Department for Communities and Local Government

Local Audit and Accountability Act 2014

Local audit impact assessment

September 2014
Department for Communities and Local Government

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If you have any enquiries regarding this document/publication, email contactus@communities.gov.uk or write to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

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Title: Local Audit Impact Assessment **IA No:** **Lead department or agency:** Department for Communities and Local Government **Other departments or agencies:**	**Impact Assessment (IA)** Date: July 2014 Stage: Enactment Source of intervention: Domestic Type of measure: Primary legislation **Contact for enquiries:** fola@communities.gsi.gov.uk
Summary: Intervention and Options	**RPC Opinion:** GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£1.351m	£0	£0	No	n/a

What is the problem under consideration? Why is government intervention necessary?

The current arrangements for local audit, whereby a single organisation - the Audit Commission - is the regulator, commissioner and provider of local audit services, as well as carrying out several other functions, are inefficient and unnecessarily centralised. This structure means the Commission sets audit fees to cover its costs and so does not include strong incentives for costs to be minimised. Local bodies have little control over the Commission's activities so often do not derive best value from its outputs. The Commission has become too focused on reporting to Government and supporting a target-driven culture which, combined with a lack of transparency in the system, has weakened local accountability.

What are the policy objectives and the intended effects?

These structural reforms are necessary to put in place a new decentralised framework for local public audit. The new audit framework will: deliver greater localism, decentralisation and transparency; incentivise competitive audit fees; and uphold high standards of auditing. Local bodies will be more accountable, and audit services will be tailored more effectively to their local circumstances. The cessation of the Audit Commission's inspection and assessment functions will free up local bodies to focus their energies and resources on better meeting the needs of local people. Ending state provision of audit services and increasing competition in the market will drive better value for money for the taxpayer.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1: Put in place a new localised audit framework by disbanding the Audit Commission, ending its unnecessary functions, allowing for local appointment of auditors, and providing for a more coherent and streamlined approach to the regulation of audit services.

Option 2: Do nothing (the counterfactual).

The Government considers that radical action is needed to move to a new system that delivers its objectives. Doing nothing (or hoping for incremental change) would not deliver the greater localism and transparency that is now needed, nor would it address the wider fragmentation of audit regulation and the duplication that exists.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: From April 2015

<table>
<tr><td colspan="3">Does implementation go beyond minimum EU requirements?</td><td colspan="3">N/A</td></tr>
<tr><td>Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.</td><td>Micro
No</td><td>< 20
No</td><td>Small
No</td><td>Medium
Yes</td><td>Large
Yes</td></tr>
<tr><td colspan="3">What is the CO_2 equivalent change in greenhouse gas emissions?
(Million tonnes CO_2 equivalent)</td><td colspan="2">Traded:</td><td>Non-traded:</td></tr>
</table>

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ______________________ Date: 22/08/14

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Yr 2011/12[i]	PV Base Yr 2010/11	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -	**High: -**	**Best Estimate: 1,351**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-	10	-	-
High	-		-	-
Best Estimate	**79.58**		**98.16**	**896.15**

Description and scale of key monetised costs by 'main affected groups'

Under the new framework, local bodies will incur costs in procuring their own auditors and taking independent advice on the auditor appointment, which is estimated will cost £3.73m per annum. There will be costs to the National Audit Office, the Financial Reporting Council and recognised supervisory bodies for undertaking their roles in the new regime. Audit firms will incur costs if they decide to tender for the increased amount of audit work that is being opened up to the market, as part of their normal course of business.

Other key non-monetised costs by 'main affected groups'

Significant non-monetised costs are not envisaged. However, the ending of the Audit Commission's inspection and assessment regimes, central data collation, and research studies, may mean that some data will no longer be available on a national basis (though it will still be collected as part of each individual audit), and less research and analysis may be undertaken centrally. This loss will be mitigated by a greater role for the National Audit Office, carrying out value for money studies, and local sectors themselves in data collection and improvement activity.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	-	-	-	-
High	-		-	-
Best Estimate	-		**261.09**	**2,247.40**

Description and scale of key monetised benefits by 'main affected groups'

The monetised benefits are largely avoided costs arising from the various elements of the reforms. Local bodies are already seeing significantly reduced audit fees as a result of the outsourcing of the Commission's in-house audit work and the reduction in its top slice (The Audit Commission has estimated £50m pa savings from 2011/12 fee levels)[ii]. The Exchequer is already seeing savings of £29.4m pa from the ending of functions that Government funded directly (see paragraph 113). The private sector will see benefits as the whole local public audit market is opened up to competition.

Other key non-monetised benefits by 'main affected groups'

In appointing their own auditor, local public bodies will be better able to tailor audit services to their local circumstances, for example where there is close partnership working or joint commissioning of services, thus improving the value of the audit outputs. Greater transparency throughout the system will lead to increased pressure for costs to be kept to a minimum. Greater transparency in the appointments process and of audit outputs will increase the ability of the public to hold local decision-makers to account.

[i] This IA uses 2011/12 as a base year for calculating all costs and benefits, hence all prices are in 2011/12 values.

[ii] Audit Commission press notice http://www.audit-commission.gov.uk/2012/04/audit-commission-announces-details-of-50-million-annual-savings-for-public-bodies/

Key assumptions/sensitivities/risks	Discount rate (%)	**3.5**

(1) The timing of the disbandment of the Audit Commission and introduction of the new framework are dependent upon the passage of legislation in Parliament. (2) In the absence of detailed financial forecasts for the final few years of the Audit Commission, a number of assumptions are made. These are subject to some uncertainty and are set out clearly in the notes. (3) The level of audit fees in the new framework is difficult to predict with any certainty as there are a large number of factors that could influence them, as set out in Annex 1.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0	**Benefits: 0**	**Net:**	No	n/a

Evidence Base

1. This impact assessment is in several parts:

   A. Background: What is the Audit Commission?

   B. The problem under consideration and the rationale for Government intervention

   C. The current Audit Commission regime (as in 2009/10: the baseline position)

   D. The new regime: Description of the new framework

   E. Approach to the analysis, underpinning assumptions and the counterfactual

   F. Summary of the costs and benefits of the reforms (monetised and non-monetised)

   G. Analysis of costs in the baseline Audit Commission framework

   H. Analysis of costs in the new local audit framework

   I. Non-monetised costs and benefits

   J. Transitional and other costs

   K. Post implementation review

   Annex 1: Factors affecting future audit fee levels

   Annex 2: Comparison of local bodies' compliance costs under the current and the new local audit frameworks

   Annex 3: Costs and benefits to businesses

   Annex 4: Smaller bodies audit regime

A) Background: What is the Audit Commission?

2. The Audit Commission ("the Commission") was set up in 1983 as a self-funding, independent body. The Commission is a public corporation and is sponsored by the Department for Communities and Local Government (DCLG). It was originally established with a remit relating to local public audit in England and Wales, though functions in respect of Wales are now devolved. Since then its functions have been extended, including into the field of inspection and performance monitoring across approximately 11,000 local bodies that it covers in both the local government and health sectors. From 2002 (2003 for district councils) the Commission was responsible for the system of Comprehensive Performance Assessment, which itself was replaced from April 2009 by the Comprehensive Area Assessment regime.

3. The 11,000 local public bodies audited by the Audit Commission are, together, responsible for some £200bn of public expenditure. Of these bodies, there are 774 principal bodies: 353 local authorities; 263 NHS bodies (in addition to Special Health Authorities audited by the National Audit Office, and Foundation Trusts); 76 police authorities; and 82 other bodies, including the Greater London Authority, fire and rescue authorities; national park authorities; conservation boards; larger internal drainage boards; joint committees; and probation trusts[1]. The remaining are roughly 10,000 'smaller bodies', with turnover below £6.5m, comprising around 9,600 parish and town councils; 130 internal drainage boards; and 270 other bodies (for example, charter trustees and port health authorities).

[1] The audit of the 34 Probation Trusts has become the responsibility of the Comptroller and Auditor General from 2012/13 in accordance with an order under the Government Resource and Accounts Act.

B) The problem under consideration and rationale for intervention

4. There are five key reasons for the Government to intervene and reform the current framework for local public audit, which are explored in more detail below:
   a) Lack of local accountability as a commissioner of audit services;
   b) Lack of transparency and incentive to drive down costs;
   c) Local bodies funding wider non-audit activities over which they have no control;
   d) Duplication across regulatory regimes;
   e) No inherent justification for the public sector to be the main provider of local public audit.

5. This impact assessment estimates the total financial benefit of the reforms will be £1.35bn over ten years. Of this, nearly £759m will be realised in the five year period from 2012 to 2017[2].

(a) Lack of local accountability as a commissioner of audit services

6. Currently, local public bodies have very little influence over who their auditor will be or how much they will pay for that service (though the Commission does consult local public bodies and audit firms before making appointments and setting fees, this is a consultation and does not mean a choice for local bodies). The Government considers that the centralised commissioning of audit services for elected bodies weakens accountability to local people. This is particularly the case for local authorities, which are directly accountable to the electorate for the spending of public money and should be able to make decisions about who provides the services that they are paying for.

7. Centralised commissioning also results in a "one size fits all" approach to local audit, which does not reflect the varied nature of local public bodies or their local circumstances. At present, for example, where there is partnership working or pooling of budgets between local bodies, or local authorities have implemented joint management teams, these bodies often have different auditors. Opportunities are therefore missed for minimising the burden on auditors and improving the usefulness of audit outputs for the local bodies.

8. In its evidence to the Communities and Local Government Select Committee inquiry in 2011 into the audit and inspection of local authorities, the Local Government Association supported the proposal of local public bodies appointing their own auditors. They considered local appointment from an open and competitive market would be a practical expression of the localism and devolution agenda, should help drive down fees, facilitate joint working between authorities, and enable local government to obtain better value from its audit through more locally-specific arrangements[3].

9. In the new framework, each local body will be responsible for appointing its own auditor, following procurement from an open and competitive market. Local bodies will be free to procure and/or appoint jointly with any number of local bodies where this allows them to

[2] Indexed on 2011/12 prices
[3] Evidence submitted by the Local Government Association available on the Parliamentary website at http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we07.htm

reduce costs and reflects local circumstances. Local bodies have indicated they will wish to explore geographical joint appointments in some cases (e.g. neighbouring local authorities, particularly if there are joint working arrangements) while others will wish to explore sector joint appointments (e.g. national park authorities might wish to have a single auditor to develop expertise and consistency of approach).

(b) Lack of transparency and incentive to drive down costs

10. The Commission is required by statute to cover its costs each year. It does this largely through the (mandatory) audit fee that it charges local bodies. This covers both the cost of providing the audit service as well as a top slice that pays for the Commission's corporate costs and certain other functions. In addition to the audit fee, the Commission charges a separate fee to local bodies for discretionary inspections, while other inspection and assessment costs are funded by grants from central Government departments.

11. The embodiment in one organisation of several functions and their complex funding arrangements has resulted in a lack of transparency, with local bodies unable effectively to hold the Audit Commission to account for what it does (and what they pay for). Local people are therefore unable to hold either the Commission to account or their local public body, since it has little influence in the way it is audited. This has meant the Commission has less incentive to minimise costs than local bodies would (e.g. its own corporate costs, the cost base of its in-house practice, and the costs of its private sector audit suppliers).

12. The new framework will be more transparent: the audit fee that a local body pays will relate only to its audit service and will be the result of a transparent procurement process (in accordance with OJEU[4] procedures); the National Audit Office's regulatory functions will be funded separately and clearly accounted for to Parliament, as will the National Audit Office local value for money studies. The costs of each element will therefore be visible individually, increasing transparency and thus the pressure from both those facing costs and the public for costs to be kept to a minimum.

(c) Local bodies funding wider non-audit activities over which they have no control

13. The functions that are funded through the Commission's top slice on audit fees include the production of a significant number of value for money studies, as well as the Commission's liaison with external partners and government. The Government considers that, particularly in these straitened economic times, local bodies should not be funding through their audit fee additional functions over which they have no say and may not see any direct benefit.

14. In the new framework, local bodies will pay their auditor only the audit fee that has been secured in the procurement process. The National Audit Office plans to undertake a small number of local value for money studies, which, subject to the approval of the Public Accounts Commission, will be funded separately by the Exchequer. Additional research, studies and improvement activity may be undertaken by the sectors themselves, and funded either by grants from government or through membership levies (or a combination, e.g. the Local Government Association). In this way, the sectors will be able to decide themselves both the subject and the form of these activities and thus drive maximum value for money from the outputs.

[4] The Office of the Journal of the European Union, i.e. the European-wide standard process for public procurement.

(d) Duplication across regulatory regimes

15. As regulator, the Commission sits alongside and partially overlaps with the more extensive regulatory regime of the Companies Act audit sector.

16. Although there are significant differences between the audit of companies and the audit of local public bodies, it is broadly the same audit firms which undertake audits for both sectors. At the moment, audit firms need to meet a specific set of requirements laid out through the Companies Act 2006 before they can be allowed to act as a statutory auditor for a listed company (some of which derives from EU directives). Alongside this, the same audit firms are required to meet a separate set of requirements set by the Audit Commission in order to act as a statutory auditor for a local public body.

17. Through the Companies Act 2006, recognised supervisory bodies (the professional institutes) and the Financial Reporting Council are required to monitor audit quality and the work of audit firms. At the same time, under the Audit Commission Act 1998, the Audit Commission monitors and assesses local public audit quality by the same audit firms. In practice, in recent years, the Commission has funded the Financial Reporting Council's Audit Inspection Unit to inspect some of the local public audits for which it has responsibility.

18. The House of Lords Economic Affairs Select Committee[5] criticised the fragmentation in the regulation of audit services. It said that "the regulation of accounting and auditing is fragmented and unwieldy with manifold overlapping organisations and functions. This is neither productive nor necessary … further impetus needs to be given to rationalisation and reform".

19. With this in mind, the Government considers that disbanding the Audit Commission and moving the regulation of the local public audit regime to the Financial Reporting Council and professional bodies provides opportunities to merge the two systems and, as far as is possible, reduce this duplication. This approach will therefore help to remedy some of the fragmentation that currently exists across different audit systems and offer greater coherence to the regulatory framework.

(e) No inherent justification for the public sector to be the main provider

20. Historically, the Commission has acted as the main provider in the current system, with 70 per cent (by value) of the audits of principal local bodies being undertaken by its in-house practice, and the remaining 30 per cent by private sector audit firms under contract to the Commission. For smaller bodies this ratio is reversed, with 30% of audits undertaken by the in-house practice, and 70% undertaken by the private sector. The Commission's in-house practice is well-respected. However, the Government does not believe that there is a compelling rationale for the audit practice – the fifth largest provider of audit services in the UK – to remain in the public sector. The Government has prioritised the need to tackle the budget deficit inherited from the last Administration, and considers that the State should focus on doing what is essential and that, where services can be provided by the private, voluntary or not-for-profit sectors, they should be given the opportunity to bid for the available work.

21. In 2011, as an interim step towards disbandment, the Government therefore asked the Commission to outsource the work of its in-house practice with effect from 2012/13, under

[5] Second report of the 2010/11 session: Auditors: market concentration and their role, paragraph 110. Available on the Parliamentary website at: http://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/119.pdf

its existing powers. As a direct result of this work being done by the private sector, the cost of external audit will reduce by £30m per annum[6]. Combined with the ending of its assessment and inspection functions, its efficiencies programme and its slimming down prior to closure, the outsourcing will allow the Commission to reduce its cost base from Autumn 2012[7], generating further savings of £19m pa[8]. This total saving (on 2011/12 costs) of around £50m per annum - £250m over the five-year period of the contracts – will allow the Commission to reduce audit fees for local bodies by up to 40% on 2011/12 levels[9].

22. When local bodies appoint their own auditors from 2017/18, they will be procuring from the private sector in a similar way. Currently, contract size represents a barrier to entry to the local audit market, and under the new regime with lower value and more numerous contracts on offer, there will be greater opportunities for smaller audit firms to enter the market.

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[6] Audit Commission press notice http://www.audit-commission.gov.uk/2013/04/audit-commission-continues-drive-to-reduce-audit-costs/

[7] The Audit Commission's corporate cost base is reducing from £48m in 2009/10 (Audit Commission Supplementary evidence to the CLG Select Committee, see http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we15.htm) to a forecast £8.4m in 2013/14 (Audit Commission forecasts).

[8] Audit Commission press notice http://www.audit-commission.gov.uk/2012/04/audit-commission-announces-details-of-50-million-annual-savings-for-public-bodies/

[9] Audit Commission press notice http://www.audit-commission.gov.uk/2012/04/audit-commission-announces-details-of-50-million-annual-savings-for-public-bodies/

C) The current Audit Commission regime (as in 2009/10: the baseline position)

23. The Audit Commission has several different functions:

    a) Overseeing local public audit: as regulator, commissioner and provider of local external audit services;

    b) Making arrangements for certifying claims and returns in respect of grants or subsidies from Government departments, such as council tax benefit and contributions payable to the national non-domestic rating pool;

    c) Undertaking assessment and inspection of various local bodies (e.g. inspection of best value authorities, and Comprehensive Performance Assessment and then Comprehensive Area Assessment until its cessation in June 2010);

    d) Undertaking or promoting value for money and research studies: including those aimed at improving the financial management of health service bodies, and the economy, efficiency and effectiveness in the provision of services by or the financial management of local government bodies; and

    e) Conducting data matching exercises in order to assist in the prevention and detection of fraud, through the National Fraud Initiative.

