



Our ref: ICAEW Rep 130/12

Future of Local Audit
Department for Communities and Local Government
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By email: foia@communities.gsi.gov.uk

Dear Sirs

Draft Local Audit Bill

ICAEW is pleased to respond to your request for comments on the *draft Local Audit Bill*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

DRAFT LOCAL AUDIT BILL

Memorandum of comment submitted in August 2012 by ICAEW, in response to the Department for Communities and Local Government consultation paper draft Local Audit Bill published in July 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the *draft Local Audit Bill* published by the Department for Communities and Local Government (DCLG) in July 2012, a copy of which is available from this [link](#).

WHO WE ARE

2. As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers all the firms that currently carry out work for the Audit Commission (and those firms likely to carry out this work in the future) in respect of Companies Act audits. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council (FRC). We provide leadership and practical support to over 138,000 Chartered Accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

EXECUTIVE SUMMARY

4. ICAEW welcomes the publication of the draft Local Public Audit Bill which provides some clarification on the future arrangements for local public audit. We are supportive of the principles to provide a streamlined approach to the local public audit regime mirroring where practical, the arrangements set out in the Companies Act 2006 and Ethical Standards. This will minimise confusion and duplication of arrangements across the public and private sector.
5. We refer back to our written submission in response to the Communities and Local Government Committee's inquiry (dated 6 January 2011) which highlighted that the policy decision by Government presents an opportunity to review the audit and accounting regime across the public sector in England, making it more transparent and consistent with other sectors of the economy. ICAEW is of the view that an opportunity has been missed to create a consistent financial reporting and auditing framework covering the public sector. Without such consistency, there is a risk that public sector external auditing could become fragmented and inconsistent.
6. The draft Bill has not been properly formulated and there are areas in the Bill where greater clarity is needed. We highlight below a number of areas where arrangements are still to be worked out. If not resolved, these inconsistencies and gaps could harm the original objectives set out by Government after its announcement in 2010:
 - 6.1. The audit arrangements for local health bodies are missing (paragraphs 15 to 19).
 - 6.2. The draft Bill and further guidance will need to clearly specify how firms and individuals are able to enter into the public audit market (paragraphs 20 to 23).
 - 6.3. The draft Bill does not provide sufficient detail on the transitional arrangements once the Audit Commission (the Commission) has been disbanded (paragraphs 24 to 28).
7. ICAEW is concerned whether an auditor panel appointed by a relevant authority will truly be independent of the relevant authority and be able to undertake the role envisaged (paragraphs 29 to 32).
8. A different regulatory regime for the local audit market may result in an increase in costs (paragraphs 33 to 34).

9. There is an inherent conflict between two of the Government's design principles: lower audit fees and higher standards of auditing (paragraphs 35 to 38).
 - 9.1. There is no certainty as to how long the current economic climate and fiscal mandate will last. Both are putting pressure on local bodies, which could raise their risk profile (eg, in terms of material mis-statement, or irregular expenditure) and put upward pressure on fees to cover sufficient work to cover these.
 - 9.2. There is currently a strong focus on audit quality, both from the FRC and also at an EU level. However, there is a danger that the expectations regarding lower audit fees could both fetter the discretion of the auditor to carry out whatever work they deem necessary to discharge their responsibilities and promote the concept of 'cheap' audits rather than advancing the quality of audit in this sector.
10. The costs to local bodies identified within the impact assessment are not realistic (paragraph 39 to 40).
11. Underlying regulations will need to be well drafted to give Limitation of Liability Agreements a chance to succeed (paragraphs 41 to 43).
12. DCLG should confer with BIS about how the current requirements for resignations could be streamlined (paragraphs 44 to 48).
13. The definition of major audits should be refined to avoid excessive numbers of local authorities being designated as of special public interest (paragraphs 49 to 53).
14. The regulatory implications of the proposals for smaller local public bodies are unclear (paragraphs 54 to 59).

