



Local Audit

ICAEW welcomes the opportunity to comment on the consultation paper *Local Audit* published by the Department for Communities and Local Government in June 2014, a copy of which is available from this [link](#).

This response of July 2014 has been prepared on behalf of ICAEW by the Regulatory Policy Team of the Professional Standards Department.

As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers all the firms that currently carry out work for the Audit Commission in respect of Companies Act audits. We are currently in the process of making our RSB application to the Financial Reporting Council to regulate principal local public bodies under the Local Audit and Accountability Act 2014.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working 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. We provide leadership and practical support to over 142,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

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.

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MAJOR POINTS

Support for the initiative

1. When considering the new framework for local audit in the Summer of 2010, the following design principles were articulated:
 - Maintaining audit standards – ensuring independence, competence and quality.
 - Transparency – ensuring that the results of audit work are easily accessible to the public and can thus help local people to hold councils and local public bodies to account for local spending decisions.
 - Localism and decentralisation – freeing up local bodies, subject to appropriate safeguards, to appoint their own independent external auditors from a more competitive and open market.
 - Lower Audit Fees – achieving a reduction in the overall cost of audit across all local bodies.
2. For the new audit regime for local public bodies, the intention has been to follow and apply the regime outlined in the Companies Act as much as possible. This was considered to be the most cost-effective way of setting up a new framework, which would allow the above policy objectives to be met.
3. For the smaller bodies, in order to ensure that costs remained proportionate (and therefore try to meet the objective of lowering audit fees), it has always been the intention (since the announcement in 2010) that the reporting regime would also be more proportionate. DCLG has always maintained that it wants to apply a similar regime to that for the private sector, under the Companies Act, in that, for those bodies with a turnover of less than £6.5million, there would be no audit requirement and a more proportionate reporting regime would be put into place.
4. Having laid out the above policy objectives, the regime that is being proposed for smaller bodies, whilst trying to mirror what is in place under the current Audit Commission regime, is not workable in the absence of the Audit Commission. The suggested way forward does not, in our opinion, reflect the policy objectives or the intentions of a proportionate regime.
5. **ICAEW is therefore unable to support this consultation (including the 4 sets of draft regulations) in its entirety.** In our view, the regulations in relation to smaller local bodies need a complete re-write. The regulations and commentary are confusing and lack clarity in many aspects of the suggested framework for smaller bodies. ICAEW is of the view that the consultation should not have been published in this form. This view was articulated to the DCLG Regulatory Working Group, by various stakeholders, at a meeting on 3rd June 2014 and in subsequent email correspondence from ICAEW. We are therefore disappointed to see the consultation and are even more concerned that it has been published with a tight 4 week deadline for response.
6. Given the tight timescales and the poor drafting of the consultation and regulations, we are only providing high-level comments on key issues which we have identified. We would have provided further, more detailed and considered comments on all the regulations and proposals if the consultation had been fit-for-purpose and if we had more time within which to consult with our member firms and provide a more detailed response.
7. In discussions and email correspondence with DCLG, we have articulated our view that we think the confusion in the draft regulations arises from a fundamental lack of understanding by civil servants of :
 - a. the differences between an ‘audit’ and an ‘assurance’ engagement;
 - b. the mix-up of the terminology around the types of bodies;

- c. the role of the specified person; and
 - d. the monitoring regime.
8. If a professional accountancy body such as ICAEW is unable to understand these regulations and make sense of them, we have concerns about the ability of approximately 10,000 smaller public bodies to not only understand them but to apply the requirements properly.
9. As it is, we would not recommend any of our member firms take this work on as the risks are too great for any benefit that they might receive from doing this work.