24. The Commission has three main statutory functions in relation to local public audit:

    a) Acting as the overall <u>regulator</u>, the Commission:

        (i) publishes two statutory codes of audit practice - one for local government bodies and one for health bodies - which are approved by Parliament and set out the work that auditors are required to undertake in discharging their statutory responsibilities. A schedule to the code of audit practice sets out the work that auditors are required to do for the audit of smaller bodies (with an annual turnover below £6.5m);
        (ii) stipulates the eligibility criteria for individuals and firms to be auditors;
        (iii) monitors the quality of audit; and
        (iv) provides guidance for auditors in undertaking their duties;

    b) Acting as the <u>commissioner</u>, the Audit Commission appoints auditors to all local public bodies, either from its in-house practice or from firms contracted to the Commission;

    c) As the main <u>provider</u> in the current system, 70% of local public audits by value have historically been undertaken by the Commission's in-house practice and 30% outsourced to private sector audit firms (for the audit of smaller bodies 30% are undertaken by the Commission's in-house practice and 70% by private sector audit firms). From 2012/13 until its abolition, all audit work will be undertaken by private sector audit firms following the outsourcing of the work of the Commission's in-house practice.

For the purposes of this impact assessment, the financial year 2009/10 is used as the baseline position, since this was the final full year of operation of the Audit Commission prior to the beginning of the programme to disband it and implement a new local audit regime. This is fully explained at paragraph 59.

D) The new regime: description of the new framework

25. The creation of the new regime can be broadly summarised as:

  a) the transfer of existing functions (currently performed by the Audit Commission) to other bodies; and
  b) the ceasing of certain functions.

26. The below table summarises broadly what is proposed in relation to the various functions.

Table 1: Changes proposed to activities previously undertaken by the Audit Commission

Function	Proposed action	Date of change
Regulation of local audit	To be transferred to Financial Reporting Council, professional accountancy bodies and National Audit Office	From April 2015
Commissioning local audit	To be transferred to local public bodies (after 2 years of Independent Company set up by LGA running the contracts	Following the end of the outsourced contracts (last financial year 2016/17)
Providing local audit	To be transferred to private sector audit firms	Already transferred under outsourcing (from Autumn 2012)
Comprehensive Area Assessment	Ceased	June 2010, as assessment was a discretionary power
Routine inspection and annual assessment of local government	Ceased (The Secretary of State will retain the power to intervene and call for an inspection where necessary)	June 2010, as inspection was a discretionary power
Research and value for money studies	To be reformed: the National Audit Office will continue to be able to examine the impact of Government policies administered by local bodies, and identify and report on wider issues as part of its programme of value for money studies which will complement the sector’s own self-improvement work.	Audit Commission reports being phased out from Summer 2010, with the National Audit Office undertaking their first reports in 2014-15
National Fraud Initiative	To be transferred to Cabinet Office	In April 2015.

Counter Fraud Tools	To be transferred to Chartered Institute of Public Finance and Accountancy	In April 2015
Value for Money Tools	To be transferred to Transitional Body for the duration of the contracts	In April 2015
Co-ordination of grant certification work	To cease: certification, where it still remains, will be done through a mix of self-certification and free standing tri-partite arrangements	As existing grant funding streams are reformed / phased out

Regulation of local audit

27. The Government's intention is to mirror, as far as is appropriate, the arrangements for regulation of external audit in the private sector (much of which is set out in the Companies Act 2006), with additional arrangements to reflect the broader scope of the audit of local public bodies.

28. Building on the arrangements that are already in place to regulate the audit of companies and other entities in the private sector (where fee income is worth £2bn per annum[10]) and the arrangements for other parts of the public sector (such as Foundation Trusts), the roles envisaged for the Financial Reporting Council, recognised supervisory bodies and recognised qualifying bodies offer the opportunity to exploit existing expertise and synergies and thus minimise the cost of providing the regulation.

29. Similarly, as the auditor of some 460[11] central government bodies and accounts, the National Audit Office has expert knowledge of the nature and requirements of public sector audit and is therefore well placed to prepare and maintain the code of audit practice for local public audit and associated guidance for auditors.

30. In the Audit Commission framework, all its oversight and overhead costs are covered by the audit fees charged to local bodies. Where private sector firms are doing the audit work (from autumn 2012 it is being wholly done in the private sector), in order to take part in the local audit market, they agree to surrender a 'top slice' of the audit fees they collect to the Audit Commission, which is passed on to local bodies. An element of this top slice is directly used to cover the costs relating to the Commission's regulation of the audit firms local public audit work, with the rest covering other Commission functions and overheads.

31. In the new audit framework, the National Audit Office will take on responsibility for setting the code of audit practice and providing guidance to auditors, and the costs of this will form part of the National Audit Office's budget which is scrutinised and agreed annually by Parliament. The Financial Reporting Council will become the overall regulator and its costs will be factored into its budget. The Financial Reporting Council currently covers its core oversight costs by charging a levy on audited bodies and professional institutes. Additionally the Financial Reporting Council undertakes a quality review of a sample of audits, and these costs are charged through the recognised supervisory bodies to audit firms. It is difficult to anticipate the changes to fees and levies to any degree, but as the

[10] *Key facts and trends in the accountancy profession*, June 2011, Financial Reporting Council Professional Oversight Board, http://www.frc.org.uk/Our-Work/Publications/POB/Key-Facts-and-Trends-in-the-Accountancy-Profession.aspx
[11] *National Audit Office Strategy 2012-13 to 2014-15*

regulatory framework will mirror as far as possible that for the private sector audit regime, there should be economies of scale.

32. In practice, we would expect all regulatory costs (except those falling to the National Audit Office) to be factored into the level of audit fees paid by local public bodies, as they are now. As the regulatory costs relating to the National Audit Office's role will form part of their budget, agreed by Parliament, and the firms will no longer make a contribution to the overheads of a central body, we consider that the cost of regulation covered by firms and recovered through audit fees should be lower than currently.

33. A new framework will also include a proportionate regulatory regime for smaller local public bodies (with a turnover below £6.5m - Annex 4 gives further details). The National Audit Office will produce a schedule to the code of audit practice, as the Audit Commission does at present, specifying the scope and audit arrangements of the limited assurance as the type of audit for smaller bodies. There will be a more limited role for the recognised supervisory bodies in regulating the sector.

Commissioning local audit

34. The commissioning function in the new framework will be transferred to local public bodies, which will acquire responsibility for appointing their own external auditors. All principal local public bodies (those with income/expenditure over £6.5m) will be under a duty to appoint an auditor.

35. Local public bodies will have the flexibility to jointly procure an auditor with other bodies, which could enable savings to be realised through economies of scale. In addition, following an amendment made during the passage of the Local Audit and Accountability Bill, the Government intends to allow (through secondary legislation) for the establishment of a sector-led collective procurement body. Under such arrangements, local public bodies would be able to choose to have an auditor appointed on their behalf by an 'appointing person' established by the sector and specified by the Secretary of State. This could enable further savings by enabling the sector to establish large-scale collective procurement arrangements.

36. All principal local public bodies that choose to make their own appointment (and do not opt-in to any sector-led collective arrangements) will be required to take advice from an "independent auditor panel" whose role will be to:

    a) provide advice on the appointment of an auditor; and

    b) advise the local body on the maintenance of an independent relationship with its auditor, to ensure independence is maintained.

37. A panel will be able to provide advice to more than one body, so joint panels and joint procurement will be possible where local bodies decide that is right for local circumstances.

38. Local public bodies are already responsible for procuring large volumes of goods and services in order to discharge their wider functions: local government's procurement, for example, totalled around £62bn per annum in 2009/10, of which £27.4bn was paid to external contractors[12]. The Government considers there should be no barriers in terms of

[12] Local Government Financial Statistics England, No. 21, 2011, Table 3.4a (Department for Communities and Local Government). Available at: http://www.communities.gov.uk/documents/statistics/pdf/1911067.pdf

expertise that would prevent local bodies procuring their external auditors, subject to the appropriate safeguards to protect auditor independence.

39. Various safeguards will be in place to uphold high standards of auditing and to ensure consistency in the nature of audits across local public bodies. Requirements relating to the production of accounts and the process for appointing an independent auditor will be set out in legislation. The National Audit Office will produce a code of audit practice, supported by detailed guidance, setting out how local auditors undertake their work, and will also undertake locally focused value for money studies. There will also be guidance produced by the Chartered Institute of Public Finance and Accountancy relating to the procurement of audit services. Indeed, the ability to procure an auditor on a more local basis may mean that some bodies are able to appoint a more appropriate auditor than that which they would be appointed under the current regime.

40. Smaller bodies will also have the option of appointment through a sector-led body (more details in Annex 4). This follows a proposal from the sector to establish such a body. This is a proportionate and localist approach that should preserve the current economies of scale in procurement whilst preserving independence of appointment. Smaller bodies will still be able to procure and appoint auditors by themselves or jointly with other bodies if they so wish, following the arrangements for larger bodies.

Re-procuring auditors

41. In the new framework, the audited body will be required to make a new appointment at least every five years. Therefore, the costs associated with the procurement of the auditor will be an ongoing cost on a five-yearly basis. While the same firm may be re-appointed following competition, the existing ethical standards[13] will continue to apply, including Ethical Standard 3: long association with audit engagement.

Auditor indemnity

42. In the current framework, the Audit Commission offers an indemnity to its private sector contractors if they should face litigation arising out of their statutory audit functions. The costs of cases against in-house auditors not recovered from the other side are also met by the Commission, and are passed on to audited bodies in audit fees, so in effect the indemnity is extended to the Commission's own auditors. In practice, calls on the indemnity are infrequent. Between 2008 and 2013, the indemnity has been used twice and there have been four instances of legal action against the auditor.

43. The Local Audit and Accountability Act 2014 makes provision for auditors to recoup reasonable costs relating to their time spent undertaking their statutory duties, but, in the new framework, there will be no central body to offer indemnity to the auditor where legal costs are not fully recovered from the other side, as the result of an auditor taking or defending legal action. The Government believes that it is appropriate for private companies to bear the risks and costs (subject to the usual rules on legal costs) for any consequences resulting from the exercise of their functions. Furthermore the Government believes that this will not unduly deter auditors from exercising their statutory functions as the indemnity has been used so infrequently. Given that auditors have only faced legal action four times out of the approximately 4,370 audits of principal local bodies undertaken in a five year period (a rate of less than 0.01%), it is expected that the additional costs

[13] The ethical standards are available on the Financial Reporting Council's website at: http://www.frc.org.uk/Our-Work/Codes-Standards/Audit-and-assurance/Standards-and-guidance/Standards-and-guidance-for-auditors/Ethical-standards-for-auditors.aspx

should be minimal. Moreover, we expect many local bodies and firms will wish to agree a limit on indemnity to be included in the contract, which should prevent this becoming a significant upward pressure on fees.

Providing local audit

Scope of audit

44. In the new audit framework, the broad scope of audit as set out in the legislation will remain the same and so, in broad terms, the cost of providing the audit service is not expected to change.

45. As the body responsible for the code of audit practice, the National Audit Office would determine the overall approach to be adopted by auditors when reaching their conclusion on local bodies' arrangements to secure value for money. The National Audit Office will undertake consultation before publishing or updating the code.

46. The National Audit Office is committed to a risk-based, proportionate approach that focuses on the issues that matter. Depending on local circumstances, this could mean some local bodies having a reduced audit burden, while some bodies may require more extensive audit work. Ultimately, the amount of work undertaken will be a matter for agreement between the auditor and the local body itself.

Smaller bodies (limited assurance regime)

47. Approximately 10,000 smaller bodies (those with turnover below £6.5m) are subject to a separate, limited assurance regime operated by the Commission. Historically, 70% of the audits have been done by private sector firms under contract to the Commission, and 30% in-house. From 2012/13, however, 100% of the work has been outsourced to private firms. Owing to the different nature of the limited assurance regime, the market for this work differs from that for principal bodies, often involving medium-sized audit firms.

48. In the new framework, the limited assurance regime will continue, and will be specified in a schedule to the code of audit practice.

49. At the moment all smaller bodies with an annual turnover of £6.5m or less, have an auditor appointed who undertakes a limited assurance review. Since 2006/7 bodies with a turnover below £1,000 have had their audit paid for by the Commission, and from 2012/13 this will be extended to all those with an annual turnover below £10,000. In the new regime, bodies with a turnover below £25,000 will no longer be subject to routine external audit on an automatic annual basis, although they will still have an auditor nominated to field any complaints from local electors. Instead, bodies with turnover below £25,000 will be subject to increased transparency requirements. Annex 4 sets out further details on the proposed audit arrangements for smaller bodies and the potential impact on audit fees for smaller bodies, but does not make an assessment of the costs of audit for smaller bodies.

Public interest reporting and unlawful spending

50. The functions of auditors in relation to public interest reporting and unlawful spending will remain the same, and we would therefore expect the costs to remain unchanged. There will be a new requirement for local bodies to publish public interest reports, for example on their website, which we do not expect will impose any additional costs.

Objections to accounts

51. Currently, auditors have little discretion to refuse to investigate objections raised by an elector. The costs of investigating objections can sometimes be disproportionate to the sums involved and these costs are then passed onto the local public body. In the new framework, auditors will be given greater discretion to decide whether or not to reject vexatious, repeated or frivolous objections made by electors to the accounts. We expect this should act as a downward pressure on audit fees.

Research and value for money studies

52. The Audit Commission's statutory duties in relation to undertaking or promoting value for money studies will cease. The National Audit Office will undertake a small number of additional value for money studies each year, with a focus on sector-wide systemic issues and end-to-end scrutiny. The Government supports such an approach. The sectors themselves are also considering a greater role in improvement activity, including research reports, which will place more emphasis on issues the sectors consider will be able to add greatest value.

National Fraud Initiative

53. The Government is committed to retaining the National Fraud Initiative as part of its commitment to tackling fraud in the public sector. In July 2013, the Government announced that the National Fraud Initiative would transfer to the Cabinet Office. The move to the Cabinet Office will allow the National Fraud Initiative to continue and develop its existing work in line with government activities to tackle fraud, error and debt. The relevant data matching powers will be transferred, in their entirety, to the Minister for the Cabinet Office, in April 2015. Since it is self-financing (by means of a fee charged to participating organisations) we would expect the costs and benefits of this to remain equivalent in the new framework, and it is treated as operating on a full cost recovery basis, after the closure of the Commission, for the purposes of this impact assessment. As part of its wider work on transition, the Department is working with the Audit Commission and Cabinet Office to refine financial plans for the National Fraud Initiative.

Routine inspection and assessment of local government

54. The Coalition Agreement set out the Government's intention to cut local government inspection and abolish the Comprehensive Area Assessment, all of which were halted in 2010.

Grant certification

55. In the new framework, there will be no central body responsible for putting in place arrangements for grant certification in respect of grants or subsidies from government departments. Instead, certification will be undertaken through a combination of free-standing, tri-partite arrangements and other forms of certification (i.e. self-certification or through internal audit). Local public bodies will therefore be responsible for procuring the necessary certification work to meet the grant conditions. In the future, this may either be done as part of its procurement of the external auditor for the annual audit or as a separate exercise.

E) Approach to the analysis, underpinning assumptions and the counterfactual

Overall approach

56. The cost-benefit approach taken in this impact assessment is, of necessity, high-level in that it compares the underlying costs associated with the baseline (2009/10) local audit framework with those attributed to the proposed new local audit framework. By implication, we assume that the difference between these two represents the ongoing cost or benefit attached to the proposed reforms.

57. In addition, various one-off costs are incurred as part of the transition to implementing a new local audit framework. These up-front transitional costs are subtracted from the total ongoing cost/benefit in order to arrive at the overall net benefit associated with the reforms.

58. Costs data has been drawn principally from the Audit Commission, both from its published sources and via iterative communication with them.

Baseline – the counterfactual

59. For the purposes of this impact assessment, the financial year 2009/10 is used as the baseline position, since this was the final full year of operation of the Audit Commission prior to the beginning of these reforms. The baseline of 2009/10 therefore constitutes the counterfactual: the functions and associated costs of the Audit Commission framework as they were prior to the announcements by the Government in July and August 2010 of the end to Comprehensive Area Assessment and the abolition of the Commission. While it is recognised that the Audit Commission had plans to make efficiency savings in line with the wider public sector, the radical reduction in its cost base (and therefore the fees it charges to local bodies) from 2010/11 onwards was made possible by Government's requests that it cease assessment and inspection activities, outsource the work of its in-house practice and streamline prior to closure.

Rolling programme of reform

60. The reforms covered by this impact assessment are a rolling programme over several years, beginning with the announcements in 2010 of the ending of assessment and inspection and the disbandment of the Commission, and ending with the full implementation of local auditor appointment from April 2017. The costs and benefits associated with each of the elements are therefore phased in during the course of the 10-year period.

61. Owing to the significant reduction in overall fee levels during the 10-year period, and since many of the benefits are only realised towards the end of that period, the average figures taken across the period significantly under-represent the full savings of the new framework compared with the baseline position.

62. The Government introduced the necessary primary legislation in 2013 and the Local Audit and Accountability Act was granted Royal Assent in January 2014. Elements of the new audit framework will therefore be introduced from 2015/16, with local bodies gaining the

freedom to appoint their own auditors from 2017/18 at the end of the contracts. Table 2 below sets out the key milestones that underpin the assumptions about the timing of implementation.

