

PURPOSE AND INTENDED EFFECT OF MEASURE

OBJECTIVE

The objective is to make the Comptroller and Auditor General (C&AG) statutory auditor of four new executive Non-Departmental Public Bodies (NDPBs):

- Thurrock Development Corporation
- London Thames Gateway Development Corporation
- West Northamptonshire Development Corporation
- The British Transport Police Authority.

This is in line with the Government's policy of strengthening the statutory powers of the C&AG that will lead to more consistent statutory audit arrangements.

CONTEXT

In its response to Lord Sharman's report "Holding to Account"¹, the Government accepted his recommendation that the C&AG be appointed auditor for all NDPBs on a statutory basis, through a provision of the Government Resources and Accounts Act 2000 (the GRAA) – Section 25(6).

Initial implementation in respect of 26 NDPBs was achieved through an Order² under the GRAA. The NDPBs covered by that Order were, up until that time, either audited by private firms, or the C&AG was the auditor by agreement. An Order under the Act was required to give statutory authority for the policy. Section 25(10) of the Act requires that such Orders be by Resolution of each House of Parliament.

Since the policy was established, new primary legislation to set up an NDPB should include provision for the body to be audited by the C&AG. But some new NDPBs are established through legislation that is already on the statute book. If this does not include provision for C&AG audit, an Order under the GRAA is required to give the C&AG statutory audit responsibility for these NDPBs.

The four NDPBs listed above have recently been established either using legislation that is already on the statute book or where no provision for audit was included in the primary legislation. The purpose of the draft Order is to seek Parliament's approval to give the C&AG statutory audit responsibility for those bodies. Without such provision it would be left to the relevant Secretary of State to appoint an auditor annually.

RISK ASSESSMENT

The main risk is that because the C&AG has become the monopoly supplier of audit services to NDPBs, private sector auditors may be precluded from

¹ Audit and Accountability in Central Government – CM 5456, March 2002

² The Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003 – SI/2003/1326

competing for business and consequently NDPB audit costs may increase and the quality of NDPB audits may reduce through lack of competition.

There is also a risk if the Order is not implemented that the C&AG's statutory audit powers would be weakened because he may not be able to take a view of audit and accountability in NDPBs as a whole.

Review of the impact of C&AG audit of NDPBs

In the light of the fact that this Order is a continuation of a policy that was begun in 2003, it was thought sensible to revisit the assumptions in the regulatory impact assessment that accompanied the 2003 Order. The 2003 regulatory impact assessment identified a number of risks, costs and benefits of moving to statutory audit of NDPBs by the C&AG. It said that:

“The main **risk** associated with extending the C&AG's audit to those NDPBs where he is not currently the auditor is that a sponsoring Department may be uncertain as to whether it will receive an equivalent level of assurance about the financial arrangements in place in its NDPB as it currently receives. This risk will be addressed by the establishment of arrangements designed to recognise the Department as a stakeholder in such bodies' audits and to provide assurances about the way in which the audit will be managed. These arrangements are set out in Section 3 of the Government's response to Lord Sharman's report.

Other potential risks arise from an initial lack of knowledge on a change of auditor of the body being audited, a need to re-provide for other services currently offered by private sector auditors, and the need to change existing contracts or wait for their expiry before the C&AG can become the statutory auditor. These risks exist in the short term only and will be addressed through the arrangements referred to in the previous paragraph.

There is a risk that the contracting of audits by the C&AG to the private sector will add an extra burden of review and liaison, as compared to the private sector carrying out these audits in its own right. This risk will be addressed by the NAO's commitment to continue to develop closer partnerships with private sector audit firms.

There is a further risk that by transferring audit responsibility from private sector audit firms to the NAO the benefits that these firms bring to the public sector, such as experience in auditing in different environments, innovation and the quality that derives from competition will be lost. In practice this risk will be minimised by the C&AG's commitment to contract out the same number of audits as are currently carried out by the private sector, thus providing scope for these benefits to continue to be available to the public sector.