Audit v Assurance

10. The consultation paper, under section 2 outlines the following policy objectives:
- a. *The objective for the reform of smaller authorities audit policy is to ensure transparency, quality and cost-effective audit.*
 - b. *Government has already set out in previous consultations that all small authorities with a turnover over £25000 pa will be subject to the current light-touch proportionate audit in order to meet accountability requirements of a public organisation handling public money.*
 - c. *Smaller authorities with a turnover below £25000 pa will be exempt from routine audit and will, instead, be subject to a new transparency requirement. Government proposes to retain a mechanism for local electors to ask questions and raise objections to items of account with an auditor for these bodies.*
11. ICAEW's view is that none of the objectives will be met because:
- a. What is being required under the legislation is not what is being proposed in the subsequent regulations and guidance i.e. the legislation requires 'an audit', but the proposals refer to an 'assurance engagement'. Transparency and quality will be affected if it is not clear what is being required and this will affect the cost of the regime.
 - b. There is no such thing as a 'light touch proportionate audit' – no such concept exists in legislation, under the Companies Act, nor within International or UK standards. As far as the profession is concerned, an audit is an audit and requires the work to be carried out in accordance with International Standards on Auditing (UK and Ireland).
 - c. For smaller bodies with turnover below £25,000, if there is no audit or assurance requirement, then who will the government get to actually take on a contract to be an auditor for a body that doesn't actually require an audit? We fail to see which accountancy firm is going to actually bid for this work when it could be a contract which will bring significant risks but without any benefit to them. Of all the aspects of the work that is different to, and riskier than, audits under the Companies Act, it is the ability to deal with objections that is the most time-consuming and risky part of these contracts. Firms, who are not carrying out any audit or assurance work, are unlikely to have the relevant knowledge of the small body to be able to answer the questions or objections sufficiently nor are they likely to have the skills to carry out the work competently and professionally, unless they are already carrying out audit or assurance work for smaller local public bodies with turnover above £25,000.

What is the problem?

12. The regulations continue to refer to '*the appointment of a local auditor to audit the accounts*' and indeed the duties of auditors outlined within the consultation still refer to an 'audit'. There is reference to an 'audit contract'. And on page 72 of the consultation, which is in relation to **General duties of auditors (in relation to smaller authorities)**, there is reference to: '*auditing the accounts of....*', '*...when an auditor has completed an audit of the accounts...*', '*... a certificate that the auditor has completed the audit in accordance with the Act....*', '*the auditors opinion*'. To any layperson picking up these regulations, these references to 'audit' would imply that an audit is required and that an audit is what will be carried out.

13. Accountancy firms have identified some real difficulties that they are having with the current regime where they are asked for information from, for example, the police, because the police are carrying out an investigation into fraudulent activities. As the firm is identified as 'the auditor' and an audit report has been issued, the public perception is that an audit has been carried out and therefore that the accountancy firm must hold information in relation to the books and records of the small body.
14. ICAEW's view is that if an 'audit' continues to be required within the legislation, and indeed there are numerous references to an audit, then we would expect a firm that chooses to take this work on to carry out an audit. To do anything less, would not be appropriate and would go against the professional standards that auditors are required to adhere to.
15. If however, as indicated within the consultation and discussions over the last 3 and half years, DCLG want something other than an audit to be carried out, then the provisions within the legislation need to be dis-applied so that another form of engagement that is not an audit can be carried out. However, there needs to be some basic competencies outlined to enable the work to be carried out by accountancy firms with the right level of skills. We have previously suggested to DCLG how the dis-application might work and indeed have even suggested a possible framework for this area of work, using a Licensed Practitioner Scheme, a scheme which ICAEW is developing with other organisations where such specific reports are required.

Types of bodies

16. There is ambiguity within the consultation and proposed regulations in relation to the different types of bodies. The terms used are: smaller authorities, full audit authorities, opted-in authorities, opted-out authorities, exempt authorities, category 1 authority, category 2 authority, and relevant authority. Even though there is an attempt within the regulations to define some of the terms, the use of different terminology creates confusion.