Table 2 - Key milestones

Financial year	Key milestones in implementing the new framework
2010/11	• Ending of assessment and inspection, including Comprehensive Area Assessment • Announcement of disbandment of the Audit Commission
2012/13	• Outsourcing contracts take effect; Audit Commission staff transfer to private sector.
2014/15	• Final year of Audit Commission framework • Residual Audit Commission closes (before April 2015, subject to the Parliamentary timetable)
2015/16	• The NAO and FRC take on regulatory responsibilities. Cabinet Office take on National Fraud Initiative • Chartered Institute of Finance and Accountancy take on Fraud tools • Outsourcing contracts are transferred to transition body to run their remaining two years.
2017/18	• Local bodies appoint their own auditors from the start of the financial year

Key assumptions

63. As far as possible, figures quoted in this impact assessment relate to the Commission's annual report and accounts, which have been audited and are published on their website. Since the Commission's financial position for 2009/10 was restated in their 2010/11 Annual Report and Accounts in order to reflect the relevant disclosure requirements, those figures are quoted where possible. This means that, although references may be to the 2010/11 Annual Report and Accounts, 2009/10 year remains the baseline year for analytical purposes. Other figures are quoted where possible from publicly available sources. The Audit Commission has contributed to the figures used in this impact assessment. Assumptions made by DCLG are clearly explained where relevant.

64. One of the key assumptions underpinning this impact assessment relates to the level of audit fees. The outsourcing of its in-house practice, the ending of inspection and assessment activity, and its general slimming down towards closure has allowed the Commission to significantly reduce its cost base over the period and therefore reduce the level of audit fees it charges local bodies. Combined with the strong competition which has driven good prices from firms, this has therefore allowed the Commission to reduce audit fees for local bodies by up to 40% for the final few years before the new audit framework is implemented, which the Audit Commission estimates will save the public purse a total of £50m per annum[14] (on 2011/12 fee levels). The Commission has also recently retendered around 30% of the existing audit contracts originally let in 2006 and 2007. They have estimated that this will allow fees to be reduced by a further 25% in 2015/16 and

[14] The Audit Commission announced fee reductions for 2012/13 of up to 40% on 2011/12 levels, see its press notice at: http://www.audit-commission.gov.uk/2012/04/audit-commission-announces-details-of-50-million-annual-savings-for-public-bodies

2016/17[15]. There is no indication this would have occurred without the previous Ministerial decision

65. When the new framework is introduced, this low level of fees will set the benchmark for local bodies as they seek to appoint their own auditors. Starting from such a low benchmark will offer local bodies the opportunity to negotiate competitive fee levels. The removal of the top slice on fees charged by the Audit Commission will offer an even lower benchmark.

66. Nonetheless, once the market is opened up, analysis[16] suggests there could be additional factors that may affect fee levels (as expected in a competitive market). Given this, our analysis assumes that fee levels will be somewhere within a range of +/-10% around existing fee levels, as explained below and in Annex 1 in more detail.

67. Further assumptions are made relating to the costs and benefits to businesses of both the current Audit Commission framework and the new framework. These assumptions, which are based on the best currently identifiable evidence, are explained in more detail in Annex 3. The department intends to work with the sectors to refine these estimates and would welcome evidence (either as part of pre-legislative scrutiny or directly) in this regard.

68. All estimates of future audit fee levels are based on assumptions about the audit requirements for and number of potential new bodies following reforms in the police and health sectors.

[15] The Audit Commission announced the results of the retender and expected savings in March 2014: http://www.audit-commission.gov.uk/2014/03/the-audit-commissions-legacy-includes-a-further-25-per-cent-reduction-in-annual-audit-fees/
[16] Including from independent advice commissioned by DCLG in report by FTI Consulting Ltd, which is published here: https://www.gov.uk/government/publications/request-for-information-on-the-impact-of-audit-commission-reform-on-local-authority-audit-fees

F) Summary of costs and benefits of the reforms (monetised and non-monetised)

Costs of current Audit Commission framework

69. Table 3 below summarises the costs which this impact assessment monetises, associated both with the existing local audit framework, and those associated with moving to the new framework. There are other associated costs, and benefits, which are not monetised for reasons of data availability, which are summarised further below. The sections below consider each of the monetised costs in turn, and sets down the approach to our analysis. The table overleaf summarises the total costs and benefits.

Table 3 – Summary of monetised costs analysed

Costs of current framework	**Costs of new framework**	
Underlying costs	***Underlying costs***	***Transitional & other costs***
Providing external audit	Providing external audit	Redundancy costs
Regulating local audit including Audit Commission corporate costs	Regulating local audit	Pension liabilities
Non-audit functions	*Continuing* non-audit functions transferred elsewhere	Termination of leases/contracts
Cost to local bodies of compliance	Cost to local bodies of compliance	Preparatory works

Overall conclusion

70. Table 4 overleaf summarises our estimate of underlying costs associated with the current and proposed local audit frameworks (the subsequent sections explain how those figures have been derived). It implies an estimated net benefit of £1.347bn over the ten-year period, of which around £759m will be realised in the five year period from 2012 to 2017. Once the new framework has been fully implemented there will be an estimated annually reoccurring benefit in the region of £200m from 2018/19, compared with the baseline year. There are, however, ranges underlying many of the figures used in the table, such as the estimated total audit fees in the new framework.

71. Table 5 summarises the benefits to taxpayers in terms of the avoided costs for local bodies, and the avoided costs for central government. This implies that once the new framework is fully implemented local bodies will see an annually reoccurring benefit of around £174m from 2018/19, with that to central government calculated at around £26m.

72. The total annual cost of the local audit regime in the final year of the residual Audit commission in 2014/15 is estimated at £87m. The total annual cost of the local audit regime from 2018/19, once the new arrangements have bedded in, is estimated at £61m.

Table 4 – Summary of costs and benefits over the 10-year period (£m)

	Baseline	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Across 10-year period		
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total	Average	NPV total
Annual Costs														
AC framework														
Income														
Audit fees paid by local bodies (includes income from NFI and PbR until 11/12)	175.53	167.00	154.12	113.88	87.30	81.60	0.00	0.00	0.00	0.00	0.00	**603.90**	**60.39**	**572.07**
CAA and other inspection/assessment income (Govt grants and fees)	35.21	14.24	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**14.24**	**1.42**	**14.24**
Other income (includes investment and rent income and income from NFI and PbR from 12/13)	2.74	2.84	2.23	6.70	2.00	2.00	0.00	0.00	0.00	0.00	0.00	**15.77**	**1.58**	**14.80**
One-off rebate to local bodies	0.00	0	0.00	0.00	-8.00	-4.00	0.00	0.00	0.00	0.00	0.00	**-12.00**	**-1.20**	**-10.70**
Contribution from reserves	9.59	26.72	0.00	0.00	7.20	1.40	0.00	0.00	0.00	0.00	0.00	**35.32**	**3.53**	**34.43**
Sub-total: AC income	223.07	210.80	156.35	120.58	88.50	81.00	0.00	0.00	0.00	0.00	0.00	**657.23**	**65.72**	**624.84**
Expenditure														
Paid to firms for outsourced audit work	40.15	40.68	36.34	45.80	79.80	74.70	0.00	0.00	0.00	0.00	0.00	**277.32**	**27.73**	**255.62**
Paid to researchers, contractors and consultants	14.31	4.46	6.42	6.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**17.47**	**1.75**	**16.82**
Costs of in-house auditors (minus overhead)	99.30	94.36	66.50	35.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**196.26**	**19.63**	**191.65**
Cost of assessment/inspection (minus overhead)	21.31	18.23	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**18.23**	**1.82**	**18.23**
AC statutory responsibilities, support and overhead costs (includes NFI and PbR costs)	48.00	38.00	23.25	15.40	8.10	8.30	0.00	0.00	0.00	0.00	0.00	**93.05**	**9.30**	**89.38**
Transitional liabilities	0.00	15.10	18.20	2.20	1.80	1.70	0.00	0.00	0.00	0.00	0.00	**39.00**	**3.90**	**37.84**
Stranded costs	0.00	0.00	0.00	8.60	-1.20	0.30	0.00	0.00	0.00	0.00	0.00	**7.70**	**0.77**	**7.21**
Surplus: contribution to reserves	0.00	-0.02	5.65	6.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**12.21**	**1.22**	**11.58**
Sub-total: AC expenditure	223.07	210.80	156.35	120.58	88.50	85.00	0.00	0.00	0.00	0.00	0.00	**661.23**	**66.12**	**628.32**
Local bodies' compliance costs (ie. CAA compliance)	25.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**0.00**	**0.00**	**0.00**
Total AC framework annual costs	**248.57**	**210.80**	**156.35**	**120.58**	**88.50**	**81.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	657.23	65.72	624.84
Transition framework annual costs														
Audit fees	0.00	0.00	0.00	0.00	0.00	0.00	58.13	58.13	37.58	0.00	0.00	**153.83**	**15.38**	**125.76**
Paid to firms for outsourced audit work	0.00	0.00	0.00	0.00	0.00	0.00	52.50	52.50	33.90	0.00	0.00	**138.90**	**13.89**	**113.56**
Contract management (transitional body)	0.00	0.00	0.00	0.00	0.00	0.00	3.00	3.00	2.75	0.00	0.00	**8.75**	**0.88**	**7.13**
FRC and prof bodies regulatory costs	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.00	0.00	**0.75**	**0.08**	**0.61**
Surplus	0.00	0.00	0.00	0.00	0.00	0.00	2.38	2.38	0.68	0.00	0.00	**5.44**	**0.54**	**4.47**
Total transition framework annual costs	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**58.13**	**58.13**	**37.58**	**0.00**	**0.00**	153.83	15.38	125.76

	Baseline	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Across 10-year period		
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total	Average	NPV total
New framework														
Audit fees paid directly by local bodies to their auditor (includes costs of regulation by FRC and professional bodies)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	20.33	54.00	54.00	**128.33**	**12.83**	**96.60**
NAO regulatory costs	0.00	0.00	0.00	0.00	0.00	0.00	1.10	1.10	1.10	1.10	1.10	**5.50**	**0.55**	**4.33**
NAO VfM studies	0.00	0.00	0.00	0.60	1.10	1.98	1.98	1.98	1.98	1.98	1.98	**13.58**	**1.36**	**11.07**
Local bodies compliance costs (ie. procurement and independent panel members)	0.00	0.00	0.00	0.00	0.00	0.00	3.73	3.73	3.73	3.73	3.73	**18.65**	**1.87**	**14.68**
Total new framework annual costs	**0.00**	**0.00**	**0.00**	**0.60**	**1.10**	**1.98**	**6.81**	**6.81**	**27.14**	**60.81**	**60.81**	**166.06**	**16.61**	**126.68**
Total annual costs of the regime	**248.57**	**210.80**	**156.35**	**121.18**	**89.60**	**82.98**	**64.94**	**64.94**	**64.71**	**60.81**	**60.81**	**977.11**	**97.71**	**877.27**
Total annual costs of the regime in 2011/12 prices	**261.09**	**215.30**	**156.35**	**121.18**	**89.60**	**82.98**	**64.94**	**64.94**	**64.71**	**60.81**	**60.81**	**981.61**	**98.16**	**881.77**
Transition costs														
Additional transition costs														
DCLG transition costs	0.00	0.00	11.90	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	**11.90**	**1.19**	**11.50**
NAO transition costs (excl. VfM studies)	0.00	0.00	0.00	1.00	1.10	1.10	0.00	0.00	0.00	0.00	0.00	**3.20**	**0.32**	**2.88**
Total additional transition costs	**0.00**	**0.00**	**11.90**	**1.00**	**1.10**	**1.10**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**15.10**	**1.51**	**14.38**
Transition costs already accounted for in AC budgets above														
Audit Commission transition costs	*0.00*	*25.83*	*19.90*	*12.40*	*4.50*	*1.30*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	***63.93***	***6.39***	**61.82**
Total transitional costs	***0.00***	***25.83***	***31.80***	***13.40***	***5.60***	***2.40***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***79.03***	***7.90***	76.21
Revised Total Transition Costs in 2011/12 prices		***26.38***	***31.80***	***13.40***	***5.60***	***2.40***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***79.58***	***7.96***	76.76
Total transition and annual costs	**261.09**	**215.30**	**168.25**	**122.18**	**90.70**	**84.08**	**64.94**	**64.94**	**64.71**	**60.81**	**60.81**	**996.71**	**99.67**	**896.15**
Baseline costs	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**261.09**	**2,610.92**	**261.09**	**2,247.40**
Avoided costs (net benefit)	**0.00**	**45.79**	**92.84**	**138.91**	**170.39**	**177.01**	**196.16**	**196.16**	**196.38**	**200.28**	**200.28**	**1,614.21**	**161.42**	**1,351.25**
Net Present value of avoided costs	**0.00**	**45.79**	**89.70**	**129.68**	**153.68**	**154.26**	**165.16**	**159.57**	**154.35**	**152.10**	**146.95**	**1,351.25**	**135.13**	**1,351.25**

Explanation of Table 4 (further detail can be found in the relevant sections of the text below)

1. Audit fee income is shown by financial year, not by audit year (since the audit year continues post-April, e.g. for local government until September). So figures for each financial year include audit fees relating to both the audit of the accounts for the previous year (April-Sept) as well as audit work undertaken in the new financial year (Sept-April). Figures for 2009/10 and 2010/11 are from the Commission's annual report and accounts 2010/11 p42, and figures for 2011/12 from the Audit Commission’s annual report and accounts 2011/12 p48. The figures for 2012/13 are from the Commission’s annual report and accounts 2012/13 p.61. Figures for 2013/14 and 2014/15 are Audit Commission estimates from the MTFP 2014-15, p9.. These figures include income from the Payment by Results initiative up until 2011/12 (Payment by Results is due to end in 2012/13) and the National Fraud Initiative. The Audit Commission estimate for audit fee income in 2015/16 is £77.5m and so that figure is used from 2015/16 for the remainder of the outsourced contracts to 2016/17, with a 25% reduction applied, based on

information set down within the Commission's press release dated 28 March 2014. The small reductions in audit fees during the period of the outsourced contracts relates to estimated small reductions in audit volumes, such as NHS trusts achieving Foundation Trust status which removes them from the Audit Commission's regime. (Though Ministers have made clear they plan to disband the Audit Commission as soon as practicable, the Government intends to transfer the contracts to another body so they can run their course, and so fees paid by local bodies are forecast to remain steady until those contracts expire).

2. Figures for Comprehensive Area Assessment and other assessment/inspection costs are taken from the Audit Commission's annual report and accounts 2010/11, p42.

3. Figures for other income in 2009/10, 2010/11 and 2011/12 are updated figures provided by the Audit Commission in September 2012.and include income from the National Fraud Initiative, investments and rent. The figures for 2012/13 are Audit Commission estimates (Medium Term Financial Plan July 2012) and include figures for NFI and outstanding income from the Payments by Results initiative Figures for 2013/14 and 2014/15 are Commission estimates taken from the MTFP 2014/15, p9.

4. The rebates to local bodies of £8.0m in March 2014, and £4m in March 2015, has been taken from the Audit Commission MTFP 2014-15, p2. It represents for the purposes of this IA a transfer from reserves to local bodies.

5. Figures for contribution from reserves for 2009/10, 2010/11 and 2011/12 are updated figures provided by the Audit Commission in September 2012. These have been adjusted to take account of IAS19 pension adjustments. Figures from 2012/13 to 2014/15 are Audit Commission estimates (Medium Term Financial Plan July 2012).

6. The amount paid to private sector suppliers for delivering audit services in 2009/10 and 2010/11 is taken from the Audit Commission annual report and accounts 2010/11 p60, and the amount for 2011/12 from the Audit Commission's annual report and accounts 2011/12 p65. The figure for 2012/13 is taken from the Audit Commission's annual report and accounts 2012/13, Table 3.2 p.78. Figures for 2013/14 and 2014/15 are Audit Commission estimates (Medium Term Financial Plan 2014/15, March 2014). Following the outsourcing, all work will be undertaken by private sector suppliers, and therefore all costs are shown as being paid to firms. The full extent of this reduction will only feed through in 2013/14 (because of the mismatch between financial year and audit year the Audit Commission estimates that these costs will reduce slightly each year, reflecting small reductions in fee income).

7. Amounts paid to researchers, contractors and consultants for 2009/10 and 2010/11 are taken from the Audit Commission annual report and accounts 2010/11 p60, and the amount for 2011/12 from the Audit Commission's annual report and accounts 2011/12 p65. Figures for 2012/13 are taken from the Audit Commission's annual report and accounts 2012/13, p78. Subsequent years are Audit Commission estimates (Medium Term Financial Plan March 2014).

8. The costs of in-house auditors are derived as follows. For 2009/10 and 2010/11, the Commission's staff and other operating costs are combined (Audit Commission annual report and accounts p42). From this total is subtracted the proportion of the Audit Commission's statutory responsibilities, support and overhead costs (see note 9 below) that is estimated as being allocated to audit, in order to avoid double-counting. For 2009/10, the assumption is that £40m of the £48m statutory responsibilities / support / overhead costs relate to audit and the remaining £8m allocated to assessment/inspection costs. An addition of £2.03m is then made to take account of IAS19 pension adjustments. Therefore, the calculation for 2009/10 is £103.39m + £33.89m -£40m+£2.03m = £99.30m. The same calculation is used for 2010/11:£99.21m + £25.86m - £32m+£1.288 = £94.36m. The figures of £66.5m for 2011/12 and £35.4m are Audit Commission estimates. For the first half of 2012/13, the Audit Commission's in-house practice will complete the audits of the 2011/12 accounts, before staff transfer to the private sector audit firms that won the outsourcing contracts. From 2013/14, therefore, there are no costs of in-house audit work as it is all undertaken by the private sector.

