paper on inspection, audit and regulation in Wales prepared by the Care and Social Services Inspectorate Wales (CSSIW), Estyn, Healthcare Inspectorate Wales (HIW) and the Wales Audit Office.*

Part 3 - Potential new arrangements for the audit of town and community councils

Current arrangements

3.65 Bodies that I designate as 'small' have audit arrangements tailored for them, using auditors' judgement, under my Code of Audit Practice. Town and community councils are subject to a 'limited assurance' audit. This limited assurance audit provides an appropriate level of audit assurance with an external audit requirement and costs which are proportionate.

3.66 The effectiveness of this arrangement depends on the councils themselves having adequate and effective arrangements for self-certification, internal audit and governance and it involves the compilation of an annual return from the council's accounts. The approach has three tiers. The first tier involves audit review of the annual return alone. In the second tier auditors also test in more detail a five per cent sample of annual returns and any returns where information comes to the auditor's attention suggesting that a particular council has a problem. The third tier involves councils with expenditure over £250,000 automatically receiving the more detailed level of testing.

Why I am considering changes to these arrangements for 2013-14 and onwards

3.67 While having the advantage of affordability, there are two important issues that I want to revisit in relation to the current 'limited assurance' approach. Firstly, and regrettably, auditors have found it necessary to report on several major irregularities at town and community councils in recent years. While it is important to recognise that the number

of reported irregularities represents a small proportion of the total number of councils, this is a very worrying situation. Secondly, an unacceptably large number of councils do not ensure their returns are completed and sent to the auditor on time or fail to respond appropriately to audit queries.

3.68 I recognise the good work of One Voice Wales and the Society of Local Council Clerks in promoting high standards of governance. However, I need to be satisfied that the sector as a whole has adequate and effective governance arrangements in place and – despite some progress – I am not convinced that, overall, it does. Examples of events and issues that have caused me to come to this view include:

- Appointed auditors regularly reporting on councils' failure to prepare their annual accounts and submit them for audit on time. The next table shows that 19 per cent of councils missed the 31 December 2010 deadline for having their 2009-10 audit completed⁴. In some cases their Members were unaware of this situation. This gives me cause for concern that Members are not discharging their responsibilities effectively. There is a sizeable group of 20 to 30 councils which are extremely late.
- Certain cases have been the subject of public interest reports by auditors. In two recent examples, the appointed auditor reported on significant failures in governance which led to significant amounts of unnecessary expenditure.

⁴ For the 2010-11 audit, the rate of non-compliance was very similar (17 per cent).

- In some other instances clerks and other officials have defrauded the councils they serve. Some of these cases are matters of public record where clerks have been convicted of theft and forgery involving thousands of pounds of public money.

Figure 6: Timeliness of small body audit

Number (and percentage) of town and community councils with their 2009-10 audit uncompleted at:	
31 December 2010	139 (19%)
28 February 2011	70 (9%)
30 April 2011	30 (4%)
30 June 2011	27 (4%)
31 August 2011	20 (3%)
30 September 2011	20 (3%)
31 December 2011	7 (1%)

3.69 These issues are not unique to Wales.⁵ The risks of poor value for money, financial mismanagement, or fraud are also likely to be exacerbated over time if town and community councils gain additional powers.

Improving governance

3.70 I see a sound case for improving governance across the sector. Part of that will entail a more robust, yet still proportionate, audit arrangement. I have considered whether the ‘charities’ model⁶ might be adopted. I have also considered whether unitary councils might be called upon to become active in the audit of the town and community councils in their area.

3.71 The element of compulsion in how community councils raise income through taxation, the need for high standards of accountability, and the ‘principles of public audit’ are all equally applicable to town and community councils. Exemption from independent audit is therefore inconsistent with the demonstration of good governance by town and community councils. While the majority of charities run without problems, the Charity Commission’s work shows that six per cent of all charities have not filed their latest accounts and annual return with the Charity Commission, and even when filed, timeliness remains a problem irrespective of whether charities are large or small. As many as one in five charities with an annual income of over £1 million missed their submission deadline. This evidence suggests that the charities model would not lead to improvement in timeliness for the audit of the accounts of smaller public bodies.

3.72 I anticipate a number of difficulties in having unitary authorities contract with me to undertake the audit of the small bodies in their areas. There are ethical issues that would need to be resolved, and councils do not have all of the powers to regulate town and community councils. Sufficient and suitable resources would need to be available to undertake the work, to respond to the public’s concerns and complaints, and undertake investigative work. Nevertheless, I should be interested in receiving comments from interested councils.

Proposals for a new approach in Wales

3.73 I believe that other arrangements would be more effective and appropriate for Wales to promote improved governance across all town and community councils.

⁵ Audit Commission report 2010, *Auditing the Accounts – Parish Councils*

⁶ The Charities Act 1993 exempts the smallest (income under £25,000) charities’ accounts from external scrutiny. Middle-ranking charities may have an independent examination or an audit. Only the largest charities (income over £250,000 and assets over £3.26 million, or income over £500,000) are required to have an audit.

Two-tier audit

3.74 Accordingly, I am consulting on contracting on the basis of changing the current three tier arrangements to an enhanced but proportionate and more robust form of two-tier audit.