Role of the specified person

17. Apart from the use of different terminology of a specified person (an appointing person is sometimes used) the credentials, role and duties of the specified person are not articulated clearly. The regulations identify that the Secretary of State may 'specify a person to appoint local auditors' but then does not articulate how that person will be identified and appointed or what eligibility requirements they will need to fulfil. In comparison, a Recognised Supervisory Body overseeing and regulating the work of auditors of principal local public bodies, has to meet criteria, set out through the legislation by the Financial Reporting Council, make a formal application to become an RSB, and indeed has to demonstrate its ability to take on that role over the longer term. However there does not appear to be a similar framework for the 'specified person for smaller bodies'. We believe that there should be similar, albeit proportionate, processes for any organisation to be appointed as a 'specified person' to demonstrate their credentials before they are able to take on such a crucial role in the market place.

Monitoring regime

18. We have previously made comments to DCLG regarding the monitoring regime of accountancy firms that may carry out this work. This consultation lacks any clarity about the potential regime that is being proposed.
19. The consultation states that there will be no routine inspection and the proposed approach seems to be based on whether the 'light-touch approach is effective'. This seems to us to differ from what should actually be in place in relation to the requirements, the scope of work required, and therefore carried out, and whether it has been done properly, in accordance with relevant standards. Monitoring arrangements should be implemented from the start of the regime, rather than waiting until something goes wrong to do so. Additionally, not implementing monitoring arrangements in the new regime actually produces a regime that is weaker than that

which currently exists under the Audit Commission. ICAEW has concerns that it is not only the reputation of accountancy firms and the profession that will suffer if there is a flawed regime, but also that there would be an increased risk for smaller bodies.

20. ICAEW, as a monitoring body for accountancy firms under the Companies Act 2006, is well aware of the systems, processes, knowledge and experience that need to be in place for such a role to be carried out properly. Our recommendations to DCLG on how the process might work through a Licensed Practitioner Scheme included the monitoring element, which, in our view, should ideally include:

- a. who will do the monitoring;
- b. what qualifications/credentials that monitoring body/person will need;
- c. what will they be monitoring against;
- d. how the monitoring will be carried out;
- e. the appeal regime; and
- f. who will bear the cost of the monitoring.

21. On page 76 and elsewhere within this consultation, we note the following:

Section 1217, as it has effect apart from its application by virtue of Schedule 5 to the LAA Act 2014 or by virtue of the Local Audit (Smaller Authorities) Regulations 2014, applies also for the purposes of these regulations, so that a supervisory body under that section is also a supervisory body for the purposes of the regulations.

22. ICAEW was surprised to see this within the consultation and we have interpreted this as meaning that a duty will be put upon the RSB to undertake a regulatory role in relation to firms carrying out the engagements for smaller bodies. However, there has been no consultation, discussion or correspondence with us to this effect. At this point in time and without substantial change to the proposals and the framework for smaller bodies, we would not be prepared to take this role on in relation to the smaller bodies. If this is a condition or an additional requirement to be placed on a potential RSB for principal local public bodies, then ICAEW will need to re-consider its impending application in that context.

23. We also note that this is a requirement being proposed for RSBs that may take on a potential role under the LAA Act 2014, but will not apply to other accountancy bodies whose firms may also be entitled to carry out this work by virtue of their registered auditor status under the Companies Act. We question how this would work in this framework.

Accounts and Audit Regulations

24. We are concerned to note that the Accounts and Audit Regulations 2014 which apply to all bodies, both principal and small bodies, have been attached to this consultation which is predominantly in relation to smaller bodies. Our comments in relation to the smaller bodies apply to these. We are however, also concerned that there are proposals to move the timetables for audited accounts forward but without a proper consultation with the bodies concerned or indeed the accountancy firms and without an impact assessment identifying the implications on systems, processes, costs, quality and resources that will be required to make such a move both for the sector and for accountancy firms.