9. Figures for the costs of assessment/inspection (which includes Comprehensive Area Assessment) are calculated by taking the estimated overhead allocated to these functions (£8m in 2009/10 and £6m in 2010/11 – Audit Commission additional evidence to CLG select committee) from the costs for assessment/inspection shown in the Audit Commission's annual report and accounts 2010/11 (in order to avoid double-counting). For 2009/10, this is £29.31m

as shown on p42 of the accounts, less £8m of the £48m overhead costs (see note 9 below). For 2010/11, the calculation is £24.23m less £6m of the £38m overhead costs. There are therefore no costs from 2011/12 onwards.

10. The figures in 2009/10 and 2011/12 for the Audit Commission's statutory responsibilities, support and overhead costs are taken from the Audit Commission's Supplementary Evidence to the Communities and Local Government Select Committee Summer 2011 (http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we15.htm). In the absence of more detailed data, the figure for 2010/11 is an estimate, reflecting the downward trajectory. The figure for 2012/13 is an Audit Commission upper-bound estimate and includes costs for the National Fraud Initiative and outstanding costs for the Payment by Results Initiative (Medium Term Financial Plan July 2012). Figures for 2013/14 and 2014/15 are derived from the Medium Term Financial Plan, 2014-15, p9 and are calculated from a total of 'net Commission costs' and 'NFI costs'.
11. Transitional liabilities: these figures need to be read in conjunction with the transitional costs section of the table. The figures are from the Audit Commission, though only included on this row are costs which are incurred as a result of the disbandment of the Commission and which DCLG assumes are being met from within the Audit Commission's budgets.
12. Figures shown as surplus (contribution to reserves) are calculated by taking away the items of Audit Commission expenditure listed from their income shown in the sub-total above in the table. These figures therefore record any surplus income that DCLG is unable to identify as being spent elsewhere.
13. Compliance costs come from the Office of Public Management Study 'Establishing the costs of Comprehensive Area Assessment' (2010) and a Deloitte study 'Measuring the Workload: Public Sector Performance Reporting and Inspection Regimes in Leicestershire' (2009); see Annex 2 for more details.
14. During the years 2015-16 and 2016-17 the Audit Commission will have been disbanded and a new regulatory regime introduced. However, the contracts outsourced by the Commission from 2012-13 will still be running. Therefore the costs during this period of transition between frameworks have been separated out.
15. Whilst the contracts are running it is assumed that the amount paid to firms will remain the same as under the Audit Commission framework, and it is assumed that audit fees will remain at the same level. The Audit Commission estimates that fees in 2015/16 and 2016/17 will be £77.5m, with the costs paid to auditors being £70m. The costs in 2017/18 relate to fee payment for the audit of the accounts for the final year of the outsourced contracts (2016/17), which will fall in the following financial year due to the mismatch between audit year and financial year. Revised estimates of payments to firms have been produced by reducing the Audit Commission estimates by 25% based on information provided in AC Press Release dated 28 March 2014.
16. The costs of contract management in the years 2015/16 to 2017/18 are based on estimates provided by the Audit Commission to DCLG in correspondence in May 2014.It is assumed that this includes the costs of contract management and quality assurance of audits. DCLG assumes that this is an upper bound estimate of the contract management costs. The estimated costs of managing the contracts in 2017/18 lower as this role will only last for part of the year.
17. Regulatory costs for the years 2015/16 – 2017/18 are based on Audit Commission estimates, provided in correspondence in May 2014.
18. The surplus shown is the difference between what local bodies will pay in audit fees and what will be paid to firms for the work, and has been included for consistency as some of this may be needed to cover transitional costs (see note 22).
19. Audit fees in the new framework are shown from 2017/18 when local bodies begin appointing their own auditors (assuming that 2016/17 will be the final year of outsourcing contracts where auditors are appointed and the fee scale fixed centrally by the body those contracts are transferred to, following the disbandment of the Audit Commission). The level of fees paid to audit firms in the final years of those contracts is taken as the starting point for fees in the new framework, since that level will set the benchmark for local bodies to procure their own auditors. Under the Audit Commission framework, the fees paid by local bodies also covered regulation of the system, and it is assumed that this will continue in the new regime, as the regulatory bodies will pass any additional charge to firms for this function, who may then pass the cost on to audited bodies. Therefore those regulatory costs relating to the Financial Reporting Council and the professional bodies (but not those relating to the National Audit Office's role, which, subject to parliamentary approval, will be funded separately) will be included in the fees.

Therefore the sum of £2m has been added on. Revised estimates for fees in the years 2017/18 to 2019/2020 have been derived by applying a 25% reduction based on information contained in the Audit Commission Press Release dated 28 March 2014. The uncertainty about the level of fees once the whole market is opened to competition is recognised and explored in more detail in the sections below and in Annex 1.

20. The National Audit Office has suggested that its regulatory costs in respect of the new framework (i.e. for preparation of the code of audit practice) will be £1.0m (based on information in the NAO 2014/15 – 2016/17 Strategy), with the addition of £0.1m to cover communication and engagement costs. Subject to Parliamentary approval, the National Audit Office's costs will be funded directly, whereas those falling to Financial Reporting Council/professional bodies have been included in audit fees, as currently.

21. The figures for the National Audit Office local value for money studies are based on information in the NAO 2014/15 – 2016/17 Strategy. The direct costs of VFM studies have been included pro-rata (6/8ths of £2.5m) with the addition of £0.1m for communication and engagement costs attributed to each of the VfM studies. All costs are assumed to stay constant after 2016/17.

22. Local bodies' compliance costs in the new framework consist of the costs of undertaking a procurement process and remunerating independent panel members in order to make the auditor appointment, as set out in Annex 2.

23. Transition costs are shown to each organisation in the year in which DCLG forecasts they are to be incurred (rather than the year in which they are accounted for). Costs to the National Audit Office are included in the overall totals, since they constitute additional costs to the taxpayer, whereas costs to the Audit Commission are largely being met from within their own operating budgets (including a one off payment of £11.9m provided by DCLG in 2011/12).

    The National Audit Office costs are taken from the National Audit Office Supply Estimate Memorandum 2012-13 (this was provided to The Public Accounts Commission and is available at: http://www.parliament.uk/documents/public-accounts-commission/06-009818-001-NAOResourceEstimate2012-13_FINALproof.pdf) reduced by the costs of undertaking value for money studies (as per note 20 above), to avoid double-counting.

    The Audit Commission's annual report and accounts 2010/11 (p62) shows that the Audit Commission incurred £10.72m redundancy costs in 2010/11 as a result of reducing its corporate costs, and p63 shows it incurred £15.1m in redundancy costs as a result of the ending of its assessment and inspection (totalling £25.83m in 2010/11)., Figures for 2011/12 include £19.9m redundancy costs taken from the Audit Commission's 2011/12 accounts (p.67), and also include the one off payment of £11.9m from DCLG towards redundancy liabilities. In addition, the Audit Commission's July 2012 Medium Term Financial Plan is forecasting stranded and transitional costs of £10.8m in 2012/13, whilst its March 2014 Medium Term Financial Plan is forecasting stranded and transitional costs of £0.6m in 2013/14, and £2.0m in 2014/15. On closure, it may also face lease liabilities of £9m. For the sake of simplicity, the table does not attempt to capture the true picture in 2015/16, where the body that takes on the outsourcing contracts will receive income for the first half of the financial year relating to the audits of the previous year's accounts and the residual Audit Commission will face closedown costs that ordinarily might have been funded from that income stream.

24. For clarity, the Commission's Payment by Results exercise for the NHS and the National Fraud Initiative are included in figures to the end of 2014/15. The former ceases in 2012/13 and the National Fraud Initiative will be transferred to another body from 2015/16 onwards. The National Fraud Initiative is self-financing (by means of a fee charged to participating organisations) and we would expect the costs and benefits of this to remain equivalent in the new framework. The body to whom the National Fraud Initiative is transferred in 2015 may wish to review this but for the purposes of this impact assessment, the initiative is treated as operating on a full cost recovery basis and these figures are therefore not included from 2015/16 onwards.

Table 5 – Summary of net benefits (avoided costs) to the taxpayer (£m, at 2011/12 prices)

	Baseline	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Across 10-year period		
	2009-10	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Total**	**Average**	**NPV total**
Cost to Central Government														
CAA/inspection costs	29.42	13.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	13.16	1.32	**13.16**
New framework costs to central government (NAO regulatory costs and VFM studies)	0.00	0.00	0.00	0.60	1.10	1.98	3.08	3.08	3.08	3.08	3.08	19.08	1.91	**15.40**
Additional transitional costs (DCLG+ NAO)	0.00	0.00	11.90	1.00	1.10	1.10	0.00	0.00	0.00	0.00	0.00	15.10	1.51	**14.38**
Total Costs	29.42	13.16	11.90	1.60	2.20	3.08	3.08	3.08	3.08	3.08	3.08	47.34	4.73	**42.94**
Baseline Costs	29.42	29.42	29.42	29.42	29.42	29.42	29.42	29.42	29.42	29.42	29.42	294.24	29.42	**253.27**
Avoided Costs (net benefit)	**0.00**	**16.26**	**17.52**	**27.82**	**27.22**	**26.34**	**26.34**	**26.34**	**26.34**	**26.34**	**26.34**	**246.90**	**24.69**	**210.33**
Cost to Local Bodies	231.67	202.14	156.35	120.58	88.50	85.00	61.86	61.86	61.63	57.73	57.73	953.37	95.34	**856.70**
Baseline costs	231.67	231.67	231.67	231.67	231.67	231.67	231.67	231.67	231.67	231.67	231.67	2,316.69	231.67	**1,994.13**
Avoided costs (net benefit)	**0.00**	**29.53**	**75.32**	**111.09**	**143.17**	**146.67**	**169.81**	**169.81**	**170.04**	**173.94**	**173.94**	**1,363.31**	**136.33**	**1,137.43**

1. The cost of Comprehensive Area Assessment/inspection to central government is taken from the Audit Commission's annual report and accounts 2010/11, p. 63.
2. The new framework costs to central government are taken as the sum of the National Audit Office's regulatory costs and the National Audit Office's other costs as given in Table 4.
3. The additional transitional costs to central government are calculated as in Table 4.
4. The cost to local bodies is calculated by subtracting the cost to central government from the total annual and transition costs given in Table 4. This approach has been taken in order to capture both clearly identifiable charges and costs for local bodies (audit fees (inc. other regulatory costs), Comprehensive Area Assessment/inspection fees, compliance costs), and the other Audit Commission income and reserves, which it is assumed originates from fee income paid by local bodies.

Table 6 – Indirect costs and benefits to business (£m, in 2011/12 prices)

	Baseline	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Across 10-year period		
	2009-10	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Total**	**Average**	**NPV total**
Costs/benefits to business														
Benefits to business (potential profit - included in audit fees in table 4)														
Benefits (potential profit)	8.39	8.27	7.23	9.11	15.88	14.87	10.45	10.45	10.79	10.75	10.75	**108.54**	**10.85**	**92.86**
Benefit compared with baseline	0.00	-0.12	-1.16	0.72	7.49	6.47	2.06	2.06	2.40	2.35	2.35	**24.61**	**2.46**	**20.63**
Costs to business (included in table 4 in fees charged by audit firms)														
Cost of tendering	1.08	1.08	1.08	1.02	1.02	1.02	1.02	1.02	2.18	2.18	2.18	**13.79**	**1.38**	**11.54**
Contribution to System Costs	13.14	9.62	9.90	12.97	7.80	7.70	2.00	2.00	2.00	2.00	2.00			
Total Cost to Business	14.22	10.70	10.98	13.99	8.82	8.72	3.02	3.02	4.18	4.18	4.18	**71.78**	**7.18**	**64.45**
Baseline cost to business	14.22	14.22	14.22	14.22	14.22	14.22	14.22	14.22	14.22	14.22	14.22	**142.20**	**14.22**	**122.40**
Avoided Costs	0.00	3.52	3.24	0.23	5.40	5.50	11.20	11.20	10.04	10.04	10.04	**70.42**	**7.04**	**57.96**

1. This table is included to show the effects of opening up the market to firms, and how the costs to businesses decrease over the course of the reform period. The costs decrease as in this new market audit firms will no longer surrender a 'top slice' of their audit fees to pay for the Audit Commission's running costs, but may instead pay a smaller charge to cover regulatory costs levied by the Financial Reporting Council and recognised supervisory bodies. We consider that these costs and benefits are indirect and therefore 'out of scope' of one-in, one-out because they will only be incurred by firms if they choose to take part in the newly opened-up market.
2. Businesses that choose to participate in the local public audit market will see new indirect costs and benefits as a result of the reforms. The costs of tendering for work will increase as audit firms tender to a larger number of bodies; however, the potential profit available to firms will also increase as a result of opening up the local public audit market fully to the private sector. Furthermore, whereas under the Audit Commission regime firms would surrender a proportion of the audit fees to the Commission which the Commission used to help cover its costs, now the only charge that may be passed to firms is that for regulation. These costs/benefits are indirect, as only those that choose to bid for work will incur costs or have access to the benefits.
3. As the benefit to businesses is indirect, and since it is assumed that firms recoup their costs through audit fees charged to local bodies, and their profit margin (benefit) is also already included within the total audit fees paid by local bodies, the costs/benefits to business are shown separately to the overall regime costs (in Table 4) in order to avoid double-counting.
4. The costs and benefits to business are calculated as set out in Annex 3. The benefit is calculated as a proportion of the work available to the private sector, taking 20% as the approximate margin (on the basis of publicly available information from major audit firms).
5. For the procurement costs, firstly it is assumed that each firm that wishes to tender for work will incur an up-front initial cost in making calculations about the audit requirements of each category of local public body (county councils, district councils, health bodies, police and crime commissioners, etc), the firm's own costs and its desired margins. There is then a smaller cost for completing the tender documentation for each contract lot that is being bid for. Since the procurement costs will be incurred at the point of procurement, they are then annualised over the expected duration of the contracts. The costs show in three broad phases: when the amount of work available was 30% of the market (2009/10 - 2011/12), during the interim phase when 100% of work was outsourced by the Audit Commission (2012/13 – 2016/17), and when local bodies appoint their own auditors (from 2017/18 under expected five-year contracts).
6. The contribution to system costs is calculated as follows: under the Audit Commission framework firms surrender part of the fee income they collected from local bodies back to the Commission. This 'top slice' is calculated by taking the proportion of the work undertaken by firms in each year as a percentage of the fees paid in that year, and subtracting the amount paid to firms (from Table 4 above). From 2009/10 to 2011/12 firms undertook 30% of audits, and from 2013/14 they undertook 100% of audits. 2012/13 is a transition year between the two, and in the absence of better data the figure is calculated by taking the mid-point of the

firms share of fees in 2011/12 (£44.58m) and in 2013/14 (£83.5m). From 2015/16 firms will no longer contribute a top slice to the Commission as it will have been disbanded, therefore the only cost in the system potentially faced by firms will be for regulation by the Financial Reporting Council and professional bodies for which a figure of £2m has been used (see note 20 to Table 4 above).

7. As the costs to businesses are already included in the fees charged, which in turn have been used to calculate the profit, the changing costs have not been combined with the benefit to avoid double counting.

G) Analysis of costs in the baseline Audit Commission framework

73. Costs associated with the current local audit framework overseen by the Commission broadly comprise:
    a) The audit fees paid by local public bodies, which fund:
        (i) the cost of providing external audit;
        (ii) the cost of regulating local public audit; and
        (iii) the cost of certain non-audit functions, including value for money reports;
    b) The cost of other non-audit functions not funded through the audit fee; and
    c) The cost to local bodies of compliance with the framework.

74. Additionally, businesses choosing to take part in the local audit market will incur costs in tendering for work. This is outlined at (d) below.

a) (i) Audit fees paid by local public bodies: The cost of providing external audit

75. Each local public body pays an audit fee each year to the Commission. The Commission sets the level of gross scale fees, so that each category of local body pays the same gross scale fee. The gross scale fee is then adjusted according to the budget of the body, the complexity of its accounts, and the auditor's assessment of risk.

76. Where (up to Autumn 2012) the auditor is an employee of the Commission's in-house practice, the fee funds the audit work carried out and also a contribution to the practice's overheads. Where the auditor is a private sector audit firm, the fee funds the audit work, a contribution to the Audit Commission's overheads, and also includes a profit margin for that firm (since all the contracts last several years, the prices must be sustainable for firms and therefore include some profit margin).

77. Historically, around 70%-75% of the audit fee has related directly to the audit services, and the remaining 25%-30% top slice[19] has funded the Commission's regulatory functions, certain other functions, and its corporate costs. In 2009/10, the Audit Commission estimated that its support and overhead costs amounted to £48m, out of income of around £223m, a top slice of 22%.

78. The ending of the Commission's assessment and inspection functions, the outsourcing of its in-house audit work, and streamlining of other functions as it prepares for closure, have enabled the Commission to radically reduce its

[19] The Audit Commission's annual report and accounts for 2008/09 (p46) show that its costs were £63.5m less than the total £213.6m income, which is a top slice of 29.7% (the £63.5m includes a surplus of £11.4m which arose for various reasons and was largely added to reserves). In 2009/10, the Commission's corporate costs were £48m (in its evidence to the Communities and Local Government Select Committee, available at http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we15.htm, out of total income of £223m (see table 4), which equates a top slice of 22%. In 2013/14, the Commission forecasts its corporate costs will be £8.4m pa out of total audit fees of £83.1m, a 10% top slice.

corporate costs from £48m in 2009/10 down to £23m in 2011/12[20] and forecast these to drop to around £8.1m in 2013/14 and £8.3m in 2014/15[21]. Combined with the good prices achieved in the outsourcing, this has enabled the Commission to reduce its top slice and the fees paid by local public bodies.

