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Draft Local Audit Bill

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1. Introduction and Background

- 1.1 On 6 July 2012, the Department for Communities and Local Government published a draft Local Audit Bill and related impact assessment. The draft Bill was anticipated in this year's Queen's Speech and is the latest development in the government's policy to abolish the Audit Commission and enable councils to appoint their own external auditors.
- 1.2 As a draft Bill, it is presented for pre-legislative scrutiny and contains a number of consultation questions which are aimed to enable the Bill to be refined before full legislation is introduced in Parliament in due course. As yet, no firm timetable for the appointment of auditors and the abolition of the Audit Commission has been established.
- 1.3 The government's impact assessment estimates the monetised and non-monetised impact of the proposals for principal local bodies and estimates the savings to the public purse to be over £1bn during a ten-year period, of which £650m will be realised over the next five years. However, these estimates include the effect of the previously implemented abolition of the Comprehensive Area Assessment inspection regime and the longer term savings as a direct result of the move to local external audit are significantly more modest.
- 1.4 For information, we have appended the DCLG consultation response form to the end of this briefing. The response form (in Word format) can be downloaded via the DCLG website¹. Responses can be emailed to fola@communities.gsi.gov.uk. Alternatively, hard copies can be posted to:

Future of Local Audit
Department for Communities and Local Government
3/J5 Eland House
Bressenden Place
London SW1E 5DU

The consultation closes on 31 August 2012.

- 1.5 The draft Bill has 8 sections. These are:
 - Part 1 – Abolition of the existing regime
 - Part 2 – Basic concepts and principles
 - Part 3 – Appointment etc. of auditors
 - Part 4 – Eligibility and regulation of auditors
 - Part 5 – Conduct of audit

¹ At <http://www.communities.gov.uk/documents/localgovernment/doc/2174744.doc>

- Part 6 – Data matching
- Part 7 – Inspections, studies and information
- Part 8 - General provisions

1.6 Subsequent sections of this briefing note will set out the key elements from each section, with the exception of Part 8 which contains information on the process by which the Secretary of State can make regulations or amend primary legislation using the powers contained in the draft Bill and various other interpretations.

2. Part 1 – Abolition of the existing regime

- 2.1 Part 1 of the draft Bill abolishes the Audit Commission and repeals the Audit Commission Act 1998. It makes provision for the transfer of the Audit Commission’s assets, rights and liabilities on closure. A firm date for the abolition of the Audit Commission is not specified, but the draft Bill includes a provision to transfer any audit contracts that are still running to a new body. Current contracts run until 2017 (with the provision of possible extension to 2020): *“As it is envisaged that the Commission will have been abolished before that date, the contracts will transfer so that they can run for their full duration”*.
- 2.2 Local bodies themselves will be responsible for appointing their own external auditor. Significantly, following the Royal assent of the Health and Social Care Act 2012, it is proposed that local health bodies will be subject to audit under this new framework as well as all local authorities.

3. Part 2 – Basic concepts and requirements

- 3.1 Part 2 of the draft Bill sets out the general accounting and audit requirements for local public bodies. A clear distinction is made between the accounting records that must be maintained during the year and the annual financial statements, which will clear up confusion over this issue as current regulations are phrased in somewhat out-dated terms.
- 3.2 Smaller public bodies are subject to a less onerous audit regime. The draft Bill confirms the government’s intention to define “smaller” as those with an annual turnover (i.e. income or expenditure) of less than £6.5 million. Small bodies will only have to change to the fuller audit requirements if their income and expenditure exceeds the £6.5 million threshold for three consecutive years.
- 3.3 The proposals for the audit of smaller public bodies include the following, more detailed, matters:

