EXPLANATORY MEMORANDUM TO

THE LOCAL AUDIT (HEALTH SERVICE BODIES AUDITOR PANEL AND INDEPENDENCE) REGULATIONS 2015

2015 No. 18

1. This explanatory memorandum has been prepared by the Department of Health and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Local Accountability and Audit Act 2014 ("the Act") replaced existing centralised arrangements for appointing auditors to health service bodies and allows them to appoint their own auditor. The Act makes provision for local public bodies to have auditor panels who will advise them on the selection and appointment of their auditor and maintaining an independent relationship with their auditor. This instrument makes provision for the constitution of the auditor panels for health service bodies and sets out specific requirements for these panels.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 Part 3 of the Local Audit and Accountability Act 2014 (the 2014 Act) is concerned with the appointment of local auditors, and also their resignation or removal from office. Section 9 of the 2014 Act requires each relevant authority to appoint an auditor panel (subject to exceptions set out in that section). Section 10 makes provision about the panel's functions and enables Regulations to be made to provide more details about the panel's functions. Schedule 4 to the 2014 Act provides for the form and constitution of auditor panels. In particular, paragraphs 3 and 4 of Schedule 4 to the 2014 Act provides for Regulations to be made about the constitution of auditor panels in respect of health service bodies and the making of further provision in respect of such panels.

5. Territorial Extent and Application

5.1 This instrument applies England only.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- What is being done and why

7.1 The 2014 Act specifies that local public bodies must have auditor panels to advise them on the selection, appointment and removal of their auditor and on maintaining an independent relationship with their auditor. These Regulations set out the composition of auditor panels specific to health service bodies.

7.2 The underlying policy aims are to provide appropriate scrutiny and oversight of the health service body's relationship with their external auditor. This is achieved through having the panel chaired by a non-executive member of the health service body's governing board who along with the majority of other panel members are independent. They are therefore not part of the body's management structure and so can objectively look at the wider public interest

7.3 Regulations also set the operational aspects for the auditor panels to function, arrangements for their appointment, remuneration, and provisions for members' removal and resignation.

7.4 In developing the Regulations the Department has taken into consideration guidance from HM Treasury and the Financial Reporting Council, which is the UK's independent regulator, responsible for promoting high quality financial reporting and corporate governance and which publishes the UK Code of Corporate Governance which sets out good practice for UK-listed companies. The Department also looked at consistency with non-health service bodies (in Schedule 6 to the 2014 Act) and NHS Foundation Trusts.

The Regulations specify that:

- An auditor panel must have at least 3 members, that prospective members not already on the health service body's governing board must be appointed in response to an advertised vacancy and after submitting an application to fill that vacancy, and that the body must adopt a set of rules for the removal or resignation of auditor panel members. This sets out minimum standards around the formation of the auditor panel, ensuring that vacancies for members are advertised to attract the broadest range of candidates possible and the vacancy is filled in an open and transparent process. It also ensures that health service bodies consider how auditor panel members can be removed or how their resignation will be handled to ensure this is fair and consistent;

- An auditor panel member may receive remuneration;

- The quorum is 2 members, or 50% of the membership of the panel and the proceedings of the meetings are valid if majority of members present are independent. This ensures proper representation on auditor

panels and ensures that the independence of the auditor panel from the health service body's governing board is maintained;

- The auditor panel should advise the health service body on the purchase of 'non audit services' from the auditor. Many audit firms offer services to their clients over and above external audit, such as consultancy, advice or project management. There can be advantages to an organisation in procuring these services from the firm also providing the external audit such their existing knowledge of the business but it is essential that an impartial relationship between auditor and health service body is maintained, in which the robustness and independence of audit is not compromised, or seen to be compromised, by considerations of additional lucrative contracts with the body;

- The auditor panel must have a chair who is an independent non-executive member of the health service body's governing body, but may include a minority of members who are not members of the governing board or who are not considered independent. This addresses the concerns of a number of health service bodies (particularly Clinical Commissioning Groups (CCG's)) whose governing boards are small and for whom forming an auditor panel of 3 independent non-executive governing board members would not be possible without additional expense and where clinical input (often from General Practitioners from the CCG who are therefore not independent), is considered key.

- The governing board must assess a prospective auditor panel member's independence by considering whether his or her circumstances or relationships could affect his judgement and by having regard to a number of factors, for example recent employment with the health service body, close family ties to its directors, members, advisors or senior employees or a material business relationship with the health service body . This ensures that governing boards have a framework but are also able to consider other circumstances to ensure that independence remains the overarching principle.