MAJOR POINTS

Health bodies

15. **The audit arrangements for local health bodies are missing.**
16. As with our response to the consultation paper *Future of local public audit* we remain concerned that the focus of the Bill is on the audit arrangements for local government bodies. Proposals still do not consider wider challenges including the audit arrangements for the health service.
17. ICAEW held initial discussions with the Department of Health (DoH) in 2011, but has had very little communication with the DoH since that time. This causes concern from ICAEW's role as a potential public sector RSB, as we have had no involvement or discussions in relation to what the RSB role is envisaged to be, or whether the arrangements for RSBs are intended to mirror the arrangements for local government.
18. ICAEW has concerns that some areas of the framework designed for local government bodies (such as the independent audit panel), may not work for health bodies (ie, Clinical Commissioning Groups). For example, the draft Bill requires the auditor panel to consist of a majority of independent members and be chaired by an independent member. It defines member independence as a member that has not been a member or officer of the authority within a period of 5 years. In the NHS, currently, audit committees must comprise of no less than three Non-Executive Directors (NEDs). This condition of membership provides the basis for the Committee to operate independently of any decision making processes and to apply an objective, knowledgeable and competent approach to the conduct of its business, exactly what the Bill strives for from its auditor panels. However, NEDs are also board members. Therefore, under the proposals in the draft Bill, they would fall foul of the draft Bill's definition of independent.

19. DCLG and DoH need to work closely together to ensure that there is a more coherent approach. In addition, the profession needs to be closely involved in discussions, as it has been for the local government framework, to ensure that the regulatory proposals for NHS bodies will be capable of implementation by RSBs. Given the lack of detail around the current proposals for health bodies, the remainder of this response will focus on the proposals as they apply to local government.

Entry to the market for firms and individual auditors

20. **The draft Bill and further guidance will need to clearly specify how firms and individuals are able to enter into the public audit market.**
21. We recognise that the eligibility criteria for firms wishing to conduct public audit needs to ensure that only competent auditors with the appropriate knowledge, skills and experience are appointed. But there also needs to be a mechanism in place to enable new firms wishing to enter the market to have the opportunity to gain the appropriate knowledge, skills and experience.
22. As such, ICAEW believes it should be adequate that firms have to comply with existing ethical and auditing standards, which require them to consider the competencies of the audit team when they take on any new engagement. The onus would therefore be on the firm to make sure they have the necessary competencies (under ISQC1) and on the independent auditor panel to ask the right questions of the audit firm prior to making the appointment.
23. We note that the schedule 3, clause 6(3) requires certain individuals to pass an aptitude test. Regulations will need to be clear as to what the aptitude test will include.

Transitional arrangements

24. **The draft Bill does not provide sufficient detail on the transitional arrangements once the Commission has been disbanded.**
25. On closure of the Commission, the current audit contracts, that the Commission has with private sector firms for carrying out the audit of local public bodies, will be transferred to another body. However, the appropriate body is still to be determined and clarification is needed on the following:
- 25.1. Whether the contracts will be transferred on the same terms, for example, will auditors continue to be indemnified?
- 25.2. How auditors will be indemnified against charges, losses, expenses and liabilities properly incurred, and not otherwise recoverable, arising out of the exercise of their statutory functions. Currently the Commission provides this indemnity.
26. In the private sector, the engagement letter, between the auditor and the audited body, sets out, as a minimum, the respective responsibilities, the basis of fees and the complaints procedure. This provides clarity in relation to the contractual relationship between the parties. In a transition period, this may be difficult to apply in practice, when the Commission is not there to provide the necessary support? It needs to be clarified whether the 'body' that is referred to in the Bill, will also take on the role of investigating the complaint and indeed, will it have the necessary skills in place to make appropriate judgements?

Abolition of the existing regime

27. Schedule 1, Clause 1(1) highlights how liabilities will be transferred. Although the Government is outlining how this will be done, the provisions will need to be robust. The draft Financial Services and Markets Bill (schedule 2.1) outlines a similar process transferring liabilities from the Financial Services Authority to the Prudential Regulation Authority.