79. The direct cost of providing audit services in 2009/10 was £139.45m. This consists of the £40.15m the Commission paid to private sector firms to deliver audit (for the 30% of work that was then outsourced) plus the £99.30m estimated cost of the in-house auditors (calculated as set out in note 8 to Table 4 above).

a) (ii) Audit fees paid by local public bodies: Cost of regulating local public audit

80. In the Audit Commission framework, regulatory costs are covered by the audit fees charged to local public bodies. When work is carried out by firms, the Commission retains a percentage of the fees that are charged and collected by audit firms. This 'top slice' thereby acts as a charge to firms, which is passed onto local bodies, that is used to cover the Commission's costs, including those assignable to its regulatory functions.

81. In 2009/10, the Commission estimates that, of the £48m total top slice, the direct costs of its regulatory function accounted for £3m, studies and research for £5m, £15m for Government and stakeholder engagement, policy and analysis, and £2m to governance. It is assumed the remaining £23m related to support and overhead costs for all the Commission's functions, including those regulatory functions and the in-house practice.[22]

82. Based on Audit Commission forecasts for 2013/14 and 2014/15, it is estimated that approximately £1.25m pa of the Audit Commission's corporate costs relates to managing the outsourced audit contracts for 2013/14 and 2014/15. In the final two years of the outsourced contracts, 2015/16 and 2016/17, it is assumed that the residual Audit Commission will have been disbanded and that another body will need to take on management of these contracts. The costs remaining in the system under the 'Transitional Framework' in 2015/16, 2016/17 and 2017/18 will relate to managing the contracts and any associated activities such as changes to auditor appointments where issues arise. An estimate of £1.25m has therefore been used for 2015/16 and 2016/17, and an estimate of £1m for 2017/18 as this role will only last for part of the year.

a) (iii) Audit fees paid by local public bodies: Cost of certain non-audit functions

83. A proportion of the top slice on audit fees funds the Commission's production of value for money and research studies. In 2009/10, the direct cost of this amounted to £5m[23] (there will have been some additional overhead/support costs).

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[20] Supplementary written evidence submitted by the Audit Commission to the Communities and Local Government Select Committee, available on the Parliamentary website at: http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we15.htm

[21] Audit Commission forecast from their 2013 Medium Term Financial Plan.

[22] Audit Commission Supplementary written evidence to the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities, 2011.

[23] Audit Commission Supplementary written evidence to the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities, 2011.

b) Cost of other non-audit functions not funded from the audit fee

84. Certain other of the Commission's non-audit functions are funded directly by central government, such as Comprehensive Area Assessment (£21m in 2009/10[24]) and other inspections (for example, of registered providers of social housing), grants for which totalled £7m in 2009/10[25], a cost to central government of £28m.

85. The Commission also charges specific fees to local bodies where it undertakes a discretionary inspection (for example, considering strengths and weaknesses in service outcomes and how these could be improved). These fees totalled £7.2m in 2009/10[26]. The total income derived from fees and grants from assessment and intervention in 2009/10 was therefore £35.2m[27].

c) Compliance costs to local bodies

86. In addition to audit fees and separate discretionary inspection fees, local bodies incur costs through compliance with the current Commission regime. While there are some costs of complying with the financial audit component of the current framework, these consist largely of staff time engaging with the auditor and are difficult to quantify. Since they are expected to remain constant in the new audit framework, these costs are treated as being cost-neutral for the purpose of this impact assessment.

87. There are also costs to local bodies and auditors arising from the need to liaise with a third party (the Commission) in relation to the initial appointments process, and ongoing monitoring and reporting during the audit year. These are difficult to quantify.

88. The wider assessment under the terms of Comprehensive Area Assessment, however, was widely held to have imposed significant compliance and cooperation costs on local public bodies. For the purpose of this impact assessment, the cost to local bodies of compliance with Comprehensive Area Assessment is estimated in the region of £11.8–£39.2 m per year, and we use a midpoint figure of £25.5m[28].

89. Table 7 below summarises the costs associated with the existing framework under each of the eight key headings:

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[24] Audit Commission annual report and accounts 2010/11, note 5 p63.
[25] Audit Commission annual report and accounts 2010/11, note 5 p63.
[26] Audit Commission annual report and accounts 2010/11, note 5 p63.
[27] Audit Commission annual report and accounts 2010/11, note 5 p63.
[28] See Annex 2.

Table 7 – Costs of existing framework to the public sector

Type of cost	Estimate of total cost in baseline year	Forecast costs in 2014/15 (final year of residual Audit Commission)
Paid to firms for outsourced audit work	£40.15m	£74.70m
Paid to researchers, contractors and consultants	£14.31m	-
Costs of in-house auditors (minus overhead)	£99.30m	-
Cost of assessment/inspection (minus overhead)	£21.31m	-
Audit Commission statutory responsibilities, support and overhead costs	£48.00m	£8.3m
Transitional liabilities	-	£1.7m
Stranded Costs	-	£0.3m
Surplus: contribution to reserves	-	-
Cost to local bodies of compliance	£25.50m	-
National Audit Office value for money studies	-	£1.98
Total costs	**£248.57m**	**£86.98m**

Note: these are estimates and forecasts, and their limitations as estimates must be acknowledged. Estimates of baseline costs are in 2009/10 prices; estimates of forecast costs are based on 2011/12 prices. The variation reflects the fact that this is how the Audit Commission provided the data. Table 4 adjusts these values to standardise them to 2011/12 prices.

d) The cost to businesses in tendering for the audit work that is not done in-house by the Commission, and of contributing to the Commission's costs through passing back the 'top slice' on audit fees

90. These costs and benefits are not included separately in Table 4, calculating the overall cost of the regime, as they are part of the fees charged to the Audit Commission under the existing framework. Additionally, firms only incur these costs or realise benefits if they choose to bid for work.

91. Historically, since its creation, the Commission has outsourced 30% (by value) of the audit work for principal bodies to private sector firms, though that proportion is at the Commission's discretion (it has been open to the Commission to outsource anywhere between 0%-100% of the work). The Commission has usually divided the work into individual lots worth £2m each, and awarded five-year contracts.

92. In asking the Commission to outsource the remaining 70% of the market from 2012/13, the Government suggested average lot sizes of £10m in order to strike a balance between on the one hand protecting as many jobs as possible, retaining expertise in the marketplace and minimising costs to the taxpayer (by ensuring

Commission staff transferred to winning suppliers in accordance with TUPE[29]) and, on the other hand, allowing a range of firms to bid for work. As part of the procurement process, bidding firms were offered data relating to the Audit Commission staff likely to transfer to them under TUPE, so that firms could factor these costs into their tenders. While it is assumed that firms reflected some of these costs in the prices bid, acquiring Commission staff also offered firms significant benefits in terms of both capacity and valuable expertise. The structural changes to the market and the commissioning function mean that, when local bodies come to appoint their own auditors from 2017/18, there will be no TUPE implications and so former Commission staff will simply be treated in the same way as any other existing employees of firms.

93. Owing to the specialised nature of audit (governed by the requirements of the accountancy professional bodies) and the specialised nature of local public sector audit in particular, audit firms tend to be of a certain size reflecting the need for appropriate capability and capacity. Of the 32 firms listed in the Financial Reporting Council's key facts and trends in the accountancy profession[30], published June 2011, 22 fall within the category of a large company (250+ employees) and seven are medium (50-249 employees), and it has not been possible to ascertain the size of three firms.

94. This impact assessment assumes that, in undertaking work for the Commission, firms will bid at prices that still allow them to make a margin of profit, not least because the prices need to be sustainable over the minimum five years' duration of the contract. In the absence of data on the actual margins that suppliers to the Audit Commission make on the prices bid, an assumption is made that the margin will be similar to that on firms' wider audit work, which audit firms' transparency reports suggest to be around 20%. In the baseline year of 2009/10, when 30% of the work was outsourced, this potential profit margin (benefit) is estimated at £8.39m per year[31]. Annex 3 explains the origin of these figures in greater detail.

95. Audit firms that decided to participate in these procurement exercises run by the Commission will have incurred costs in the preparation of their tenders, relating largely to staff time. Firstly, in firms making calculations on a generic level about the work associated with the variety of local bodies that are in each lot and the firm's own costs, desired profit margins etc. Secondly, in applying those calculations to each of the lots available. Thirdly, particularly given the large value of the work on offer in a single procurement, firms will have devoted significant senior resource to consider their bidding strategy. Taking as a starting point the figures suggested in a report by the National Audit Office and the Audit Commission, A review of collaborative procurement across the public sector,[32] and making a series of assumptions about the costs involved, this impact assessment estimates the costs to firms around £1.08m per year in 2009/10.

96. Additionally, firms that decided to tender for the work outsourced by the Audit Commission bid on the basis of the percentage of fees charged by the Commission that the firms themselves will receive for the work. The rest of the fee

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[29] The Transfer of Undertakings (Protection of Employment) Regulations 2006
[30] Last published in June 2011 and available at: http://www.frc.org.uk/pob/publications/pub2592.html
[31] Indexed to 2011/12 prices.
[32] http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

is thereby a ‘top slice’ payable to the Commission by the firms carrying out audit work, which is ultimately passed on to local bodies. Taking the difference between the percentage of fees assignable to firms (30%) and the amount the Commission paid to firms, this impact assessment estimates the firms’ contribution to system costs in the baseline year (2009/10) as **£13.14m**[33].

97. However, these costs will have been factored into audit firms’ costs before calculating their profits. Therefore, in order to avoid double counting, the costs of bidding for work, whether successful or not, are taken as already accounted for in the calculation of profit for the baseline year. The baseline benefit of the regime is therefore £8.39m per year[34].

[33] Indexed to 2011/12 prices.
[34] Indexed to 2011/12 prices

H) Analysis of costs in the new local audit framework

98. The costs (and therefore the avoided costs/benefits) associated with the new audit framework arise from a combination of the different elements of the overall reform package, which are being phased in over the 10-year period. The approach taken here involves, where possible, using costs under the current framework adjusted for changes proposed to the nature or scope of current functions; and drawing on recent research examples in order to estimate the costs associated with functions that are fundamentally changed. The difference in costs between the current framework and the new framework represents the net cost/benefit of the reforms.

99. Underlying costs associated with the proposed, new local audit framework broadly comprise the following, with an indication of their expected implementation date:

    (a) The cost to local bodies of their external audit service – from 2017/18;

    (b) The cost of regulating local public audit – from 2017/18;

    (c) The cost of other continuing non-audit functions currently performed by the Audit Commission that will be transferred elsewhere – from 2015/16; and

    (d) The cost to local bodies of compliance with the new audit framework – from 2017/18.

100. Additionally, there will be indirect costs and benefits to businesses as a result of the reforms. These comprise the benefits of opening up the market to private sector firms, the decreasing contribution to system costs made by the firms, and the cost to businesses in tendering for audit work to local bodies. This is outlined at (e) below.

(a) Cost to local bodies of their external audit service

101. In the new local audit framework, local bodies' audit will be provided by private sector audit firms. The freedom for local bodies to appoint their own auditor is expected to be implemented from the start of the 2017/18 financial year after expiry of the outsourced contracts in March 2017. The cost of the audit will depend on the level of fees that local bodies are able to procure from an open and competitive market.

102. In the new framework, local bodies will pay their fee directly to their auditor (unless they decide to participate in any sector-led collective procurement arrangements). The top slice on audit fees that is used to fund the Audit Commission will no longer exist.

103. The level of audit fees in the final year of the outsourcing contracts will therefore set the benchmark from which local bodies can begin negotiations. With the 40% reductions in fees for 2012/13 onwards (on 2011/12 levels), and the removal of the remaining top slice that funds the Commission's annual corporate costs, the low level of fees should offer a good starting point for local bodies. While local bodies may not realise the whole of this saving when they procure their auditors themselves, there should be plenty of scope to negotiate fees well below the level

that the Commission was charging in 2009/10 prior to the announcement of these reforms. Taking the firms' charges in 2016/17 and incorporating regulatory costs of £2m as the fee level baseline, Table 4 estimates fees from 2018/19 as being £54m per year.

104. In the long-term, fees will be determined by the market, and so are difficult to predict with certainty. Independent advice indicates that the movement of fee levels is subject to too many variables to be certain about the direction of travel[35]. On the one hand, certain factors are likely to exert downward pressure on audit fee levels – including local bodies procuring directly from an open and competitive market, the removal of the Commission as the "middle man" in the existing relationship between local bodies and their auditors, the potential for joint procurement, including larger-scale sector-led collective procurement arrangements, and reducing data and communication burdens., On the other hand, factors such as the increased tendering requirements to be placed on audit firms wishing to participate in the new local bodies audit market (auditors will submit bids to multiple bodies as opposed to currently just one) and decreased buying power on the part of local bodies commissioning their own audit services, may exert a degree of upward pressure on fee levels.

105. The Government is optimistic that there is scope for local bodies to negotiate competitive audit fees from the newly-opened market. A potentially comparable situation is the creation of NHS Foundation Trusts, when they were empowered to appoint their own auditors, and fees appear to have fallen. Our independent financial advisers noted that "experience in the NHS Foundation Trusts audit market since it opened up to competition suggests strong tendencies to concentration – but also fee reductions (at least in the short-run)"[36]. Annex 1 considers the range of factors which is likely to exert pressure, both upwards and downwards, on future fee levels in more detail.

106. Ultimately, recognising the absence of complete and certain information about the future level of audit fees, this impact assessment takes the figure for the direct cost of audit in 2016/17 as the final year of the outsourcing contracts£52.5m as the starting point for the cost of fees in the new regime, adds on the £0.25m regulatory costs which it is envisaged will continue to be passed to local bodies, and applies a sensitivity range of 10% either side of this figure of **£47.5m - £58m per year** as the estimated cost to local public bodies in audit fees under the new local audit framework. This choice of a relatively broad range reflects the uncertainty around future market activity, as explained in Annex 1. **For each additional 5% increase or decrease, these figures would change by +/- £2.6m.**

Table 8 – Range for fees in new framework

Scenario describing future audit fee levels	Estimated total cost to local public bodies in audit fee payments

[35] Future of Local Public Audit report by FTI Consulting Ltd for DCLG, published here https://www.gov.uk/government/publications/request-for-information-on-the-impact-of-audit-commission-reform-on-local-authority-audit-fees
[36] Ibid p14.

10 % decrease on current levels	£47.48m
Equal to current levels	£52.75m
10 % increase on current levels	£58.03m

107. Given the uncertainties, our best estimate for the incremental benefit/cost of future audit fees for local bodies is zero compared to fee levels in 2015/16.

(b) Regulatory costs

108. While the Audit Commission is set to be abolished under the proposed reforms, some of its functions will continue to be exercised through different groups or bodies under the new local audit framework. Accordingly, a proportion of the regulatory costs of the Audit Commission regime will be present under the new framework.

109. The Government considers that the regulatory costs in the new framework will be no greater – and should be less – than those present in the current Audit Commission regime. In evidence to the Communities and Local Government Select Committee in 2011, the Audit Commission estimated that, of their £48m costs, £3m directly related to their regulatory responsibilities. It is estimated that in the final years of the residual Audit Commission around £0.3m of the Commission's governance/support costs will relate to the regulatory function. This puts the total regulatory cost at £3.3m per annum in the final years of the residual Audit Commission.

110. Since regulatory and oversight functions will continue to be exercised – albeit through a different set of agencies – under the new framework, a regulatory cost equivalent to that of £1.35m per year is assumed to be present. In practice, the actual cost may differ for a variety of reasons. While the fact the regulatory function is being split between several bodies arguably might exert an upward pressure on costs, those bodies already have considerable expertise in their respective areas and an existing infrastructure, which should exert a downward pressure on costs. Given the available synergies, the Government's intention is that costs should be lower and certainly no higher than the current regulatory costs. Accordingly, a 20% sensitivity has been applied to £1.35m to reflect the uncertainty around this figure, putting the estimated range for the purposes of this impact assessment at **£1.08m – £1.62m per year.** .

111. In practice, some of this will be a cost to the National Audit Office, which will be scrutinised and agreed by Parliament, and ultimately falling to the Exchequer, while the costs of the Financial Reporting Council and the recognised supervisory bodies may either be absorbed or be passed on ultimately to audit firms who may pass the cost to local bodies (as is the case in the current framework). For the purposes of this impact assessment, the costs of regulation relating to the Financial Reporting Council and professional bodies continue to be counted as funded by the audit fees paid by local bodies. This is consistent with where the costs fell under the Audit Commission framework, and how in practice they are likely to be recovered. As it will be a statutory requirement for all relevant public bodies to appoint an auditor, this cost will be spread across all of them. Of the £1.35m, it is assumed that roughly £1.1m will relate to the National Audit Office's

role, and around £0.25mm to that of the Financial Reporting Council and the professional bodies. Hence whereas previously all regulatory functions and Audit Commission overheads were funded through audit fees, now only those falling to the Financial Reporting Council and the professional bodies will be funded this way.