25. Within the preamble, in paragraphs 4.6 and 4.7, there is reference to the challenges that authorities and accountancy firms will face but these challenges are not articulated nor are there recommendations to address these challenges. Indeed there is also reference to authorities and accountancy firms' ability to make adjustments to their processes and business models but we note that there is again no reference to what these adjustments are and what the impact will be on the cost, quality and resources that this will entail.

26. We note that the consultation only refers to the date by which the audited accounts must be submitted. There is no mention of the date by which local public bodies need to present a good quality set of accounts for audit.
27. At present a large majority of authorities finalise their accounts only a limited number of days before 30 June and audits are not generally complete until the last two weeks of September, this is despite the limited number of accounting changes over the last few years. The reason for this is, in our view, the size of many principal local public bodies and the complexities associated with their accounts (i.e. local government accounts are not comparable to NHS accounts in terms of complexity).
28. Our understanding was that the new regime for local public bodies was supposed to mirror, as much as possible, the Companies Act. Under the Companies Act, private companies are required to submit their accounts 9 months after their financial year-end, whilst public companies have 6 months to submit. Local government is already in line with the tighter deadlines applicable to public companies. Bringing forward the deadline to 31 May and 31 July reduces the timeframe from 3 and 6 months (for NHS and local government bodies respectively) to 2 and 4 months, which is substantially shorter than in the private sector for what are arguably (in the case of local government at least) more complex accounts.
29. Many local public bodies already struggle with their financial management and do not currently have an adequate control environment when they produce their accounts. Bringing forward the timetables in the way proposed would make it more difficult for them to produce a good set of quality accounts earlier than they currently do.
30. Going forward there are significant changes to the accounting framework proposed which will add an additional burden and potential time pressure, these include:
 - Changes in the measurement of infrastructure assets
 - A revised fair value framework (IFRS 13)
 - A revised revenue standard (IFRS 15)
 - A revised financial instruments standard (IFRS 9)
 - A significantly revised leasing standard (expected to be issued 2015).
 - This is in addition to changes in funding and regulatory changes.
31. Audit firms tend to use the same staff across local government and NHS audits given the sector similarities and specialisms. Bringing forward the timetable for local government principal body audits may have an effect on the NHS audit timetable depending on when the local government accounts will have to be presented for audit. If this is the case, there is a potential that it will increase the demand on resource requirements to ensure that the quality of the work carried out by audit firms is not compromised. Increasing resources will impact on the costs associated with audit. This could potentially lead to increased audit fees over the longer term.
32. The Audit Commission Act 1998 included the following provision: *'At each audit under this Act, other than an audit of accounts of a health service body, any persons interested may—*
 - a) inspect the accounts to be audited and all books, deeds, contracts, bills, vouchers and receipts relating to them, and*
 - b) make copies of all or any part of the accounts and those other documents.*

At the request of a local government elector for any area to which the accounts relate, the auditor shall give the elector, or any representative of his, an opportunity to question the auditor about the accounts.'
33. However, we note that section 4.8 of the consultation, which deals with public rights, simply refers to 'Category 1' bodies, which we assume includes health service bodies. Given that the right to inspect documents and question the auditor is currently limited to local government and not health service bodies, it is unclear whether the proposals as drafted are workable for all

Category 1 bodies without creating an additional regulatory burden to that in the current regime.

34. This proposal to bring forward the deadline for submission of audited accounts brings to light the following risks:

- Increased likelihood of missed deadlines, especially if local public bodies do not present their accounts for audit in sufficient time;
- Reduced quality of draft accounts due to decreasing the time available for preparation and quality control at the audited entity level;
- Increased likelihood of requests for additional audit fees due to reduced quality of draft accounts; and
- Increased risk of qualified audit reports.

What needs to be done?

35. Our recommendations for the smaller bodies reporting and monitoring regime are as follows:

- 1) The proposals need to be completely reworked and redrafted;
- 2) In relation to the misconception about 'audit' and 'assurance', it would be helpful if Ministers were to instruct officials to work with the profession to:
 - a) First clarify what it is that government wants from the smaller bodies' regime: starting with getting the legislation right first. Eg. what is it that you want from a reporting regime for smaller bodies?
 - I. An audit: which will require the application of the full auditing standards and will cost more; or
 - II. An alternative assurance engagement – which will result in a more proportionate regime being applied.