28. We recommend that DCLG obtains further legal advice on these and other aspects of the abolition of the Commission to ensure that the transition is carried out as smoothly as possible.

Independence of auditor panel

29. **ICAEW is concerned whether an auditor panel appointed by a relevant authority will truly be independent of the relevant authority and be able to undertake the role envisaged.**
30. While we broadly support proposals to have a panel to advise local public bodies on auditor appointment and independence, we recommend that proper safeguards are put into place to ensure that an auditor panel cannot be interfered with by the Council once appointed. When discussing the independence of the panel members, the draft Bill concentrates on the relationships between the panel members and local body officers. However, it does not address the potential relationship between the panel members and auditors or those individuals who have business relationships with members and officers.
31. In addition, the challenge that still exists for the vast number of local public bodies will be to find sufficiently independent panel members who have the right expertise and experience to enable them to carry out their role robustly, and are prepared to undertake this role for 'reasonable expenses'.
32. The existence of auditor panels will be new territory for all parties involved, and is an area where additional guidance will need to be developed. ICAEW recommends that guidance should cover areas such as auditor appointment, tendering and qualitative factors to consider regarding the appointment of an auditor, and could be produced by the National Audit Office (NAO), alongside its codes of audit practice, or by the FRC, alongside guidance it has published on the role of audit committees. ICAEW publishes model engagement terms for auditors to discuss with their clients and will continue to do so for local public audit.

Increased regulatory costs

33. **A different regulatory regime for the local audit market may result in an increase in costs.**
34. The draft Bill's impact assessment assumes that the regulatory costs, estimated at £4m, will remain the same as under the current regime, and that these costs will be equally split between the NAO and the FRC and RSBs. To date ICAEW has not provided any estimate of its likely regulatory costs and would find it difficult to do so until more detail was available about the underlying regulations, guidance and detailed application material. However, ICAEW notes that the Bill proposes a new audit scrutiny and monitoring regime under the auspices of the FRC and RSBs which will lead to a more regulated local audit market in general, which in itself may result in an increase in costs. ICAEW would like to see the detail underlying these proposals as soon as possible in order to resolve any issues that may exist and help ensure the successful introduction and implementation of the new regime.

Lower audit fees v high standards of auditing

35. **There is an inherent conflict between two of the Government's design principles: lower audit fees and higher standards of auditing.**
36. There is a danger that the expectations regarding lower audit fees could both fetter the discretion of the auditor to carry out whatever work they deem necessary to discharge their responsibilities, and promote the concept of 'cheap' audits rather than advancing the quality of audit. However, this will be the task of the RSBs and the FRC to make sure that quality is not compromised.
37. There is currently a strong focus on audit quality, both from the FRC and also at a European Union level. In its 2011/12 report of *Audit Quality Inspections*, the FRC concluded that '...while

acknowledging that fee pressures are a commercial reality that cannot be ignored, we remain concerned that audit efficiency is becoming progressively more important to firms as audited entities seek to reduce fees. Firms should ensure that they maintain appropriate controls centrally to ensure audit efficiencies are not achieved at the expense of audit quality.'

- 38.** The draft Bill assumes local bodies will be able to negotiate competitive fee levels (at a rate equal to the price obtained by the Commission during its recent procurement exercise). However, there is currently significant uncertainty surrounding the economic climate, which is causing local bodies to implement severe spending cuts. As local bodies shed staff across the organisation and make cuts in service levels, their risk profile increases. Inevitably, some of these cuts will be in their finance and reporting functions which may affect the quality and timeliness of information auditors receive. These factors, amongst others, could put upward pressure on fees.

Local body costs

- 39. The costs to local bodies identified within the impact assessment are not realistic.**
- 40.** Local bodies will face additional costs around tendering, appointing, reviewing and monitoring the contract and involvement in some major decisions. There is also going to need to be some up-front investment in resource and training for those individuals appointed to auditor panels to ensure that they have the relevant skills and experience.