(c) Other continuing non-audit functions

112. Whilst not directly replacing the Audit Commission's value for money studies programme, there is an opportunity for the National Audit Office to enhance the assurance it provides to Parliament, and identify and share good practice, by developing gradually its own value for money programme to include a small number of studies relating to local government. As the Audit Commission phases out its value for money reports, the National Audit Office will begin undertaking a small number of studies, which more explicitly take in delivery by local government, thus giving a more end-to-end, systemic view on the use of public money. The National Audit Office will not be undertaking the full range of types of studies that the Audit Commission did. The National Audit Office has estimated the costs of its studies at some £275,000 each and it expects to produce around six reports a year from 2014/15. This would be a significant reduction on the number of studies previously produced by the Audit Commission, which in 2009/10 was 16 studies with a budget of £5m (an average of £312,500 per study). In the new framework, the annual cost of local value for money studies would total **£1.7m**, compared to a current cost of £5m a year, an annual **saving** of **£3.3m per year**.

113. The Commission's routine inspection and assessment activities were halted during 2010/11 and ceased fully from 2011/12. In 2009/10, central government funded Comprehensive Area Assessment at an annual cost of £21m, and provided grants for specified inspections at an annual cost of £7m, meaning a total annual current cost to central government of £28m[37]. In 2010/11, when Comprehensive Area Assessment and inspection was halted, central government paid reduced grants of £9.7m and £3.1m respectively, a total of £12.9m[38]. Compared to the baseline cost to central government, of £28m, this resulted in a saving to central government of £15.1m in 2010/11 (£16.3m at 2011/12 prices). From 2011/12 onwards, central government will no longer provide any funds to the Commission for assessment or inspection, meaning the Government will realise annual savings from 2011/12 of £29.4m[39]. The total benefit to central government over the 10-year period totals £240m.

114. Local bodies incurred additional fees as a result of discretionary inspections of £7.2m[40] in 2009/10. From 2010/11, when discretionary inspections were reduced, local bodies incurred fees of £1.4m[41]. From 2011/12, discretionary inspections have ceased, which results in annual savings to local bodies of £7.6m[42] from 2011/12. However, the Commission still has the power to undertake an inspection in exceptional circumstances. Table 9 displays the savings to local bodies and central government from the ending of inspection and assessment functions.

[37] Audit Commission annual report and accounts 2010/11, p63
[38] Audit Commission annual report and accounts 2010/11, p63
[39] £28m uplifted to 2011/12 prices.
[40] Audit Commission annual report and accounts 2010/11, p63
[41] Audit Commission annual report and accounts 2010/11, p63
[42] £7.2m uplifted to 2011/12 prices.

Table 9 – Annual avoided costs (benefits) to local bodies and central government from ending assessment and inspection functions (£m)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Across 10-year period	
	Yr0	**Yr1**	**Yr2**	**Yr3**	**Yr4**	**Yr5**	**Yr6**	**Yr7**	**Yr8**	**Yr9**	**Total**	**NPV**
Savings to Central Government	£16.3	£29.4	£29.4	£29.4	£29.4	£29.4	£29.4	£29.4	£29.4	£29.4	£281.1	240.1
Savings to local bodies	£6.0	£7.6	£7.6	£7.6	£7.6	£7.6	£7.6	£7.6	£7.6	£7.6	£74.0	63.5
Total Savings	**£22.3**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£37.0**	**£355.1**	**303.6**

(d) Compliance costs to local bodies

115. Compliance costs under the new framework will alter significantly, given the ending of inspection and assessment, and as local bodies will be required to appoint their own external auditors and take independent advice in doing so.

116. The main costs associated with the new commissioning function for local bodies are likely to be (1) procurement costs (to be incurred on a 5-yearly basis) and (2) recruitment and remuneration of independent members for the auditor panel. Estimating these costs is inherently difficult owing to a range of uncertain factors, not least the extent of collaboration between local bodies in their approach to appointing auditors under the new framework. Annex 2 explains the methodology used to estimate these costs for the purposes of this impact assessment. Based on this approach, total local body procurement and recruitment costs are expected to range from **£2.98m - £4.48m per year** for local bodies**, a best estimate of £3.73m per year** from 2015/16. As this will be a new requirement, this will be an additional cost to local bodies totalling £14.24m - £21.36m over the four relevant years[43] of the 10-year period of this impact assessment, a best estimate of £17.8m.

117. However, local bodies have realised savings in compliance costs from the immediate ending of Comprehensive Area Assessment. In the baseline year of 2009/10, local bodies incurred annual costs of complying with Comprehensive Area Assessment of £11.8m - £39.2m, a best estimate of £25.5m. With the immediate ending of Comprehensive Area Assessment in 2010/11, local bodies have already begun to realise average annual benefits of £11.8m - £39.2m, a best estimate of £25.5m.

118. Further details of the compliance costs for smaller bodies are set out in Annex 4.

(e) The (indirect) costs and benefits to businesses

119. These costs and benefits are not included separately in Table 4 (calculating the overall cost of the regime) as they will form part of the fees charged by the Audit

[43] Local appointment will start the financial year after the outsourcing contracts end. These run to 2016/17, so local appointment will be needed for 2017/18 – 2019/20. However, the costs are incurred in the financial year prior to the appointment taking effect, as local bodies will need to recruit independent members for their panel and undertake a procurement in advance, so that an auditor can be in place from April 2017. For this reason, costs are incurred for four years.

Commission under the outsourced contracts, and part of the fees paid directly by local bodies to their auditors in the new framework. Additionally, as firms will only incur these costs or realise benefits if they choose to bid for work they are an indirect rather than direct benefit resulting from the reforms.

120. In asking the Commission to outsource the audit work currently done by its in-house practice from 2012/13 as an interim step towards disbandment, the Government has increased the proportion of the local public sector audit market that is open to competition. This has increased the amount of work that is available for private sector audit firms to bid for, from £40.15m in 2009/10 (30% of the total market) to £75.3m from 2013/14 (100% of the total market, which itself is smaller than in 2009/10 owing to reductions in both the volume of work and costs).

121. The potential profit margin (benefit) open to private sector audit firms is therefore **£14.98m per year** in 2013/14, calculated as 19.9% of revenue on the basis set out in Annex 3. As with our calculations in relation to the current framework, this figure is taken to include costs to firms of tendering both successfully and unsuccessfully. A similar calculation has been undertaken for years 2014/15 to 2016/17, covering the remainder of the outsourced contracts.

122. Once the new framework comes into effect in full, and local bodies are able to appoint their own auditors from 2017/18, firms wishing to bid for work will face increased tendering costs as they will need to participate in multiple procurement processes. As when tendering to the Audit Commission, firms will incur costs relating to staff time for making calculations on a generic level about the work associated with the variety of local bodies, the firm's own costs, desired profit margins etc. Secondly, in deciding which bodies' work to bid for and thirdly, though possibly to a lesser extent than when bidding to the Commission, firms will need to consider their bidding strategy. Taking as a starting point the figures suggested in a report by the National Audit Office and the Audit Commission *A review of collaborative procurement across the public sector,*[44] and making a series of assumptions about the costs involved, this impact assessment estimates the costs to firms around **£2.18m per year from 2017/18,** as set out at Annex 3. This represents an additional cost to business compared with the baseline of **£1.1m per year from 2017/18**.

123. The figures relating both to potential profit and procurement costs are estimates and subject to a significant degree of uncertainty.

[44] http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

I) Non-monetised costs and benefits

124. The Government does not envisage any key non-monetised costs to local bodies or central government arising from these reforms. However, the ending of the Audit Commission's inspection and assessment regimes will mean that some data will no longer be collected, and that less research and analysis may be undertaken centrally. This loss will be mitigated to an extent by the greater role for the National Audit Office in locally focussed Value for Money studies and for the sector itself in data collection and improvement activity where it feels this would be of value

125. In terms of non-monetised benefits, the Government considers that the ending of the Audit Commission's centralised and top-down inspection and assessment regimes will increase localism, accountability and transparency, and release local bodies to focus on the priorities of local people. The greater transparency of the new framework will provide increased pressure on all the organisations that have a role to keep costs under review and prevent "mission creep".

126. By mirroring the new framework on the regulatory arrangements in place for the private sector, those regulators will be able to take a wider and more coherent view across the audit market, reducing fragmentation and overlap.

127. Local appointment of auditors will allow greater tailoring of audit services to local circumstances, such as joint working arrangements or the development of sector-specific expertise. This will offer the opportunity for the quality and relevance of audit outputs to local bodies to be increased. Any risks that differentiation of audit in different areas may have an effect on overall standards will be mitigated through statutory requirements on auditors and audited bodies, the code of audit practice and guidance (see paragraph 38).

128. The lower audit fees that are already being seen as a result of these reforms are reducing the pressure on council tax by creating cashable efficiencies that local public bodies can choose either to release to be deployed on other local services or to reduce the local tax burden.

J) Transitional and other costs

129. The transitional costs are likely to relate to:

   (a) Redundancy costs (including from the decision during 2010/11 by the new Government to end inspection and assessment functions);

   (b) Any liabilities arising from the Audit Commission Pension Scheme;

   (c) Early termination costs for leases and other contracts etc;

   (d) Preparatory work by participants in the new framework.

(a) Redundancy costs

130. The Audit Commission has indicated that redundancies resulting from the cessation of its inspection work, including Comprehensive Area Assessment, the transfer of its audit practice to the private sector, and its eventual closedown, will result in a transitional cost of nearly £50m, incurred between 2010/11 and 2014/15 when the Commission is disbanded[45].

(b) Pensions

131. The Audit Commission Pension Scheme is a non-statutory defined benefit scheme, managed by a board of trustees. The scheme has been effectively managed by the trustees and has been well funded to date. It has around 3,500 members, with annual benefit payments of around £10m.

132. The Government has negotiated a crown guarantee in respect of the scheme's liabilities. This will avoid the potential early crystallisation of long-term liabilities as a result of the Commission's forthcoming closure, and enable the Audit Commission Pension Scheme to be run on as a closed scheme in the future. While running on the Audit Commission Pension Scheme as a closed, funded scheme after the Commission in the future appears to be the most value for money option now, the department is keeping options open and will consider the long-term future of the scheme further closer to the Commission's closure.

133. The 2011 triennial valuation of the scheme estimated that its funding levels were around 104%. The actual long-term funding outcome will depend on the scheme’s forward investment strategy and performance, and other variables (such as mortality rates) which could affect the eventual size of liabilities. As part of providing the guarantee, the department has sought key protections and influence over the future management of the scheme, including its investment strategy, which will enable the Department for Communities and Local Government to work

[45] £15.1m redundancy liabilities incurred by the Audit Commission directly from the end of Comprehensive Area Assessment and inspection (see Audit Commission annual report and accounts 2010/11, p63) with an additional £10.72m from redundancies among continued operations (see p62 Audit Commission annual reports and accounts 2010/11) , and £19.9m in 2011/12 (see p67, Audit Commission annual reports and accounts 2011/12) with a £3.8m estimated redundancy cost as a result of the outsourcing of the in-house practice in 2012/13 (Audit Commission Medium Term Financial Plan July 2012), As a contribution towards these costs and to prevent the Audit Commission declaring negative earnings for the year, DCLG provided £11.9m funding in 2011/12). It has not been possible to estimate any additional costs relating to these redundancies, such as strain on the pension fund for which the Commission may be liable.

with trustees to minimise liabilities and/or manage them in line with the department's wider financial planning and priorities.

134. Since the department's financial obligations in respect of the Audit Commission Pension Scheme only become effective once the scheme has insufficient funds to cover payments, it is unlikely that any costs incurred will fall with the timescale covered by this impact assessment. There is the (theoretical) possibility that the department chooses to make earlier contributions (within the next 10 years) to cover deficits in the scheme if that is deemed financially prudent. For the purposes of this impact assessment, however, it is assumed that the department will not do so.

c) Early termination costs for leases, etc

135. The Audit Commission is already closing its offices as lease contracts end, or earlier if possible, given the reduction in its workforce due to the cessation of Comprehensive Area Assessment in 2010 and the outsourcing of its in-house audit practice in October 2012. There are only three properties in respect of which the leases extend beyond 31 December 2012. Property market conditions may mean the Commission is unable to dispose of these as planned, in which case the maximum additional cost is estimated to be £9m[46] in 2015/16. The Audit Commission has also forecast the following stranded costs until its closure in 2014/15 - £8.6m in 2012/13, £4.5m in 2013/14 and £1.3m in 2014/15. Any outstanding liabilities are likely to be transferred to another body upon closure of the Commission. The Audit Commission currently estimates that, upon closure at the end of the 2014/15 financial year, it would deliver a net margin of £4.9m to the interim body that would oversee completion of the 2014/15 audit work and £0.5m to the body taking over ownership of the National Fraud Initiative.

(d) Preparatory work by regulators for the new framework

136. The regulators in the new framework, including the National Audit Office, Financial Reporting Council and recognised supervisory bodies, will need to undertake some work to prepare to take on their responsibilities under the new framework. This is likely to lead to some transitional costs.

137. For example, the National Audit Office's budget has been adjusted to reflect the work of developing the new code of audit practice and starting to undertake local value for money studies. The Public Accounts Commission has agreed increased funding in net resource requirements of £2.3m in 2012/13, £2.8m in 2013/14, and £3.4m in 2014/15[47]. Stripping out amounts not related to the abolition of the Audit Commission, this amounts to £1.6m in 2012-13, £2.2m in 2013-14, and £2.8m in 2014-15. The growth over the period reflects a gradual increase of locally-focussed value for money studies, increasing from two in 2012-13, to 4 in 2013-14 and 6 in 2014-15 and thereafter.

[46] Audit Commission Medium Term Financial Plan, July 2012

[47] National Audit Office Strategy 2012/13 – 2014/15, p24 figure 3. Available at: http://www.nao.org.uk/publications/1012/nao_strategy_2012-13_2014-15.aspx.

K) Post-implementation review

138. The reforms set down within the Local Audit and Accountability Act reflects four overarching principles underpinned by five more specific aims of the reforms. Any post-implementation review of the Act needs to consider the extent to wich these aims have been met. These aims are interdependent, and seek to find the right balance between an effective, robust, quality audit for local bodies whilst keeping fees as low as possible.

139. Overarching objectives:
   - Deliver greater local accountability and transparency
   - Maintain competitive audit fees
   - Save £1.35bn
   - Uphold high standards of auditing.

140. More specifically, the aims of the reforms are:
   - Increase local accountability of audit services through local appointment of auditors
   - Increase transparency regarding the cost of local audit services, and provide incentives for local bodies to reduce the costs of local audit
   - Removal of non-audit activities from audit fees
   - Reduce fragmentation of regulatory regimes for audit services
   - To enable a plurality of audit providers, and reduce audit fee levels.

141. Taking these together, the desired outcomes of the audit reforms might be characterised thus:

FLA desired outcomes	Possible indicators of success
1. A local audit regime which is more accountable to local bodies and local citizens 2. A regime which allows greater clarity about the cost of local audit 3. Local bodies incentives for reducing costs? 4. A regulatory framework which is less fragmented 5. A market in which there is greater numbers of providers, and allows the market to work in favour of customers of audit. 6. Lower audit fees for public bodies 7. Uphold high standards of audit	**Shorter term** • A more open and competitive audit market • Citizens understand the purpose of local audit, who the auditors of a local public body are, and how (and to whom) they make representations should they have concerns about financial probity • Local public bodies are content with the process for, and their role in, the procurement and management of local audit function. • Audit committees with independent members have been established in an open and transparent manner. • The independence of audit is maintained • There are appropriate safeguards

	for protecting the integrity of the local audit system **Longer term** • Citizens are satisfied that local bodies are practising sound financial management and spending taxpayers money effectively and efficiently. • High quality statutory local audit will be obtained and reviewed. • A more competitive audit market results in lower audit fees, and higher turnover rates of auditors. • That spatial variation in fee levels does not disadvantage those public bodies which are considered more costly for audit purposes (due to perceived risk or geographical remoteness).

Summary of indicators

142. **Audit fee levels**

- Extent to which audit fees paid by local bodies have fallen, relative both to baseline year (2009/10) and prior to local appointment of auditors (2017/18).
- Extent to which there is an accessible competitive audit market for all local bodies
- Impact of joint procurement arrangements upon audit fee levels
- Review following both first and second self-appointment exercises
- Possible baseline measures: existing audit fee levels, procurement arrangements for audit, number of audit providers.

143. **Localism and accountability**

- Local public bodies able to appoint their own independent external auditors from a more competitive and open market
- Officials feel adequately resourced and informed to procure and manage the local audit function.
- Possible baseline measures: number of audit firms providing local audit services in different localities; perceptions of local bodies regarding their capacity to procure audit services.
- Results of audit work are easily accessible to the public, who are more able to hold their councils and other public bodies to account as a result.
- Possible baseline measures: Knowledge of local citizens about local audit arrangements; degree of satisfaction with financial probity of local bodies; knowledge of methods for raising concerns; numbers of objections raised by electors to auditors.

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144. **High standards of auditing maintained**
    - Effective regulation of public audit and conformity to principles of public audit
    - Local public bodies feel able to procure local auditors with ease, and to do so jointly if they wish
    - Independent audit committees are assembled and operate effectively and independently.
    - Possible baseline measures: citizen satisfaction with the process for, and their role in, the procurement and management of local audit; the existence of audit committees that have been created, and are run, in an open and transparent manner; citizen satisfaction with financial probity in local public bodies.
145. **Methods.** The Post Implementation Review methodology has been designed so that it makes the most effective use of existing and continuing data sources where possible and is undertaken in a cost effective way, with out placing undue burden on the Department or partners who will be responsible for implementing the new local audit framework and providing feedback on impacts.

