



Local Audit – Extension of Contracts

ICAEW welcomes the opportunity to comment on the informal consultation by the Department for Communities and Local Government in June 2015.

This response of June 2015 has been prepared on behalf of ICAEW by the Regulatory Policy Team of the Professional Standards Department. Our response has been prepared in the short timescales requested by Government. We would have submitted a more considered response if there had been more time available to us.

As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers all the firms that currently carry out work for Public Sector Audit Appointments Ltd in respect of Companies Act audits. We have made 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 144,000 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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INTRODUCTION

1. Before answering the questions posed by DCLG, ICAEW's view is that it is important to take a step back to 2010 and consider the original policy objectives that were set by the then Secretary of State, Eric Pickles.
2. The key objective of abolishing the Audit Commission was to refocus public audit on helping local people hold their councils and other local public bodies to account for local spending decisions. The four principles that government was working towards when announcing the policy objective were:
 - Localism and decentralisation;
 - Transparency;
 - Lower audit fees; and
 - High standards of auditing.
3. The then Secretary of State's aspiration was to implement the policy quickly and efficiently to deliver the best possible value to the taxpayer. We are not aware that the policy and principles have changed with the election of a new government.
4. We are therefore mindful that, almost five years after the original policy objectives were announced, with a new Act having been enacted in January 2014, and the Audit Commission having been abolished, the full framework that was intended at that time is still not yet in place and indeed, there are continuing discussions to pro-long the previous regime (via the Public Sector Audit Appointments Limited (PSAA)) for another five years, until 2020.
5. We consider that the four principles that were outlined as part of the policy objective (as above) will not be fully met by an extension. This is explained in the following paragraphs.

Consistency across the public sector

6. We note that the focus of this consultation appears to be on local government bodies. It is not clear to us whether the Department of Health has been consulted. If not, it would be of concern that the arrangements for local government bodies are being developed in isolation to health. If this is the case, it will likely create a disjointed future local public audit system.

MAJOR POINTS

7. ICAEW's view is that a decision to extend the contracts:
 - Will not necessarily drive innovation and improvement: fair and equitable competition is needed for that;
 - Could create a restricted audit market which would be the opposite of the government's original intention;
 - May disengage a number of stakeholders who have invested time, cost and resources into setting themselves up for the new regime (these stakeholders may choose not to re-engage as it may not be cost-effective for them to continue);
 - May frustrate those local bodies that want to appoint their own auditors and reap the benefits of a competitive market;
 - May cause job and/or skills losses within firms who are denied access to the market place.

Responses to specific questions

8. In responding to the questions that DCLG has posed, we are answering in our capacity first and foremost as a Chartered body with a public interest remit, a professional body that represents the wider profession and finally as a potential Recognised Supervisory Body that will regulate firms in the future local public audit market.
9. We note that DCLG's consultation has been to a very limited number of bodies and in particular only to the current firms in the market. We are concerned that this could potentially be seen as anti-competitive. In compiling our response, we have sought to liaise with a wider network of firms, in particular with those we know to have just left the current market and indeed, with those firms who have expressed interest in entering the market in the future.

What would be the key benefits or dis-benefits of contract extension?

10. The key advantages of contract extension are that it maintains a status quo and provides stability to a number of local government bodies and the handful of firms who are currently in the market. We are aware that:
 - a) Little progress has been made by a number of local government bodies in implementing the local appointment aspects of the legislation, leading to a perceived lack of readiness to procure and appoint their own auditors;
 - b) The timetable to secure faster closing of accounts will fall within the same timeframes and there is a perception that it could affect the quality of the audit if new auditors were appointed at the same time;
 - c) The NAO's planned review of VFM auditing could fall within the same timescales; and
 - d) Current firms in the market place would have certainty of continued work in this area for the firm as a whole, and for their staff, allowing them to further strengthen their skills and knowledge base.
11. However, we consider that there are more dis-advantages than benefits:
 - a) There will be a lack of competition in the market place – If the contracts are extended to 2020, there will only be five firms carrying out this work. Firms who have recently lost contracts (as a result of the last Audit Commission procurement process) and potential new firms seeking to enter the market would be frustrated. This would, in our view, create a restricted market which government would be promoting;
 - b) Firms who have recently lost contracts would have no incentive to maintain their current public audit staffing structure. Depending on their ability to re-deploy those staff this could potentially result in job or skills losses;
 - c) Inadvertently, the contract extension would also prevent the current firms in the market place from bidding for other contracts and expanding their portfolios;
 - d) Current firms in the market-place have limited incentive to innovate if there is no competition;
 - e) By continuing to allow the centralised setting of fees up to 2020, there is no opportunity to test whether audit fees are set at competitive levels. An important part of an auditor's role is to make a judgement on the amount of work needed in line with an assessment of the risks associated with that particular body including external factors which may impact on the organisation.
 - f) We are aware that there may be some local public bodies (especially the largest county and unitary authorities) who are likely to want the opportunity to appoint their own auditor and who will therefore not welcome the extension of contracts; and
 - g) Allowing prolonged centralisation and bulk awarding of contracts delays the implementation of wider government policy objectives of localism and decentralisation.

12. For these reasons we do not believe that putting off the full implementation of the Act for another five years is in the wider public interest. Local government bodies have known about the government's intentions since 2010. Local government bodies need to take immediate action to prepare now rather than defer making the decisions for a few more years. If they are not ready yet, who is to say that they will be ready in another five years' time?
13. We do not believe that it is a viable argument to suggest that Audit Panels or Audit Committees will not have the skills or knowledge to procure auditors. Many bodies procure contracts for much larger sums of money and for far more complex contracts. If there is concern about their ability to procure and appoint auditors, then we would question their ability to carry out other forms of governance. It might perhaps be an option for their representative bodies (eg the Local Government Association) to publish guidance on the procurement of auditors and to provide training in time for the procurement to take place. Indeed, local government bodies will be able to take assurance from the fact that there will be a list of registered firms who have already been through a process of vetting, approval and registration by an RSB. And indeed there are examples of good practice where local bodies have procured their own auditors from which lessons could be learnt, for example, Foundation Trusts have been appointing their own auditors for a number of years.

Is there a specific risk if contracts were to be extended or not extended?

14. The specific risks if contracts are extended are as outlined under the disadvantages section above.
15. A risk for ICAEW is that it has applied for the RSB status with the assumption that it will start to license firms at least by early 2016. The FRC is assessing our application based on the systems and processes that we currently have in place. However, by 2020, the regime may look very different. There is a potential risk that there will not be any RSBs in the regime as potential RSBs may not be able to justify the cost of being part of a framework where they have no role and the costs would far outweigh the benefits.
16. A wider and more general risk is the dis-jointed regime that will be put into place for local audit if local government contracts are extended but health contracts are not. Not only will this result in a lack of consistency in the local audit regime, it will also lead to disproportionate costs for firms who would have to license for health audits or indeed for any new local bodies that are set up. This could lead to a new local audit regime for a small number of bodies, running alongside PSAA, which would cause uncertainty in the marketplace. There would also be a disproportionate cost of regulating the new regime.

Would there be a resourcing impact? If so provide brief details.

17. Those firms that recently lost contracts would potentially need to make public sector staff redundant if they could not be redeployed. Firms might be more likely to redeploy staff for a short time if they thought that they might be bidding for work in a couple of years (without the extension).
18. With the small number of firms in the market-place, the specialised nature of the role and the restrictive eligibility criteria, there is a potential risk that it creates a dis-incentive for accountants to build a career in local audit.