Limitation of liability agreements

- 41. Underlying regulations will need to be well drafted to give Limitation of Liability Agreements (LLAs) a chance to succeed.**
- 42.** In principle, ICAEW regards LLAs as a good thing, for both the profession and audited bodies. However, LLAs have been difficult to implement in the corporate world. Therefore, in the public sector, there needs to be a better chance of implementation and success as limitation is for everyone's benefit. The draft Bill says very little and makes provision for more detailed regulations to be put into place at a later date. These regulations will need to be well drafted to give LLAs a chance to succeed.
- 43.** In addition to these regulations, for LLAs to work there will need to be clear support from the Government and bodies, such as the FRC, and strong guidance for senior officers of local bodies and their auditor panels on how they would continue to meet all their duties by agreeing to an LLA. ICAEW suggests that standard (model) terms for LLAs within the engagement letters will be necessary and could be produced by either the FRC or the RSBs (in consultation with local bodies). As outlined above in paragraph 32, standard engagement terms are currently provided by ICAEW for its member firms for their audit engagement contracts in the private sector. These will also cover paragraphs for LLAs in line with any guidance that is drafted.

Resignations

- 44. DCLG should confer with BIS about how the current requirements for resignations could be streamlined.**
- 45.** We note the power to make regulations regarding resignation and removal of auditors under clause 17 of the draft Bill and the expectation that these will mirror the requirements for companies. The current Companies Act rules on auditor resignation are complex and require duplication of information. BIS consulted on simplification for companies and auditors in November 2009 and indicated that they would implement changes when an opportunity arose but this still has not happened. It is important that the Local Public Audit Bill avoids the same traps. ICAEW recommends that DCLG reflects the BIS proposals for simplification.

46. In particular, ICAEW would suggest that the framework could be streamlined in the following ways:
- avoid parallel notifications from the auditor and audited body being sent to the same 'authority';
 - have clearer definitions as to what constitutes a major audit and an auditor's 'end of term';
 - remove the requirement to issue a statement of reasons where the resignation is for routine reasons, such as the auditor panel decides not to reappoint a firm at the end of its five year term, or the audit firm is bought out or merged with another;
 - have one authority to notify regardless of whether the audit client is 'major' or not; and
 - provide clarification as to which body takes primary action for resignations at major Public Interest bodies.
47. ICAEW also recommends that DCLG consider the protections that will be put in place for auditors who decide to issue a report in the public interest in the face of opposition from the audited body. At present the draft Bill states that the authority's auditor panel must advise the authority's auditor on any proposal to make a public interest report in relation to the authority or any entity connected with it. However, it is not clear how this would work in practice, when the auditor panel is presumably accountable to the authority that appointed it.
48. Without some form of safeguard, ICAEW fears that public interest reporting will diminish under the new arrangements for auditor appointment. This has already been the experience for NHS Foundation Trusts, the only other area of the public sector that currently appoints their own auditors.

Definition of major audits

49. **The definition of major audits should be refined to avoid excessive numbers of local authorities being designated as of special public interest.**
50. It is not practical to have a large number of public bodies categorised as public interest entities within the local public audit framework.
51. For the purpose of this work and the overall regulatory regime, it will be necessary for DCLG to consider the level at which a body's audit will be subject to a higher level of monitoring. This could be based on either income, expenditure or even the level of risk associated with that particular body based on the services that the body provides.
52. ICAEW recommends that a more sophisticated and rounded approach to the identification of bodies defined as 'major audits' is needed, which is not based primarily on a financial threshold. If a financial threshold is to be used, then a high net revenue threshold needs to be considered by DCLG eg, at least £500 million. Whatever definition is set, it should be clearly set out in either legislation or regulation so that there is no room for misinterpretation¹.
53. How major audits are defined within the draft Bill will have a direct impact on the regulatory costs, given that the greater the number of bodies that are designated as 'major audits' the higher the costs, as these audits will be subject to the full range of scrutiny by the FRC.