This will need officials to fully understand the differences between an 'audit' and the different types of 'assurance' engagements. If the intention is to keep the regime proportionate, then the legislation/regulations need to spell this out clearly and clarify that an audit is not required but an alternative reporting mechanism is required and identify what that alternative mechanism is (e.g. a limited assurance engagement). We note the Government's intentions to try to do this through the NAO's Code of Audit Practice. However, we think that is insufficient. In our view it is important that a new definition of 'audit' is not created. Existing recognised standards should be utilised and we see two options:

- An assurance engagement in accordance with ISAE 3000 which would allow for a range of limited and reasonable assurance engagements; or
 - Agreed upon procedures, which would be undertaken by a reporting accountant (who is a registered auditor). Under this option the procedures would be specified by government or the specified person rather than the reporting accountant and the resulting report would be a factual presentation of findings, no opinion would be offered.
- b) Identify what the scope of work will be that will provide government with the assurance that it requires once it has decided the answer to (a).
 - c) Identify what the form of reporting will be that clarifies and supports the work that has been carried out under (b).
 - d) Once (a) to (c) above have been clarified, then it's important to identify who government wants to do this work and what the eligibility and competency criteria will be (linking to the policy objective of trying to open up the market). Each of these approaches, whilst having a common minimum data set, also requires distinct and particular skills for each – particularly in the public sector context of the wider responsibilities on the auditors.

e) Monitoring of the accountancy firms doing this work can then follow which will need to consider properly:

- a. who will do the monitoring,
- b. the monitoring body/person's skills and competencies to undertake this role;
- c. how will the monitoring be carried out;
- d. what they will be monitoring against;
- e. what the appeal mechanisms will be; and
- f. who will bear the costs of the firm in complying with the request.

How the monitoring will be carried out, and who by, will need to be clear at the start of the regime so that any accountancy firm that bids for smaller bodies reporting work is clear about what will be expected of them through a monitoring regime.

36. Setting up the framework properly from the beginning will provide clarity around the whole framework for smaller bodies. A clear framework will also help to minimise the expectation gap between the various parties involved in the regime and indeed in the work that is being carried out, whether it be 'audit' or 'assurance'.

37. On some of the other aspects of the consultation (outlined under paragraphs 16 and 17), DCLG need to work through the framework in a much more structured and logical way so that it is clear what is required for each type of body, the specified person and the accountancy firm.

38. In relation to the Accounts and Audit Regulations proposal to bring the timetable forward (paragraphs 24 – 34), we recommend that DCLG consider the end to end process of how this might work and how this can be done in as cost-effective way as possible without it increasing the costs on both local public bodies and accountancy firms, both of which will inevitably fall down to local tax-payers.

39. Before bringing the timetables forward, it would be better to:

- a. Review the scope of the accounts and breadth of disclosures required in local government, primarily to make them easier to understand for the general public, but also to reduce the impact on the audit timetable (some sets of local government accounts were over 150 pages long in 2013/14);
- b. Consider the control environment that needs to be in place for local public bodies to enable them to produce accounts earlier; and
- c. Consider introducing a phased approach which includes monthly reporting. Do local public bodies have strong and robust financial management systems, processes and skills in place which are necessary to enable them to carry out monthly reporting? It will be easier for local public bodies to produce the year-end accounts earlier if they are able to produce monthly accounts.

40. The more robust the bodies' own systems and processes are, the less adjustments will need to be made to the accounts and the easier it will be for the audit to be carried out on a timely basis. There are comparisons to how such reporting is carried out in the private sector that DCLG could learn from.

41. ICAEW would be happy to discuss any of its comments in more detail.