146. We will want to ensure that we identify outputs and outcomes that are both proportionate yet methodologically robust. We intend to draw up the finer detailsof the review methodology in the months ahead through a review steering group, and the benefits realisation group.

147. We are proposing that the the Post Implementation Review will entail a multi-method approach including the analysis of quantitative data and administrative data gathered from local public bodies, such as audit fee levels, along with qualitative data relating to the process of procuring and managing local audit services. We may need to commission some specific new research and analysis that might include questions to be carried in existing omnibus surveys or further secondary analysis of existing data gathered by other providers. It is also likely that we will want to consider some qualitative case study research, either undertaken by analysts in DCLG or completed in collaboration with other research suppliers to make the most of our resources and expertise.

148. It is the intention that the details of the methodology, including the particular details of the data sources and the types of indicators that we will focus on, will be worked up over the next few months, alongside a more detailed collection plan for baseline data. This will be one of the main initial tasks of the Review Steering Group.

ANNEX 1: FACTORS AFFECTING FUTURE AUDIT FEE LEVELS

149. As set out above, the level of audit fees in the final year of the outsourcing contracts will set a good benchmark for local bodies when they come to procure their own audit services from April 2017, as total fees will be significantly less than their level in 2009/10 prior to the announcement of these reforms.

150. In the long-term, of course, fees will be determined by the market, and so are difficult to predict with certainty. Further analysis of the issue of fee levels was commissioned by DCLG and demonstrated the difficulties in predicting the direction of travel in respect of fee levels[48]. There are a number of factors which we expect to exert a downward influence upon current fee levels, but others which we anticipate might increase fee levels. Moreover, there are other factors where it is impossible to determine whether the pressure will be upward or downward. The following table summarises these drivers.

Table 10 – Summary of possible drivers of local bodies' audit fees

Upward pressure	Downward pressure	Unknown
1. Increase in tendering requirement on audit firms	4. More transparent regulatory and appointments process will mean greater pressure throughout the system for costs to be kept to a minimum	12. Market forces and impact on local context
2. Reduced bargaining power on part of commissioners of audit	5. End of some of the Audit Commission's non-audit functions and removal of top slice on audit fees	13. Possible reduced utilisation for firms: larger number of discrete contracts could reduce their ability to plan staff utilisation beyond 5-year contract period
3. Removal of Audit Commission auditor indemnity	6. Reduced costs through merging private and public sector audit compliance regimes	
	7. Giving auditors greater discretion in relation to objections to accounts	
	8. End to existing grant certification arrangements	
	9. Increased competition in the local public audit market	
	10. Joint procurement by local bodies, increasing bargaining power and economies of scale (including through potential sector-led collective procurement arrangements)	
	11. Potential reduction in fees	

[48] See Future of Local Public Audit report by FTI Consulting for DCLG, , published here: https://www.gov.uk/government/publications/request-for-information-on-the-impact-of-audit-commission-reform-on-local-authority-audit-fees

	resulting from liability limitation agreements	

Upward Pressures

(1) Increase in tendering requirement on audit firms

151. In the new audit framework, local bodies may contract audit firms individually rather than collectively via the Audit Commission. This will require additional resource in order for the audit firms to tender effectively, although the level will depend on the size and capacity of the firm and the approach taken to preparing tenders. This additional resource could be reflected in audit fees and as such may act as an upward pressure on fees. The costs to firms will be directly linked, of course, to the amount of work for which they tender, and as such will be a commercial decision about the balance of risk and potential profitability. To the extent that local bodies undertake collaborative approaches to procurement of audit (which the Government intends to facilitate and encourage) this will reduce the tendering requirements on audit firms. See Annex 3 for further details.

(2) Reduced bargaining power on the part of commissioners of audit

152. In the current regime, the Audit Commission procures audit services from private sector firms for 30% by value of the audits of principal local bodies. In the financial year 2009/10, this amounted to £40.15m[49]. The Commission therefore has significant bargaining power as a monopsony buyer and is able to offer large amounts of audit work to firms - which should drive competition and lower prices. In the new audit framework, each individual local body will be responsible for procuring its own auditor representing a relatively small amount of work. Each local body will therefore have a lower bargaining power than the Audit Commission does at present, though if local bodies undertake joint procurement, their bargaining power will increase.

(3) Changes to current auditor indemnity arrangements

153. The Audit Commission provides an indemnity for those audit firms it currently contracts, for certain aspects of that work. The Audit Commission also acts as a mediator if a dispute arises between the audit firm and the body it is auditing. Audit firms may reflect the loss of the Audit Commission's indemnity and its role in setting fees.

154. In practice, however, this indemnity is rarely used (as explained in paragraphs 42 and 43): Between 2008 and 2013, out of 4,370 principal audits, the indemnity has been used twice and there have been four instances of legal action against the auditor. In the new framework, auditor liability may be limited as part of the contractual arrangements between the audited body and the auditor, thus providing a downward pressure on the audit fee. Local public bodies will have the freedom to choose whether to do this. We would also expect the new independent auditor panels to have a role in dealing with disputes between the audit firm and the audited body, which may negate the impact on fees of the loss of the Audit Commission's fee-setting role.

Downward Pressures

[49] The Audit Commission has also provided data relating to the 2009/10 audit year, which ran from 1 April 2009-31 October 2010 (19 months), a figure of £48.6m.

(4) More transparent regulatory and appointments process will mean greater pressure throughout the system for costs to be kept to a minimum

155. The Audit Commission's structure (setting mandatory audit fees which allowed it to cover its costs no matter how high) meant it lacked the incentive to keep costs to a minimum. Its mix of complex funding arrangements and lack of transparency made it difficult for local bodies or the public to understand or challenge costs at any point in the system, or successfully challenge the audit fee. The new framework will be more transparent so there will be incentives throughout the system to minimise costs. In particular, with local bodies procuring their own auditor from an open and competitive market, there will be clarity over the audit fee and exactly what is being delivered for that cost. This transparency will increase pressure on the local body and the auditor to keep costs to a minimum, and will enable the local body to challenge where it does not feel it is getting best value for money from the audit outputs.

(5) End of some of the Audit Commission's other functions and removal of top slice on audit fees

156. Some costs will be removed from the system altogether in the new framework. For example, under the current Audit Commission framework, the top slice on audit fees also funds the production of value for money studies. In future, if these functions are undertaken, they will be funded by other means and not fall to the audit fee.

(6) Increasing the commonality between the private and public sector audit regimes reducing the cost of compliance by audit firms

157. Many suppliers participating in the local bodies' audit market are also active participants in the private sector audit market. As such, they are required to comply with a set of rules and arrangements for private sector audit as well as a separate set of arrangements for the local public audit market (currently overseen by the Audit Commission).

158. In the new regime, firms will need to comply with a set of rules and arrangements for the public sector which are put in place by the same bodies responsible for this in the private sector. This may offer small efficiency savings to audit firms, dependent upon the approach taken by regulatory bodies and firms to compliance, and therefore may act as a downward pressure on audit fees.

(7) Giving auditors more discretion in relation to objections to accounts

159. In the current audit regime, auditors have little or no discretion as to whether to investigate an objection made to the accounts. Sometimes objections are valid and useful, at others they may be vexatious. Auditors can spend a lot of time investigating objections which do not warrant investigation, with the cost charged to local bodies through the audit fee.

160. In the new regime, auditors will be given more discretion as to whether or not to investigate objections to the accounts by giving an explicit discretionary power to the auditor to reject vexatious, repeated or frivolous objections (which they do not have currently). We would expect this to lead to the auditor undertaking less work to deal with objections and therefore act as a downward pressure on fees.

(8) End to existing Grant Certification arrangements

161. In the new framework, there will be no central body responsible for putting in place arrangements for grant certification in respect of grants or subsidies from government departments. Instead, certification will be undertaken through a combination of free-standing, tri-partite arrangements and other forms of certification (i.e. self-certification or through internal audit). Local public bodies will therefore be responsible for procuring the necessary certification work to meet the grant conditions. In the future, this may either be done as part of its procurement of the external auditor for the annual audit or as a separate exercise.

162. A significant reduction in costs will, in any case, occur with the end of grants which are currently certified through Audit Commission arrangements, a direct result of the Government's move to non ring-fenced funding. The biggest reduction will occur through the wind-down of housing benefit and council tax benefit, which represents some £11m of the total audit fee cost for local bodies. Universal credit will not be subject to central grant certification.

163. However, the new approach, where the onus is the on the grant-paying body to consider fully whether certification is required and if so, at what level, has the potential to act as a driver to reduce unnecessary or disproportionate certification and thus see a further reduction in the costs. Further work is underway to develop a new approach in respect of any grants that may need to be certified in future.

(9) Increased competition in the local public audit market

164. The outsourcing of the Audit Commission's in-house audit practice in 2012 means that 100% of local public audit work can now be bid for by private audit firms (as opposed to the 30% of the market that has traditionally been outsourced by the Audit Commission). The existing contracts for principal bodies are currently let in lots to a total of seven audit firms. When those audit contracts expire in 2017 and local bodies start to appoint their own auditors, this will open up the market to greater competition by increasing the number of opportunities to tender and will increase points of access to the market, as there will be a larger number of contracts and a greater variation in contract size. While there will be increased tendering costs on firms as they will have to bid to individual or small consortia of local bodies, these costs will only be incurred as a result of a commercial decision to bid for the available work. This offers a significant commercial opportunity for firms. Increased tendering costs will therefore be balanced against the potential for a much greater income stream from this sector.

(10) Joint procurement by local bodies, increasing bargaining power and economies of scale

165. Allowing local bodies to share independent auditor panels will enable them to share the costs of undertaking a procurement exercise and also increase their bargaining power and the potential for economies of scale to be achieved both by local bodies and by tendering audit firms. This should act as a downward pressure on fees.

166. Moreover, the new framework will enable local bodies to appoint the same auditor where they are involved in partnership working, sharing back-office functions or

leadership teams. This may lead to some cost reductions where there is less duplication of audit work, and will also allow local bodies to get better value from the audit by ensuring outputs are more tailored to those particular local arrangements.

167. The Government also intends to allow, through secondary legislation, for the potential establishment of a sector-led collective procurement body. If the sector decides to develop such arrangements, there may be further opportunities to reduce cost through large-scale bulk purchase of audit.

168. There may be practical implications arising from the decision of local bodies to undertake joint procurement, such as constraining the number of firms that are eligible to be appointed to audit the bodies owing to independence issues (e.g. existing consultancy contracts).

(11) Liability Limitation Agreements

169. In the new framework, auditor liability may be limited as part of the contractual arrangements between the audited body and the auditor, thus providing a potential downward pressure on the audit fee. Local public bodies will have the freedom to choose whether to enter into a liability limitation agreement, subject to them meeting relevant conditions set out in primary legislation and subsequent regulations.

Unknown pressures

(12) Market forces and impact on local context

170. The largest unknown variant in relation to audit fees is the effect of market forces. In the new regime, local bodies' audit fees will be determined by the market (and it is likely this sub-market of local public audit will be influenced by the dynamics of the wider audit market). In contrast, under the current system the Audit Commission sets price levels through its 'scale fees' system.[50]

171. It is inherently difficult to predict how the market will affect the future level of audit fees. The possible impact of various factors on audit fees was considered in more detail in an independent report commissioned by DCLG.[51]

172. In addition, under the new framework there will no longer be the Audit Commission's "Post Office" pricing policy, which generally meant that the same gross fee scale was applied regardless of geographical location or commercial attractiveness/level of risk, and so this may lead to a differential impact on fees as determined by the market. While this impact assessment focuses on overall costs and savings, and average fee levels, the actual audit fee that will be paid by each individual local body is likely to vary by differing degrees from the average. While some bodies could pay more for their audit fees, others may pay less and the

[50] For an explanation of the current 'scale fee' system: http://www.audit-commission.gov.uk/audit-regime/audit-fees/Pages/default.aspx
[51] See Future of Local Public Audit report by FTI Consulting for DCLG, published here: https://www.gov.uk/government/publications/request-for-information-on-the-impact-of-audit-commission-reform-on-local-authority-audit-fees

prospect of paying lower audit fees could also act as an incentive for local bodies to improve systems and lower their risk levels.

(13) Possible reduced utilisation for firms: larger number of discrete contracts could reduce their ability to plan staff utilisation beyond 5-year contract period

173. When audit firms were bidding to the Audit Commission for the 30% of audit work that was historically outsourced to the private sector, they could be confident that, if they won work, there was a secure income stream for the duration of the contracts. If difficulties (such as independence issues) arose meaning the firm was no longer able to audit a particular local body, the Commission would try to reassign the firm to a different body in that or a subsequent year. The Commission undertook as part of the contract to provide work equalling the minimum notional value of the contract.

174. In addition, since the contract lots averaged £2m, firms could be confident that it would be worth establishing/maintaining a presence in the part of the country that formed part of their lot. This structure – medium-sized lots combined with a secure income stream - would have allowed firms to maximise the utilisation of their employees across the period, minimising their costs and maximising productivity.

175. In the transitional period, where the Commission has outsourced 100% of the market to the end of 2016/17, utilisation is arguably maximised as the suppliers that won work have the certainty of a significant income in larger contract lots (averaging £10m) over a five-year period.

176. In the new framework, local bodies will be required to appoint an auditor not less than every five years. Local bodies have indicated they are likely to offer five-year contracts, in order to secure better prices. Since independence issues should have been identified upfront, it is unlikely that such issues would cause contracts to be terminated. Government therefore expects the of resignation or removal of auditors to be an extremely rare event. Firms that win work will, therefore, have a secure income stream for the duration of those contracts, and so be able to maximise utilisation of their staff in a similar way to the current framework.

177. Bidding for a larger number of individual contracts might, however, result in a firm winning work that is spread less evenly and/or across a wider area, which might increase marginal costs and reduce utilisation (e.g. if auditors have to travel further between audited bodies). Firms will, of course, factor such issues into the prices they bid and it is therefore possible that this could act as a marginal upward driver on audit fees.

178. However, the fact local bodies have indicated that many of them will undertake joint procurement could easily result in larger contract lots than in the baseline year (when lots averaged £2m), which would allow increased utilisation for firms and therefore act as a marginal downward pressure on fees. Since any effect on fees would be dependent on the demand-side behaviour of local bodies, utilisation is treated at this stage as being of uncertain implication for audit fees.

ANNEX 2: COMPARISON OF LOCAL BODIES' COMPLIANCE COSTS UNDER THE CURRENT AND NEW LOCAL AUDIT FRAMEWORKS

The current framework

179. Two sources were drawn on to estimate the compliance costs under the current framework:

    a. An Office for Public Management study commissioned by the Audit Commission entitled 'Establishing the Costs of Comprehensive Area Assessment', 2010[52]; and,

    b. A Deloitte study commissioned by Leicestershire County Council entitled 'Measuring the Workload: Public Sector Performance Reporting and Inspection Regimes in Leicestershire', 2009[53].

180. Both of these studies appear to assess the broad 'strategic and corporate' component of Comprehensive Area Assessment compliance activity (as distinct from the institutional and service focus of the main Ofsted and Care Quality Commission inspection regimes).

181. The Office for Public Management study which drew on the responses to a survey of local authorities calculated that the cost of Comprehensive Area Assessment to local authorities ranged from a total of £11.8m to £39.2m. The mid-point of this range is approximately £25.5m. The reason the range is wide is that different authorities responded to assessment in very different ways, and the sample used by the study does not allow a greater degree of precision in the estimate.

182. The results from the Deloitte study, which focuses on the costs to Leicestershire local authorities, were analysed further to estimate the aggregate cost to all local authorities across England. This exercise suggested that the total cost to local authorities of complying with Comprehensive Area Assessment was in the region of £26m.

183. **Given the similarity of the findings from the two studies, the compliance cost of Comprehensive Area Assessment is estimated at £25.5m for the purposes of the impact assessment**. However, this should be treated with a degree of caution, as the Office for Public Management study, in particular, suggests that the true cost is likely to have a margin of error of +/-£14m above and below the estimated value.

184. There will also be smaller compliance costs for local bodies relating to their financial audit. Much of this will consist of staff time, but there is no available evidence to enable it to be quantified. Nonetheless, since the scope of audit is remaining overall unchanged, the Government expects the overall cost of compliance with the financial audit itself will remain unchanged.

[52] http://www.audit-commission.gov.uk/SiteCollectionDocuments/Downloads/20100316establishingthecostsofcaa.pdf
[53] http://www.leicestershiretogether.org/oct09_deloitte_inspection_rpt.pdf

The new framework

185. However, in relation to the procurement and appointment processes in the new framework, compliance costs to local bodies will alter significantly, as local bodies will be required to appoint their own external auditors and take advice from independent auditor panels in doing so. The main costs associated with this are likely to be (1) procurement costs (to be incurred on a five-yearly basis) and (2) recruitment and remuneration of independent panel members.

(1) Procurement costs

186. We have found there to be little evidence on the costs of undertaking local body procurement exercises. In practice, costs vary widely between cases due to differences in the type of local body; the nature of the good or service being procured; and the procurement procedure employed. Evidence on procurement costs that we have come across is in the form of (1) a report by the Local Government Association[54] on the average cost of undertaking various types of procurement exercise based on a survey of four local authorities; and (2) a report by the National Audit Office[55] which estimates the average cost of 'managing service contracts' (a wider measure of costs which includes procurement amongst other things).

187. Given potential efficiencies available to local bodies through collaborative procurement approaches, for instance purchasing consortia and procurement frameworks, we have also drawn on relevant evidence to estimate what local bodies' procurement costs might be in the event that collaborative approaches to auditor procurement are pursued by local bodies.