Smaller local public bodies

54. **Further work is required to understand the regulatory implications of the proposals for smaller local public bodies.**

¹ A recent innovative approach that has been adopted by the South African government in their definition of major audit has been to apply a points based system based on number of employees, turnover and beneficial stakeholders (Regulation 26 of Companies Act 2012). This sort of approach might be helpful in meeting the proportionality objectives of the legislation.

- 55.** We note the proposals outlined in the consultation paper which include the adoption of a more proportionate approach, similar to that applied to charity audits. However, under the charities regime, the Charity Commission acts as regulator. Under the proposals outlined in the draft Bill, there appear to be no similar safeguards.
- 56.** While we do not consider that using the same threshold as that applied to small companies (currently £6.5 million) is necessarily the right threshold, we do agree that the principles that need to apply are similar, in that it should also take into account gross assets and employees, which the draft Bill currently does not.
- 57.** The £6.5 million audit threshold is taken directly from the Companies Act with the current upper thresholds set by the European Commission, and as such it is an entirely private sector concept. We would caution against applying this audit threshold directly across from the Companies Act. There is currently thought that the threshold for companies might increase to as much as £25 million in the future. Given that it is public money at stake, ICAEW recommends that DCLG consider a separate set of thresholds for the local public audit regime.
- 58.** DCLG should consider including whatever threshold is applied in subsidiary regulations, rather than on the face of the Bill, to make it easier to update should the need arise in the future.
- 59.** The draft Bill stipulates that small bodies with turnover below £25,000 will not be subject to audit, but will be required to appoint an auditor to receive complaints from the electorate. It is not clear how the auditor appointed in these circumstances will be remunerated, or who would bid for this work given that the only work they are likely to have to undertake will be high profile public interest work. This requires further clarification.

RESPONSES TO SPECIFIC QUESTIONS

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

- 60.** Schedule 1, Clause 1(1) highlights how liabilities will be transferred. Although the Government is outlining how this will be done, ICAEW's view is that the provisions will need to be robust. The draft Financial Services and Markets Bill (schedule 2.1) outlines a similar process transferring liabilities from the Financial Services Authority to the Prudential Regulation Authority.
- 61.** We recommend that DCLG obtains further legal advice on these and other aspects of the abolition of the Commission to ensure that the transition is carried out as smoothly as possible.
- 62.** We recommend that a provision should be made for the audit of a devolution (or completion) statement. This would reconcile the closing balances of the Commission with the opening balances of the newly devolved bodies and set out clearly the allocation of the assets, rights and underwritten liabilities.

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

- 63.** We recommend that, in relation to adequate accounting records, clause 2 (2) should also make reference to evidenced authorisation.
- 64.** We recommend that 'Except as elsewhere provided for in this Act' should be added to clause 2(4), to ensure consistency with clause 2(5).

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

- 65.** The aim of clause 6(1) is not clear and we recommend clarification. For example, is the aim to require a relevant authority to appoint an auditor to audit its accounts for a financial year not later than three months before the commencement of that financial year, rather than by a specified fixed date?
- 66.** The draft Bill does not address the fact that significant business relationships could affect the independence balance. We recommend Clause 12(2) cover business relationships and also address the definition of 'close friend' (ie, how close is close?).
- 67.** In relation to clause 16, LLAs have been difficult to implement in the corporate world. Therefore, in the public sector, there needs to be a better chance of implementation and success as limitation is for everyone's benefit. The current draft Bill says very little and makes provision for more detailed regulations to be put into place at a later date. ICAEW recommends these regulations will need to be well drafted to give LLAs a chance to succeed (paragraphs 41 to 43 above).
- 68.** Some of the terms within clause 12(2) need to be more clearly defined. For example, 'member' of a local authority is presumably meant to encompass those holding office and/or receiving remuneration for services to the authority? However, as drafted it could include ratepayers or subcontractors. We suggest that this and other terms need to be properly defined somewhere (even if not in legislation). In our view, although an audit firm or someone with knowledge of the sector will understand what these terms mean, a layperson will not. ICAEW's view is that a layperson needs to fully understand the Bill, in order for the Bill (and the terms within it) to not in themselves become a barrier to entry.