While there may be some small variation in charges on a change of auditor, we expect the overall cost to be broadly the same as if the current arrangements had continued.

The main **benefit** of the change will be to achieve consistency in the statutory auditing arrangements for NDPBs.”

On the pros and cons of the move to statutory C&AG audit, the 2003 Regulatory Impact Assessment said that:

“The main advantage of the change will be to achieve consistency in the statutory audit arrangements for NDPBs - a matter on which the PAC, on behalf of Parliament, has expressed concern to successive Governments.

The main disadvantage is that sponsor Departments will lose the ability to select a new auditor if they are unhappy with the service provided. The C&AG recognises the stakeholder interest of audited bodies and their sponsors in his audit work and is putting arrangements in place to provide an opportunity for those bodies to comment on the way the audit is staffed.”

The 2003 Regulatory Impact Assessment concluded that:

“The overall cost of the new arrangements is expected to be broadly the same as if the current arrangements had continued. The arrangements set out above may not be completely without cost in each individual case. However, in the light of the assurances provided by the C&AG that the new powers, particularly those of access, are unlikely to be used in a way which, taken as a whole, increases existing burdens, the Government is satisfied that on balance the advantages and disadvantages of these arrangements add up to a clear and continuing net gain for Parliament and the public.”

In view of the monopoly position that the C&AG now enjoys, it is necessary to ensure that the risks identified above are minimised. To that end, the Government has reviewed the impact that C&AG audit had on the first batch of NDPBs that moved from their previous auditor to the C&AG, i.e. those covered by the 2003 Order, and which were audited by the C&AG as from financial year 2003-04³. In carrying out the review, the Government took into account the issues considered in the regulatory impact assessment for the 2003 Order, to test the risks and assumptions made in 2003 to see whether they have been proven in practice. NDPBs submitted their views in confidence.

In brief, the responses from NDPBs were generally positive, with bodies enjoying good relations with their National Audit Office (NAO) colleagues. They said that all sides worked hard to ensure that there was no loss of continuity. If there were problems, these were the usual learning curve issues that any audited body would find with a new auditor. However, some bodies thought that experience over one audit cycle was not long enough to take a view.

A few bodies had criticisms. For example, some were concerned about the rigid timetable that the NAO prefers, which can strain limited resources. Similarly, it was said that the NAO did not always respect clients' timetables, for example in completing audits in time for annual general meetings. Some bodies also thought that the NAO should improve its understanding and knowledge of bodies that are not grant-aided. Finally, some regretted the C&AG inability to audit companies, especially trading subsidiaries of bodies he audits⁴.

³ This is in line with the policy that C&AG audit would begin once existing contracts expire.

⁴ The C&AG cannot, as yet, audit NDPBs that are registered as companies. This would require amendment of a European Directive, as well as the Companies Act.

We have shown the NAO a summary of the responses (suitably edited to ensure anonymity) and they were pleased with the positive tone of the feedback. They said it was encouraging that the transition to C&AG audit had been smooth.

Turning to the particular risks identified above, the exercise found the following (with NAO comments indicated).

Competition

The 2003 regulatory impact assessment recorded the risk that transferring audit responsibility from private sector firms would mean that the benefits that these firms bring to the public sector in terms of experience in auditing in different environments, innovation and the quality that derives from competition could be lost.

At that time (and in line with Lord Sharman's recommendation) the C&AG had made a commitment to contract out 25% of its audits to the private sector by 2005-06. This is the same number of private sector audits as were then currently carried out, thus providing scope for the benefits (of private sector audits) to continue to be available to the public sector.

A number of NDPBs recorded that the NAO had sub-contracted the work to private sector auditors following a competitive tender exercise. In addition, the NAO is confident that it is on target to meet its 2005-6 target. Currently 22% of its financial audits are contracted out.

Audit Costs

The 2003 regulatory impact assessment recorded that, whilst there may be some small variation in charges on a change of auditor, it was expected that the overall costs would be broadly the same as if the then current arrangements had continued.