8. Consultation outcome

8.1 Two public consultations have been conducted and, in particular, brought to the attention of health service bodies and their auditors. The first ran from 18th October until 31st December 2013 and received 64 responses, mainly from NHS Trusts and CCGs. It set out initial proposals for the way in which existing audit committees of health service bodies would be able to act as auditor panels. It considered in particular

- whether the panel should have a majority of independent non executive members;
- whether the chair should be an independent non executive member;

- whether the committee should normally, wholly or mainly, comprise of independent non executive governing board members;
- whether it would be appropriate in some circumstances to have non executive governing board members who are not considered independent or independent members who are not members of the governing board; and
- the definition of 'independent' for these purposes,

8.2 Overall there was clear support for all these proposals, although some concerns were raised, mainly by CCGs, on whether the independence requirements were too restrictive and could affect their governing body membership. The Department agreed with the views raised that making an auditor panel comprise wholly, or mainly, of independent non-executive members of the governing board could be restrictive for small organisations and could require them to appoint additional independent members to their governing boards or bodies, and more members on their auditor panel. The Department decided that core requirement for the panel to have a majority of independent members was sufficient, together with the panel's ability to include independent persons who are not members of the governing body. It was therefore decided to remove the requirement for the panels to wholly or mainly comprise of independent non-executive members of the governing body. This will reduce the likelihood of additional governing board or body members, particularly in CCGs.

8.3 About half of respondents thought there could be some additional costs from the proposals, primarily for CCGs. The Department considers there could be some additional costs to appoint new members in order to reach the independence and governance standards, but they are not expected to be significant. Also the above change will reduce the need and also the cost relating to additional independent members,

8.4 The Department also adjusted the wording in the Regulations of the independence criteria to make the language more appropriate for CCGs. The wording was also adjusted to make it clearer that the listed independence factors are to be considered by the governing bodies and boards in their assessment of members rather than a straight qualifying/ disqualifying criteria. The consultation response also clarified the independence requirements and some comments raised on their application to registered nurse or clinical doctor members of a CCG and also retirees from other health bodies.

The consultation paper can be found here:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251493/Audit_committees_consultation.pdf.

Full results of this consultation can found here:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/310019/DH_Consultation_on_NHS_Trust.pdf

8.5 A second consultation ran from 28th July until 19th September 2014 and asked for comments on the draft Regulations and whether the auditor

panel's role in agreeing 'non-audit services' from the appointed auditors is set in Regulations. 38 responses were received, with 28 from NHS Trusts and CCGs, and the others from health interest groups, auditors and an individual. 84% of respondents agreed that the auditor panel's role in agreeing 'non audit services' should be set in Regulations. A number of comments were made on minor amendments to the Regulations to make them work better in practice, and the Department has taken the following on board:

- adjusting the Regulations' wording for the auditor panel's minimum quorum to two or 50% of the members, whichever is higher so as to strengthen the requirement for the larger panels;

- adjusting the Regulations to clarify that the appointment requirements are for auditor panel members who are not already a member of a health body's governing board, as governing board members are already appointed through a separate appropriate process.

- strengthening the wording around the auditor panel's role in agreeing non audit work by the external auditor.

The full results of this consultation can be found here: https://www.gov.uk/government/consultations/new-regulations-for-how-nhs-auditor-panels-work. Hard copies of all the documents referred to in this memorandum relation to consultation can be obtained by writing to the Accounts Branch, Department of Health, Quarry House, Leeds LS2 7UE.

9. Guidance

9.1 The Department has already published a timetable to communicate the timescales for change to affected health service bodies and will continue to develop a communications plan. The Department is working with partners in a number of stakeholder organisations to produce operational guidance which will support health service bodies in establishing and managing auditor panels. This is expected to be completed in Spring 2015, in good time to support health service bodies in appointing their auditor panels at the earliest in Spring 2016.

10. Impact

10.1 There is no impact on charities or voluntary bodies. The 2014 Act will have an impact on audit firms and this is explored more fully in the Impact Assessment for the Act. Costs for audit firms are likely to increase, however this is offset by the opening up of the local public sector audit market to firms. These Regulations are unlikely to have any additional impact on audit firms over and above these identified in the impact assessment to the 2014 Act.

10.2 The impact on the public sector is also described in detail in the Impact Assessment, and relates to compliance costs such as the cost of procuring audit services and the remuneration of auditor panel members. These

Regulations are unlikely to have any additional impact on the public sector over and above that identified there.

10.3 The Impact Assessment can be accessed at the following address:- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/349418/2014_FINAL_Local_Audit_IA.pdf. A hard copy can be obtained by writing to the Accounts Branch, Department of Health, Quarry House, Leeds, LS2 7UE.

11. Regulating small business

11.1 The legislation does not apply to small business, except where an audit firm wishes to tender for health service body audit contracts. The Impact Assessment to the 2014 Act describes this more fully, but these Regulations are unlikely to have any additional impact on small business.

12. Monitoring & review

12.1 As part of the Government's commitment to review the implementation of new legislation within three to five years of receiving Royal Assent, Government has set out some general principles towards developing a possible approach to such a review and assessing the impacts/outcomes associated with the Government's reforms to local audit. An overriding objective for the final approach would be to ensure that any proposed measurement is both proportionate and cost effective.

12.2 The aims and success criteria of the local audit reforms are to:

- Deliver greater localism, decentralisation and transparency;
- Maintain competitive audit fees; and
- Uphold high standards of auditing.

13. Contacts

Keith Morton (Tel: 0113 254 5428, keith.r.morton@dh.gsi.gov.uk) or Heather Suckling at the Department of Health (Tel 0113 254 5963, heather.suckling@dh.gsi.gov.uk) can answer any queries regarding the instrument.