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?

- 69.** In principle, ICAEW believes that it is a good idea to have a panel to advise local public bodies on auditor appointment and independence. However, the challenge that still exists for the vast number of local public bodies will be to find sufficiently independent members who have the

right expertise and experience to enable them to carry out their role robustly, and are prepared to undertake this role for 'reasonable expenses'.

- 70.** We would question whether an audit panel appointed by a relevant authority, will be truly independent from the relevant authority, therefore we recommend that proper safeguards are put into place to ensure that the panel cannot be interfered with by the Council once appointed. When discussing the independence of auditor panel members, the draft Bill concentrates on the relationships between audit panel members and local body officers. However, it does not address the potential relationship between audit panel members and auditors or those individuals who have business relationships with members and officers. These need to be considered.
- 71.** The existence of audit panels will be new territory for all parties involved, and is an area where additional guidance will need to be developed. Guidance should cover areas such as auditor appointment, tendering and the qualitative factors to consider regarding the appointment of an auditor. Such guidance could be produced by the NAO, alongside its codes of audit practice, or by the FRC, alongside guidance it has published on the role of audit committees. ICAEW publishes model engagement terms for auditors to discuss with their clients and will continue to do so for local public audit.
- 72.** It should also be noted that independence is borne out in much more than just the appointment process. It is borne out in how the audit work is carried out, the decisions auditors take and also by issues such as fee dependence and the provision of non-audit services. One of the safeguards of independence is an audit firm does not have a significant amount of its audit fees tied up in one client.

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?

- 73.** Yes, subject to any panel appointed as an auditor panel by a relevant authority and one or more other relevant authorities being able to comply with the provisions applying to auditor panels made by or under section 12 (ie, independence).
- 74.** The greater the number of authorities involved in these joint arrangements, the more difficult it will be to find members who are sufficiently independent from all authorities for which the panel acts, who have the right expertise and experience to enable them to carry out their role robustly, and are prepared to undertake this role for 'reasonable expenses'.
- 75.** Where a single panel serves one authority then there are clear lines of accountability. However, where there are joint panel arrangements serving a number of authorities, it is not clear what the mechanisms might be for the panel's accountability. It may be appropriate to define some terms of governance for these joint arrangements.

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

- 76.** It is difficult to comment on the balance between prescription and guidance until such guidance has been developed and published.
- 77.** To ensure consistency across the sector, and the effectiveness of the panel, we recommend the draft Bill prescribes the minimum number of members that an auditor panel must consist of (ie, a minimum of three independent members with a quorum of two) and the minimum number of times that the panel should meet.
- 78.** We also feel that consideration should be given to the auditor panels' role in relation to the provision of non-audit work performed by external auditors. This is currently monitored by the Commission, and in the private sector and the NHS this is monitored by their audit committees.

79. It is also worth noting that the FRC envisage that, in the private sector, audit committees will:

- scrutinise the proposed scope of the audit and, following a reduction in audit fees, consider whether the overall level of work to be performed is likely to be sufficient to identify material misstatements and ensure that audit quality is not compromised; and
- have an important role to play in supporting and encouraging a sceptical approach by discussing the concerns of audit teams about management's key judgments and encouraging audit teams to demonstrate the extent of their challenge in relation to these judgments.

80. Both of these expectations of audit committees could equally apply to the proposed functions of auditor panels in the public sector, and could be addressed via guidance on their role.

Q7. Do you have any comments on the proposals set out above on removal and resignation?

81. We note the power to make regulations regarding resignation and removal of auditors under clause 17 of the draft Bill and the expectation that these will mirror the requirements for companies. The current Companies Act rules on auditor resignation are complex and require duplication of information. BIS consulted on simplification for companies and auditors in November 2009 and indicated that they would implement changes when an opportunity arose but this still has not happened. It is important that the Local Public Audit Bill avoids the same traps. ICAEW recommends that DCLG reflects the BIS proposals for simplification.