NDPBs reported little change in audit costs, with some modest savings and some modest additional costs. They were, however, looking for reassurances that the costs would continue to be similar.

The NAO said in response that they are committed to keeping fees, including the cost of contracted out work, at or below the level charged by the private sector. This forms the base costs for future audit subject to relevant inflation trends.

Audit Quality

Bodies thought that there was advantage with the NAO because they knew first-hand what was behind government finance directives and were better placed to advise on what is required, whereas external auditors with their wider commercial experience did not have the experience or knowledge of these issues.

However, some bodies said that the NAO judgement on some issues was based primarily on their routine experience of those who are funded by grant-in-aid, whereas other bodies get their income from other sources. It was hoped that, in time, the NAO would develop a greater understanding of these situations.

The NAO said that they appreciated and were aware of this concern.

Conclusion on risks

In the light of the Government's review of C&AG audit of NDPBs covered by the 2003 Order, it appears that the assumptions in the 2003 regulatory impact assessment that arrangements would be put in place to minimise the risks have been proven to work. But the Government intends to monitor this in the

future, not least because of the comment from a number of NDPBs that one-year's audit was not long enough to take a considered view.

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OPTIONS

Option 1

Do nothing: this is not viable because of the commitment entered into in the Government's response to Lord Sharman to strengthen the C&AG's statutory audit powers, and the potential consequences resulting from a failure to meet that commitment.

Option 2

Make the C&AG the statutory auditor of the Thurrock, London Thames Gateway, and West Northamptonshire Development Corporations; and the British Transport Police Authority: this maintains a consistent approach to implementing the Government's policy on statutory audit of all NDPBs.

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BENEFITS

As explained in the 2003 regulatory impact assessment, the main benefit of C&AG audit of NDPBs continues to be consistency in the statutory audit arrangements, a matter on which the PAC, on behalf of Parliament, has expressed concern to successive governments. The Government believes that these benefits will hold good for the new NDPBs covered by the 2005 Order.

4

COSTS

The expectation in the 2003 regulatory impact assessment was that the overall financial costs would be broadly the same as if departments had continued to engage the auditors themselves.

The survey results indicate that direct financial costs have remained broadly neutral, with marginal decreases and increases in one or two limited instances. Again, the Government believes that this will hold good for the NDPBs covered by the 2005 Order.

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COMPETITION ASSESSMENT

Whilst the C&AG will have a monopoly of the audit of NDPBs, the fact that he is committed (and is on target) to contract out 25% of the financial audits by 2005-06, enables private firms to compete for a substantial proportion of the business. The public sector as a whole will therefore benefit from the innovations and wider expertise of private sector auditors. It will also benefit from a continuing downward pressure on costs as a result of the competitive tendering exercises that the C&AG has put in place.

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MONITORING AND REVIEW

HM Treasury has monitored, and will continue to monitor, the implementation of this policy. This will be conducted through regular surveys of all NDPBs covered by this and previous Orders.

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CONSULTATION

The C&AG and the four NDPBs affected by this Order have been consulted and are content.

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CONCLUSION AND DECLARATION

CONCLUSION

The Government reviewed the risks made in the 2003 regulatory impact assessment covering the initial implementation of the policy to give the C&AG statutory audit responsibility for all NDPBs. This confirmed that the proposals to minimise the risks have (and will continue) to be addressed. For example, to eliminate any adverse use of the C&AG monopoly position in terms of costs and quality of audits, as well as making continued provision for substantial use of private sector auditors.

Giving the C&AG statutory audit responsibility for these four new bodies continues the government's policy that executive NDPBs are to be audited by the C&AG. The benefits of the policy in this instance are the same as originally set for NDPBs as a whole – that is consistency in the statutory audit arrangements across all equivalent bodies. In short, there is a clear and continuing net gain for Parliament and the public.

DECLARATION

I have read the regulatory impact assessment and am satisfied that the benefits justify the costs



Signed



Date

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