- Bodies with a turnover of less than £25,000 per annum will not be subject to an external audit. This is higher than the £1,000 proposed in the government’s original consultation document. The higher threshold would still remove around 64% of smaller bodies from the requirement to have an audit.
- There would be a “new, proportionate, transparency code for all smaller bodies with an annual turnover below £200,000”. The code would require the publication, probably online, of all items of expenditure and end of year accounts, minutes and papers of formal meetings, an internal audit report, a list of councillors (or their equivalent), an annual governance statement and the location of any public land and building assets.
- The local electorate will be able to inspect the accounts of all smaller public bodies and make complaints to an auditor. Therefore, all smaller public bodies will still be required to have an auditor to whom people can report problems, but the auditor will not carry out any work unless problems are reported.
- Where audit work is required, the existing “limited assurance” regime will continue and will not be replaced by an “independent examination” similar to that in smaller charitable bodies, which was suggested in the original consultation document. The National Audit Office will be responsible for specifying the approach to limited assurance through a schedule attached to the code of audit practice (see section 5 of this Briefing).
- Auditors carrying out such limited assurance reviews will be required to hold an appropriate qualification but firms will not be required to be part of the register of local public auditors as this requirement “would be disproportionate and may preclude smaller firms from entering the market”.
- The government has recently received a proposal from the National Association of Local Councils and the Society of Local Council Clerks to set up a sector-led body to procure and appoint audit services to smaller local public bodies. The body would be made up of a management board of 10 members, including 3 independent members. This body would be funded from a top-slice on audit fees and would consult on and determine fee scales for smaller public bodies every five years. The body would also monitor the quality and timeliness of auditors’ work as part of its contract management role. The government welcomes this approach.

4. Part 3 – Appointment of auditors

- 4.1 Part 3 of the draft Bill sets out the appointment framework for auditors. The audited body will have to take into consideration the advice of an independent auditor panel before making the appointment of their auditor. The Bill makes it clear that the appointment of an auditor must be made by full council and cannot be delegated to any executive function.

- 4.2 The appointment must be made at least every 5 years and existing auditors may be re-appointed. Appointments may be made for more than one year and there is no requirement for incumbent auditors to step down after 10 years as was contained in the original consultation document. The impact assessment notes that existing ethical standards published by the Financial Reporting Council already cover issues of long association and so there is no need to specifically require auditors to regularly step down from local public audit work.
- 4.3 The auditor panel must consist of a majority of independent members and must have an independent chair. To be classified as independent, a panel member must not have been a member or officer of the body within the last five years, and must not at that time be a relative or close friend of a member or officer of that body.
- 4.4 Provided that the body's current Audit Committee (or equivalent) meets the independence criteria, it can fulfil the function of the auditor panel. Bodies can share independent panels should they so wish.
- 4.5 The auditor panel has three functions set out in legislation. These are:
- To advise on the appointment of an auditor;
 - To advise the local body on the maintenance of an independent relationship with the auditor; and
 - To advise on proposals for a public interest report.
- 4.6 Bodies will be able to delegate additional functions to the auditor panel if they so wish. The legislation also includes powers to prepare guidance to be issued on the role and practical operation of the panel.
- 4.7 The auditor panel must act in a transparent manner and the draft Bill requires that all appointments are publicised together with the advice given by the panel and the reasons why the local body chose not to follow the advice given where relevant.
- 4.8 The draft Bill includes the provision for the Secretary of State to make regulations regarding the resignation or removal of an auditor. However, it is envisaged that the auditor will be required to make a statement explaining their reasons for their resignation to the audited body and the auditor panel, and the auditor's supervisory body. The local body would then be required to publish a response.
- 4.9 In the case of removal, the local body would be required to give notice to both the auditor and the auditor panel, including a statement of reasons. The auditor will be able to respond to this statement, with the response considered by the auditor panel. The decision to terminate the appointment of the auditor will also be subject to the advice of the auditor panel.

5. Part 4 – Eligibility and regulation of auditors

- 5.1 This section considers how providers of audit services to local public bodies will be registered and regulated to ensure that they have the necessary skills, qualifications and experience to carry out local public audit work.
- 5.2 The draft Bill provides powers for the Secretary of State to authorise the professional accountancy bodies to act as recognised supervisory bodies for local public audit. In practice, the Secretary of State will delegate these powers to the Financial Reporting Council, who will be able to authorise the professional bodies to act as supervisory bodies.
- 5.3 The role of the supervisory bodies will be to put rules and practices in place to cover:
- The eligibility of firms to be appointed as local public auditors;
 - The qualifications, experience and other criteria that individuals must have before being permitted to carry out an audit of a local public body and sign off an audit report; and
 - Arrangements for monitoring the quality of audit work by member firms. In particular, the Financial Reporting Council will have responsibility for monitoring the quality of “major audits”, but a definition of this term has yet to be prepared.
- 5.4 The Secretary of State will make regulations regarding the preparation and maintenance of a register of those firms and individuals eligible to undertake local public audit work, and it is envisaged that the register itself will be held by “one or more of the recognised supervisory bodies”.
- 5.5 The draft Bill requires an auditor to ensure that they are independent of the audited body and cannot be a member or officer of that body, or an officer or employee of an entity connected with the body. This is further defined as an entity whose financial transactions are consolidated within the group accounts of the local public body. There will not be a criminal offence attached to lack of independence as in the Companies Act, but the audit panel will play a key role in maintaining suitable auditor independence and will advise the audited body on the maintenance of an independent relationship with their auditors at least once a year.