82. In particular, ICAEW would suggest that the framework be streamlined in the following ways:

- avoid parallel notifications from the auditor and audited body being sent to the same 'authority';
- have clearer definitions as to what constitutes a major audit and an auditors 'end of term';
- remove the requirement to issue a statement of reasons where the resignation is for routine reasons, such as the auditor panel decides not to reappoint a firm at the end of its five year term, or the audit firm is bought out or merged with another;
- have one authority to notify regardless of whether the audit client is 'major' or not; and
- provide clarification as to which body takes primary action for resignations at major Public Interest bodies.

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

83. Clause 26 and 27 use the term 'reasonably requires'. Although we understand that this is a direct lift from the Companies Act, there have been discussions with the FRC over the exercise of this power which has created some uncertainty. The term 'reasonable' means different things to different people. It would therefore be helpful to have a definition as to what this means and where the boundaries are so that the same uncertainty is not created under this regime.

84. Clause 37 (2) defines 'address' but does not define 'name'. There have been issues in relation to this under the Companies Act. There needs to be clarity about whether this is the name they were born with or the name they are known by.

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

85. Clause 20 (7) should be clarified to confirm whether trusts and trustees fall within the scope of the definition.

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

86. By their very nature, all public bodies could be categorised as major audits. In ICAEW's view it would not be practical to have such a wide definition for the future local public audit framework. If a financial threshold is used then the definition will need to be clear to ensure bodies are not

unwittingly included or excluded. For example, if 'net current expenditure' was to be used there would be a risk of excluding high spending authorities.

87. However, we would recommend that a more sophisticated and rounded approach to the identification of bodies defined as 'major audits' is needed, which is not based primarily on a financial threshold. If a financial threshold is to be used, then a high net revenue threshold needs to be considered by DCLG eg, at least £500 million.

88. DCLG should carry out some modelling and analysis to identify those bodies that would be captured by any proposals that it develops. This would be helpful to provide assurance that bodies that one would expect to capture within the FRC/AIU regime are not excluded (for example, pension funds).

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

89. The Audit Commission currently provide specimen audit reports for local authority audits.

90. In the private sector, APB Bulletin 2010/2 provides a compendium of illustrative auditor's reports applicable to United Kingdom private sector financial statements for periods ended on or after 23 March 2011. The auditor's reports support and illustrate the requirements of ISAs (UK and Ireland) 700 'The auditor's report on financial statements', 705 'Modifications to the opinion in the independent auditor's report' and 706 'Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report'. They also support the requirements of the law and regulations applicable to the particular type of entity to which the illustration applies.

91. Once the Commission is abolished, we recommend that the FRC be asked to maintain specimen reports as they do for the private sector.

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

92. Yes.

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

93. No.

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

94. No.

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?

95. No.

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?

96. Yes, so long as they do not become too onerous at the local level to carry out.

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

97. No.

Q18. Does the impact assessment identify the main components that will affect the level of fees in future? Are there any other drivers on fees?

98. Rather than purely focusing on cost, DCLG should consider audit quality or the preventative cost to the public of poor local government husbandry that audit is intended to check. For example, taking an example from the area of insurance, one might begrudge the premium and not pay it, if only focusing on cost, without looking beyond the costs to the consequences of a disaster.

99. Other drivers of fees might include the:

- size, complexity and location of the public sector body; and
- significant barriers to entry and auditor concentration in the hands of a small number of firms, putting upward pressure on fees.

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

100. The costs to local bodies in the impact assessment appear to be very low. Given that there will be costs around tendering, appointing, reviewing and monitoring the contract and involvement in some major decisions, ICAEW would question whether this would all be feasible in the costs identified. There is also going to need to be some up-front investment in resource and training for those individuals appointed to auditor panels to ensure that they have the relevant skills and experience.

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

101. It is for firms to comment on whether the costs and benefits to businesses are realistic.

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?