- First tier – all councils to be subject to an audit approach which includes testing the annual return back to elements of the accounts. Councils would prepare and submit an annual return and provide evidence to the auditor to demonstrate compliance with key governance requirements. The work would be extended where returns, or where information comes to the auditor's attention, suggest a body has a problem.
- Second tier – irrespective of their size, a sample of councils would be subject to a more detailed audit. The scope of the audit would seek to provide assurance that the sort of failures identified earlier in paragraph 69 do not occur at the council under audit. Councils would receive a second-tier audit at least once every five years.

3.77 My local government fees consultation (for 2012-13⁷) retains the 'free audit' for the smallest councils. Most other councils (ie, those with income/expenditure below £200,000) will see increases limited to between only £10 and £25.

3.78 While future rates cannot be finalised until my new contracts are arranged, modelling work shows that a two-tier audit approach will result in a substantially smaller increase than if inflationary increases had been applied over the past decade. Fees will therefore remain proportionate and affordable.

Affordability

3.75 While affordability is an important factor for all audited bodies, it is especially so for small town and community councils. A large number of these have very small budgets indeed. Audit fees are currently based on a fixed scale related to the bodies' income and expenditure. This long-standing principle is clear and I wish to retain it.

3.76 During the last 10 years, the fee scales were fixed for two five-year periods. In 2007, the rises that were applied were minimised, and fees for the very smallest councils (those with annual income or expenditure under £5,000) have not risen since 2002.

⁷ Local government audit and inspection fee scales 2012-13. My consultation letter, dated 20 October 2011.

Part 4 - Questions for stakeholders

- 4.79** To recap, my view is that the Wales Audit Office should remain as my principal supplier for public audit work in Wales but with accountancy firms and other new suppliers also playing a significant role. I intend to ensure that future audit services, and the arrangements for delivering them, will continue to optimise the benefits for people in Wales who use and pay for their public services.
- 4.80** I am keen to secure your feedback on my proposals set out in this draft strategy and would be most grateful if you could let me have your views by **Friday 13 April 2012**. You can do so in the following ways:
- Print out and complete the response form which follows and post it to:

Consultation
Auditor General's Private Office
Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ
 - Email your views to us at waoappointments@wao.gov.uk
 - Visit our website, www.wao.gov.uk/reportsandpublications/currentconsultations.asp and download a response form to e-mail back to the above address.
- 4.81** In particular, please respond to the following questions:
- 1** What are your views on my proposals to establish a more competitive and open market for the supply of audit and related services, supported by more flexible procurement arrangements?
 - 2** Is increased involvement by audited bodies' representatives in the procurement processes desirable?
 - 3** Do you think my proposals are likely to support more robust, though affordable, arrangements for town and community councils?

Response form

Please send your response to the address below by **Friday 13 April 2012**. Please make it clear whether you represent one organisation or an association of many and show in what capacity you are responding.

Your name and job title (include capacity in which you are responding)	
Name of your organisation	
Your address, email address and telephone number	
What are your views on my proposals to establish a more competitive and open market for the supply of audit and related services, supported by more flexible procurement arrangements?	
Is increased involvement by audited bodies' representatives in the procurement processes desirable?	
Do you think my proposals are likely to support more robust, though affordable, arrangements for town and community councils.	

Please return to:
Consultation, Auditor General's Private Office, Wales Audit Office, 24 Cathedral Road, Cardiff, CF11 9LJ.

Publication of responses – confidentiality and data protection

Information provided in response to this consultation may be published, or disclosed in accordance with the access to information regimes (chiefly the Freedom of Information Act 2000, but also the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want any information you provide to be treated as confidential, it would be helpful if you could explain to us why you regard the information you have provided as confidential.

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 Auditor General.

Personal data will be processed in accordance with the Data Protection Act. Where such data falls within the scope of a request for information from another person, the provisions of the 1998 and 2000 Acts will need to be considered in the particular circumstances. While no situation can be prejudged, this is likely to mean that information concerning senior officials and public figures is likely to be disclosed while the names and addresses of ordinary members of the public are likely to be withheld.

Appendix 1 - My work as Auditor General

As Auditor General for Wales, I have statutory duties to:

- audit the accounts of the Assembly Commission; the Welsh Consolidated Fund; the Welsh Government and its sponsored and related bodies – including all NHS Wales bodies;
- appoint auditors to local government bodies (including fire and rescue authorities, police authorities, the probation trust, national park authorities and town and community councils) following consultation with them;
- arrange for certification of grant claims and other returns if requested to do so by a relevant body;
- undertake and publish certain studies of Welsh local government bodies;
- undertake improvement plan audits and improvement assessments of all Welsh improvement authorities (ie, county councils or county borough councils, national park authorities, and fire and rescue authorities); and
- perform certain other functions, including benefit-fraud inspection; and control of the Welsh Consolidated Fund.

I can choose to do other things as well. I have powers to:

- undertake and publish examinations and studies on economy, efficiency and effectiveness and for making recommendations for improvement;
- undertake an inspection of a Welsh improvement authority if it has failed to comply with its improvement duties under the Local Government (Wales) Measure 2009 (the 2009 Measure) – this becomes a duty if I am directed by the Welsh Ministers;
- provide administrative, professional and technical services to public bodies, accountancy bodies and qualified auditors; and
- undertaking data matching exercises for the prevention and detection of fraud.