6. Part 5 – Conduct of audit

- 6.1 The National Audit Office will replace the Audit Commission and become responsible for preparing detailed audit codes of practice. Any draft Code will be subject to consultation and laid before Parliament, where it will be passed after 40 days as long as there has been no resolutions against it. Any Code needs to be produced and agreed at least every five years.
- 6.2 Audit scope and outputs “will remain broadly the same as they currently are”. This includes the need to be satisfied that the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 6.3 Reports in the Public Interest and the right for local electors to be able to inspect, question, object and make copies of the statement of accounts, related records and the auditor’s report remain. In the case of objections, the auditor will have discretion to reject vexatious, repeated and frivolous objections.
- 6.4 The right of an auditor to apply to the court for a declaration on the lawfulness of an item of account and the right for an auditor to seek a judicial review of a decision of the audited body remains.
- 6.5 The Accounts and Audit Regulations will continue to be required and published from time to time.

7. Part 6 – Data matching

- 7.1 The Audit Commission Act 1998 requires local public bodies to provide data for the purposes of data-matching, in particular, for use as part of the National Fraud Initiative. On the abolition of the 1998 Act, the Secretary of State will be given powers to require data to be provided to the new “owner” of the National Fraud Initiative. The National Fraud Authority (an executive agency of the Home Office), the Department for Work and Pensions and the Cabinet Office (ERG) have expressed an interest in taking over responsibility for the National Fraud Initiative and discussions are on-going.
- 7.2 The Audit Commission Act 1998 requires local public bodies to provide data for the purposes of data-matching, in particular, for use as part of the National Fraud Initiative. On the abolition of the 1998 Act, the Secretary of State will be given powers to require data to be provided to the new “owner” of the National Fraud Initiative. The National Fraud Authority (an executive agency of the Home Office), the Department for Work and Pensions and the Cabinet Office (ERG) have expressed an interest in taking over responsibility for the National Fraud Initiative and discussions are on-going.

8. Part 7 – Inspections, studies and information

- 8.1 Section 10 of the Local Government Act 1999 enables the Secretary of State to require the Audit Commission to carry out an inspection of a local authority. The draft legislation amends this so that the Secretary of State can appoint an inspector to carry out such an inspection. However, the government envisages “that this power would be rarely used, only where there are concerns about significant governance failure in a local authority”.
- 8.2 The Audit Commission is currently winding down its programme of national studies. Remaining studies will focus on summarising the results of audits and on the materials drawn from the support and information provided to auditors. For the future, “the Government would like to see a smaller, coherent and complimentary programme of value for money studies on local issues”. The National Audit Office currently envisages undertaking a small number (6 in 2014/15) of local studies and is committed to work in collaboration with other agencies such as the Local Government Association and the Care Quality Commission.

LG Futures
July 2012



Draft Local Audit Bill

Consultation response form

We are seeking your views on the following questions on the Government's draft Local Audit Bill and proposals for the audit of smaller local public bodies.

If possible, we would be grateful if you could please respond by email.

Please email: foia@communities.gsi.gov.uk

Alternatively, we would be happy to receive responses by post. Please write to:

Future of Local Audit
Department for Communities and Local Government
3/J5 Eland House
Bressenden Place
SW1E 5DU

The deadline for submissions is 5pm on 31 August 2012.

(a) About you

(i) Your details

Name:	
Position:	
Name of organisation (if applicable):	
Address:	
Email:	
Telephone number:	

(ii) Are the views expressed on this consultation an official response from the organisation you represent or your own personal views?