102. We note the proposals outlined in the consultation paper which include the adoption of a more proportionate approach, similar to that applied to charity audits. However, under the charities regime, the Charity Commission acts as regulator. Under the proposals outlined in the draft Bill, there appear to be no similar safeguards.

103. We also have concerns about the ability of a body whose turnover is below £25,000 to find an auditor if they opt out of the sector-led procurement exercise. The draft Bill stipulates that small bodies with turnover below £25,000 will not be subject to audit, but will be required to appoint an auditor to receive complaints from the electorate. It is not clear how the auditor appointed in these circumstances will be remunerated, or who would bid for this work given that the only work they are likely to have to undertake will be high profile public interest work. And there is the added cost to the local public body in pursuing a tender exercise.

104. The situation as outlined in the draft Bill only really works where framework contracts are awarded, as is currently the case, with each firm being given all the appointments in a contract area based on county boundaries, or similar.

105. It is also difficult to see, where a body opts out of the sector-led procurement exercise, how a failure to appoint an auditor would be spotted without the maintenance of a central list of relevant bodies which is monitored for compliance with the duty to appoint an auditor.

106. In addition, if it hasn't already, ICAEW recommends that DCLG ensure that their proposals for smaller bodies fit with the NAO requirements to ensure there is sufficient overall audit coverage of bodies consolidated into Whole of Government Accounts.

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?

107. The commentary in the draft Bill states that ‘as some smaller bodies have received qualified opinions on their accounts several years in a row, external scrutiny by an auditor is not proving to be an effective way of holding these bodies to account.’

108. A quick review of the public interest reports issued shows that the majority relate to small bodies, and relate to a failure to prepare an annual return about the bodies’ finances and governance. Given these public interest reports are public documents, which provide taxpayers with a mechanism to hold these bodies to account, ICAEW would like clarity on who will ensure that transparency codes will be complied with.

Q23. Are these transparency requirements proportionate to the low levels of public money these bodies are responsible for? What steps will smaller bodies need to take in complying with these new requirements? Are there any cost implications?

109. This is ultimately for smaller bodies and NALC (as their representative body) to comment on. However, there could be costs associated with the production and publication of information for bodies that are not currently doing so. While these costs may not be significant, there are approximately 6,500 smaller local public bodies with income or expenditure below £25,000. As such, even a small cost of compliance for these bodies individually could add significant costs to the sector as a whole.

110. ICAEW recommends DCLG work out the steps and related costs that smaller bodies will need to take to comply with these new requirements if it chooses to proceed with this proposal.

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?

111. Paragraph 106 of the consultation document states that auditors will continue to be members of a professional body and will be subject to the remit of that body. However, paragraph 107 seems to imply that this work could be carried out by a firm that is not a registered auditor, as it states that they would not need to be registered with an RSB. Clarification is required.

112. While ICAEW accepts that limited assurance reviews could be undertaken by firms that are not registered auditors, and it could potentially be a mechanism for gaining experience of the public sector, we would question whether such firms would have the appropriate skills and expertise to deal with the wider powers such as public interest reporting, dealing with objections from the public, declarations from the public that items of account are unlawful, issuing advisory notices and seeking judicial review.

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

113. The draft Bill raises a number of questions. Would a sector-led body have the skills and expertise to monitor the quality of the limited assurance reviews and what would be the implications for poor quality results? In the instances where bodies have been appointed independently from the sector-led body, how will the reviews be monitored as they cannot carry out the review themselves as they could not be independent and impartial in the process (ie, it is not in their favour to find something wrong)?

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

114. The maintenance of a residuary commissioning function for smaller local public bodies, as implied by the sector-led body, should make it possible to retain highly cost-effective limited assurance reviews of smaller bodies. However, the concern is that membership of this body is only optional and where bodies do not join they will not benefit from the economies of scale

and will be subject to similar compliance costs as larger public bodies, in terms of the costs associated with auditor panels.

115. In the absence of the sector-led body, ICAEW would recommend clarity on what the mechanism for monitoring compliance with the new duty to appoint an auditor will be.

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