Organisational response	<input type="checkbox"/>
Personal views	<input type="checkbox"/>

(iii) Please tick the *one* box which best describes you or your organisation:

Upper tier local authorities	<input type="checkbox"/>	
Lower tier local authorities	<input type="checkbox"/>	
Parish and town councils	<input type="checkbox"/>	
Audit and accountancy firms	<input type="checkbox"/>	
Professional auditing and accountancy firms	<input type="checkbox"/>	
Other audited public body (e.g. fire authority, police authority, national park authority, pension authority - please state which)	<input type="checkbox"/>	
Other (please state)	<input type="checkbox"/>	

(iv) Do your views or experiences mainly relate to a particular type of geographical location?

City	<input type="checkbox"/>	
London	<input type="checkbox"/>	
Urban	<input type="checkbox"/>	
Suburban	<input type="checkbox"/>	
Rural	<input type="checkbox"/>	
Other (please comment)	<input type="checkbox"/>	

(vi) Would you be happy for us to contact you again in relation to this consultation?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

(b) Consultation questions

Draft Local Audit Bill:

Part 1 - Abolition of existing audit regime

Q1. Do you have any comments on the clauses in Part 1 or Schedule 1?

Comments (please state clearly which clause you are referring to):

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Part 2 - Basic requirements and concepts

Q2. Do you have any comments on the clauses in Part 2 or Schedule 2?

Comments (please state clearly which clause you are referring to):

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Part 3 - Appointment etc of auditors

Q3. Do you have any comments on the clauses in Part 3?

Comments (please state clearly which clause you are referring to):

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Q4. Do the clauses in Part 3 strike the right balance between ensuring independence in the audit process and minimising any burden on local bodies?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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Q5. Does Clause 11 provide sufficient flexibility to local bodies to set up joint panel arrangements and/ or put in place other arrangements to suit local circumstances?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Q6. Does the draft Bill strike the right balance in terms of prescription and guidance on the role of auditor panels?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Q7. Do you have any comments on the proposals set out in paragraphs 26-34 of the consultation document on removal and resignation?

Comments:

Part 4 - Eligibility and regulation of auditors

Q8. Do you have any comments on the clauses in Part 4 or Schedules 3 and 4?

Comments (please state clearly which clauses you are referring to):

Q9. Do you agree with the proposed definition of connected entities in clause 20?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Q10. Do you have any views on how major audits should be defined in regulations?

Comments:

Part 5 - Conduct of audit

Q11. Do you have any comments on the clauses in Part 5?

Comments (please state clearly which clauses you are referring to):

Q12. Do you agree that public interest reports issued on connected entities should be considered by their 'parent' local body?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Part 6 - Data Matching

Q13. Do you have any comments on the clauses in Part 6?

Comments (please state clearly which clauses you are referring to):

Q14. Do you have any views on the new owner(s) of the National Fraud Initiative?

Comments:

Part 7 - Inspections, studies and information

Q15. Do you have any comments on the powers provided to the Comptroller and Auditor General to undertake studies and access information within clause 94?

Comments:

Q16. Do you think that the National Audit Office should be able to undertake thematic value for money studies regarding all sectors whose bodies are subject to audit under this draft Bill?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further Comments:

Q17. Do you have any comments on the other clauses in Part 7 or Schedule 5?

Comments

Impact Assessment:

Q18. Does the impact assessment identify the main drivers on fees?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Are there any other drivers on fees?:

Q19. Are the estimates of local bodies' compliance costs realistic?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Q20. Are the estimates of the costs and benefits to businesses realistic?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

Proposals for Smaller Bodies

Q21. Do you agree that the threshold below which smaller local public bodies should not be subject to automatic external audit should be £25,000?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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Q22. Are the additional transparency requirements we have proposed for those bodies who will not be subject to external audit robust enough to ensure that they will be accountable to the electorate?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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Q23. Are these transparency requirements proportionate to the low levels of public money these bodies are responsible for?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

What steps will smaller bodies need to take in complying with these new requirements? :

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Q24. Do you agree that our proposals for the eligibility of auditors of smaller local public bodies will ensure that they have the requisite expertise to undertake limited assurance audits?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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Q25. Are our proposals for the regulatory framework for the audit of smaller bodies proportionate?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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Q26. Do these proposals provide a proportionate and sufficiently flexible mechanism for procuring and appointing audit services to smaller local public bodies?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>

Further comments:

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(c) Additional questions

Do you have any other comments you wish to make?

END