188. This evidence has been used to produce the estimates in Table 11 below.

[54] Available on the Local Government Association A website at: http://www.local.gov.uk/c/document_library/get_file?uuid=a1c67dd1-0537-4fde-b328-0e501711a8f5&groupId=10171
[55] Available on the National Audit Office website at: http://www.nao.org.uk/publications/0809/central_governments_managemen.aspx

Table 11 – Procurement costs

Description of estimation approach	Estimated total annual cost to local bodies	
	Assuming an individual body approach to audit procurement	Assuming a more collaborative approach to audit procurement
Costs of average procurement exercise (indicative, obtained from Local Government Association report) multiplied by total number of local public bodies expected to undertake process.	£1.5m[56]	£1.05m[57]
Two per cent (informed by National Audit Office report) of the estimated total annual worth of local public bodies' audit contracts.	£1.44m[58]	£1.0m[59]
Total	**£2.94m**	**£2.05m**

[56] The Local Government Association report (http://www.local.gov.uk/c/document_library/get_file?uuid=a1c67dd1-0537-4fde-b328-0e501711a8f5&groupId=10171) suggests that the cost of undertaking an EU-wide, simple (open or restricted) procurement exercise may lie in the region of £4,000 to £15,600 per exercise, once applying a 20 per cent sensitivity either end of the report's original range to account for uncertainty. The mid-point of this range (£9,800) multiplied by the total number of bodies expected to undertake a procurement (774) divided by the period of years over which this cost will be borne (5) is equal to £1.5m. Whether or not a local body is required to undertake an EU-wide procurement is determined by whether the value of the contract being tendered is above certain financial thresholds. In practice, some of the smaller principal local bodies may not be required by law to undertake an EU-wide procurement, which will mean their procurement costs are much lower. The Local Government Association report suggests a non-EU procurement exercise might cost between £1,000 and £2,000. This implies the figure of £1.5m may be in the high side if audit contracts for the smaller of the principal bodies are below the financial threshold of approx £100,000.

[57] A number of studies estimate the potential efficiency gains through collaborative procurement practices; of the more relevant is the South West Improvement and Efficiency Partnership's estimate of a 30 per cent projected saving through South Western local authorities participating in procurement frameworks for consultancy services (which are often provided by the same or similar companies that provide audit services) (http://www.swcouncils.gov.uk/media/Publications/Casebook/SW_Casebook_2010_Chapter_2.pdf). £1.05m is simply the individual approach estimate (£1.5m) reduced by 30 per cent.

[58] The National Audit Office report (http://www.nao.org.uk/publications/0809/central_governments_managemen.aspx) estimates that for central government the cost of managing a service contract (which includes contract planning, letting and management, storage, ordering, delivery, invoice processing and accounting) is equivalent to two per cent of the annual expenditure on the contract. On the basis that annual audit fee expenditure in the new framework is expected to be in the region of £72m, this puts the estimated cost of managing a service contract in the region of £1.44m per year.

[59] Calculated by reducing the estimated cost of managing a contract by 30 per cent assuming a more collaborative approach.

189. As well as underlying differences in methodology used, some of the difference in the size of the above estimates can be explained by the much wider measure of costs included in the second estimate – which potentially make it a more accurate reflection of the overall costs involved in procuring an external auditor. Ultimately, however, this is uncertain and the above estimates are considered to provide reasonable basis to estimate procurement costs at around **£2.05m per year** for the purposes of this impact assessment.

(2) Remuneration of independent panel members

190. Estimating the total cost associated with independent auditor panels is difficult owing to a number of uncertainties, not least: (a) the size of the allowance paid to each independent panel member (which will be a matter for local bodies to decide and evidence suggests is likely to differ between bodies); (b) the chosen size of each auditor panel (which will determine total allowance costs and will also be a matter for local bodies to decide); (c) the proportion of local bodies already operating a similar practice (and that will therefore incur no additional cost); and (d) the extent to which local bodies decide to undertake collaborative approaches to auditor procurement / participate in sector-led collective procurement arrangements (which may reduce the overall number of auditor panels).

191. Given these uncertainties, this impact assessment provides a best estimate of the potential cost.

192. Table 12 below shows indicative independent member allowance levels for different local authority types, based on local authority standards committees (which have been abolished through the Localism Act 2011) although in practice it is expected that costs may be lower as auditor panels are likely to be carrying out less work than local standards committees:

Table 12 – Independent member allowances

Local authority type	Indicative independent member allowances (£)	
	Chairman[60]	Member[61]
London borough	1,974	398
Metropolitan district	3,593	424
County	3,782	782
Shire district	1,597	313
Unitary	3,456	702

193. Using the figures in the above table, Table 13 below estimates the allowance costs of independent auditor panels, based on one independent chairman and two independent members.

[60] Chairman allowance estimates based on the average standards committee chairman's allowance (according to Local Government Association Members' Allowances Survey 2008) who at the time of the survey was required by law to be independent.
[61] Member allowance estimates are based on an internal survey of council websites.

Table 13 – Independent member costs

Type of local authority	Number	Est. auditor appt. allowance (one chairman plus two members)	Total cost
London Borough Council	33	£2,770	£91,410
Metropolitan District	36	£4,441	£159,876
County	27	£5,346	£144,342
Shire district	201	£2,223	£446,823
Unitary	55	£4,860	£267,300
GLA	1	£3,928	£3,928
TOTAL:	353	n/a	£1,113,679
Using average cost	774	£3,154	£2,441,196
		TOTAL (774 bodies)	£2,441,196

194. In the event that every local body appointing an auditor has their own independent auditor panel (which local government has indicated is highly unlikely), using the average figures in the above table implies total costs could be in the region of £2.4m per year. Although these figures only refer to local government, given the wide variety of other local bodies concerned, the local government figures form the basis of a best estimate across the whole sector.

195. It is expected costs will be lower than this in practice, however, given the unknown factors as set out above it is not clear by what proportion they might be lower. In the absence of a clear guide, a reduction of 30 per cent – in line with our approach to estimating the potential efficiencies in the procurement process – is applied to the average value. This puts the estimated total cost for the purposes of this impact assessment in the region of **£1.68m per year**.

Total compliance costs

196. Recognising the uncertainty and applying a sensitivity range of 20% to these figures, therefore, we estimate local bodies' compliance costs in the new framework to range from **£2.98m - £4.48m per year, a best estimate of £3.73m per year**.

197. This equates to roughly £4,800 per body per year in compliance costs.

ANNEX 3 – CALCULATION OF COSTS AND BENEFITS TO BUSINESSES

Benefits to firms (profit)

198. Several firms produce a transparency report, and Deloitte and KPMG list their revenue and operating profit directly relating to audit services. These figures have been used to estimate that firms on average make a profit of around 19.9%.[62]

Table 14: Average profit of firms

	Total revenue (audit)	Total profit (audit)	Profit as % revenue
2011 KPMG	£405m	£50m	12.35%
2010 KMPG	£417m	£70m	16.79%
2011 Deloitte	£510m	£117m	22.94%
2010 Deloitte	£476m	£131m	27.52%
		Average profit (%)	**19.90%**

199. Taking the 'direct cost of audit' to the Audit Commission and then later local public bodies, the firms' potential profit is calculated as 19.9% of that cost.

Table 15: Potential profit for firms (19.9%) (£m)

	Baseline 2009/10	**Year 0 2010/11**	**Year 1 2011/12**	**Year 2 2012/13**	**Year 3 2013/14**	**Year 4 2014/15**	**Year 5 2015/16**	**Year 6 2016/17**	**Year 7 2017/18**	**Year 8 2018/19**	**Year 9 2019/20**
Audit fees paid to firms	40.15	40.68	36.34	45.80	79.80	74.70	52.50	52.50	54.23	54.0	54.0
Potential Profit	7.79	8.09	7.23	9.11	15.88	14.86	10.45	10.45	10.80	10.75	10.75

200. For years 2009/10 to 2011/12 the direct cost is taken from figures provided by the Audit Commission. An explanation of any calculations is given in footnote 4 to Table 6. From 2013/14, the market available to the private sector increases to £75.3m per year, giving a potential profit margin of £15.88m. This then reduces over subsequent years based on revised estimates provided by the Audit Commission following retendering of contracts.

[62] http://www.kpmg.com/UK/en/about/AboutKPMG/Documents/transparency-report-9-january-2012.pdf
http://annualreport.deloitte.co.uk/audit-transparency-2011/AT-report-2011.pdf

Firms' contribution to system costs

201. Under the Audit Commission framework, a proportion of the audit fees that firms collect from local bodies is passed back to the Commission. This 'top slice' is calculated by taking the proportion of the work undertaken by firms in each year as a percentage of the fees paid in that year, and subtracting the amount paid to firms. From 2009/10 to 2011/12 firms undertook 30% of audits, (in which the topslice was around 20%), and from 2013/14 they undertook 100% of audits (by which point the topslice had fallen to approximately 8%). 2012/13 is a transition year between the two, and in the absence of better data the figure is calculated by taking the mid-point of the firms share of fees in 2011/12 (£46.24m) and in 2013/14 (£87.3m). We recognise that this figure does not fit with the general pattern of declining costs, but do not currently have better data. This calculation is set out in Table 16 below:

Table 16 – Audit Commission top slice

	Baseline 2009/10	Year 0 2010/11	Year 1 2011/12	Year 2 2012/13	Year 4 2013/14	Year 5 2014/15
Firms' share of audit fees	£52.66m	£50.10m	£46.24m	£66.77m	£87.30m	£81.60m
Amount paid to firms	£40.15m	£40.68m	£36.34m	£45.80m	£79.80m	£74.70m
Top slice returned to Audit Commission	£12.51m	£9.42m	£9.90m	£20.97m	£7.50m	£6.90m

Note: The above figures for 2009/10 and 2010/11 do not reconcile with the data in Table 4 since the latter data has been indexed to 2011/12 prices, and the above data is in current prices in order that it reconciles with published Audit Commission sources.

202. From 2015/16, after abolition of the Audit Commission, the only cost in the system potentially faced by firms will be for regulation by the Financial Reporting Council and professional bodies for which a figure of £0.25m has been used (see note 17 to Table 4 above), which we expect to be passed onto local bodies as is the case in the current framework.

Cost of tendering

203. When audit firms state their profit, it is assumed that these figures already take into account their costs of bidding both successfully and unsuccessfully. Therefore, any calculation of profit already takes into account the cost of bidding for work. However, we recognise that the cost of tendering will increase in the new framework, even if firms factor this into their bid prices. Therefore, we have calculated the cost to firms of tendering for work in the current regime (30% of work outsourced), in the transitional period with the outsourcing of the additional 70% of work, and in the new framework (100%).

204. In calculating the cost to audit firms of tendering for work we used figures found in the National Audit Office and Audit Commission report, *A review of collaborative*

procurement across the public sector.[63] This contains estimates from suppliers of the amount it costs to tender for a contract above the OJEU threshold. Averaging these out leads to an estimated cost to tender of £30,500.

205. However, audit is a commodified service and when tendering for multiple similar contracts it is assumed that the costs will reduce significantly. Therefore, we have taken the £30,500 figure to represent the up-front cost to a firm of making calculations on a generic level about the work associated with the variety of local bodies that are in the market and the firms' own costs, profit margins etc. This initial up-front cost is therefore followed by a cost of £5,000 for applying these calculations to each lot for which the firm wishes to bid. This is an estimate based on staff time, strategic input from senior managers, overheads and back-office functions.

206. In order to calculate the initial costs, we have identified twelve broad groups of local public bodies.[64] Taking the number of firms that bid for the outsourced contracts for 2012/13, we have assumed that 13 firms undertook these calculations for all these groups for outsourced audits under the Audit Commission framework. In the new framework, it is likely that more audit firms will undertake this up-front work, however, not all firms will undertake it for all sets of bodies. We have therefore continued to assume around 13 firms incurring full up-front costs for consistency.

207. For years 2009/10 to 2011/2012, 30% of the audit work was outsourced to the private sector. When this work went out to tender[65], the Commission awarded 18 contract lots. For years 2011/12 to 2016/17, 100% of audit work was outsourced to the private sector. This includes both the 30% previously outsourced, and 70% outsourced from 2012/13 onwards. The latter was made up of 10 contract lots. From 2017/18 all work will be in the private sector, and all bodies can procure their own auditor. This means there will be a maximum of 874 lots (the number of principal bodies). However, discussions with local bodies suggest that the vast majority of them will undertake joint procurement of auditors. We have therefore assumed an average of groups of five local bodies joining up to procure together, giving 175 lots for firms to bid for.

208. In order to calculate the initial up-front cost of tendering, the average cost of an OJEU procurement (£30,500) was multiplied by the number of types of body (12), and then by the number of firms incurring this cost (13). This gives a figure for initial costs of tendering of **£4.76m, or £0.95m per year**.

209. In order to calculate the subsequent cost of bidding for work, the estimate of the cost of subsequent work (£5,000) was multiplied by the number of lots, and then multiplied again by the estimated number of firms bidding for each lot (seven). We estimated the number of firms bidding for each lot as seven as this is the mid-point between the minimum number (one) and the maximum number (thirteen) in the 2011 outsourcing exercise. It is likely that this number could be slightly lower in the

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[63] http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

[64] NHS bodies, County Councils, District Councils, Fire & Rescue Authorities, London Boroughs, Metropolitan Authorities, National Park Authorities, Pension Authorities, Police Authorities, Passenger Transport Executives, Unitary Authorities, and Waste Authorities.

[65] In two procurement exercises, in 2006 (20% of the market) and 2007 (a further 10%).

new regime, however this is difficult to quantify therefore we have continued to use seven for consistency. Table 17 below sets out the calculations.

210. To calculate the total costs incurred by firms when bidding for work the initial costs and subsequent costs were added together. For the 30% of outsourced contracts this gives a total cost of **£5.39m**, **or £1.08m per annum from 2009/10 to 2011/12** (three years of the five year contracts). For the 70% outsourced contracts this gives a total cost of **£5.11m, or £1.02m per annum from 2012/13 to 2016/17**. This, of course, understates the costs in this period because it refers to only the 70% of the market that was outsourced in a new procurement exercise. The Audit Commission extended the contracts it already had in place with suppliers for the remaining 30% of the market, avoiding additional costs (but also passing up the opportunity of driving down costs further by deciding not to put those contracts out to market again). In the new regime, the costs are estimated to be **£10.89m, or £2.18m per year** (based on five-year contracts).

211. The table below sets out the calculations:

Table 17: Subsequent costs to firms

	Number of lots	Up-front costs (initial calculations by 13 firms for 12 categories of body)	Subsequent work (translating across to tender forms) £5000 x 7 x number of lots	Total cost to firms	Annualised cost to firms (over 5 years)
30% outsourced contracts (2009-12)	18	4.76m	0.63m	5.39m	£1. 08m
70% outsourced contracts (2012-17)	10	4.76m	0.35m	5.11m	£1.02m
New regime (2017 onwards)	175	4.76m	6.13m	10.89m	£2.18m

212. This represents an increased cost to business. However, this is offset by the opening up of the local public sector audit market to firms, enabling them to realise greater profits than in the baseline year, and a decreased contribution to system costs.

ANNEX 4 – THE AUDIT REGIME FOR SMALLER LOCAL PUBLIC BODIES

213. The Audit Commission currently operates a separate 'limited assurance' regime for nearly 10,000 smaller local public bodies with an annual turnover below £6.5m. The new audit arrangements will continue to set out a proportionate framework for these bodies.

Current audit regime for smaller local public bodies:

214. Since 2002 the Audit Commission has operated a limited assurance regime for the smaller local public bodies. The limited assurance regime offers a lighter touch form of audit, conducted in volume and off-site. It involves the analytical review of certain financial and other information provided by the body in an annual return to the auditor.

215. The Audit Commission procures and appoints auditors to smaller bodies on the basis of geographically determined contract "lots". An auditor awarded the contract for a particular lot carries out the limited assurance reviews for all smaller bodies within this lot area, unless there is a reason why they cannot undertake an audit (for example, where there is a conflict of interest).

216. In 2009/10, 30% of limited assurance audits were conducted by the Audit Commission's in-house audit practice. In 2012 all limited assurance work was outsourced to the private sector through a public procurement exercise. Therefore, from 2012/13, all limited assurance reviews will be carried out by private audit firms.

217. The costs of the current audit framework for smaller local bodies are met entirely from audit fees paid by smaller local public bodies to the Audit Commission. These fees are set by the Audit Commission so as to cover both the cost of audit (since 2012 fees paid to audit-firms) and the cost of supporting the limited assurance regime.

Current audit fees for smaller local public bodies:

218. The Audit Commission sets the level of fees for smaller local public bodies, following consultation with representative associations and the accountancy profession. Smaller bodies pay a fee roughly proportionate to their turnover, but with some cross-subsidy from larger to smaller bodies, for example, bodies with a turnover of less than £1,000 are exempt from paying any audit fees.

219. For the 2012/13 to 2016-17 period, the Audit Commission has reduced overall fees to the sector by 30% on the previous period, by passing on savings from the outsourcing of in house audit services and other efficiencies. These efficiency savings have been used to exempt all bodies with a turnover below £10,000 from paying audit fees from 2012/13-2016/17.

Table 18: Audit fee levels under current regime

Turnover (£)	Fee level 2009/10 (£)	Fee level 2011/12 (£)	Fee level 2012/13 to 2016/17 (£)
0 to 1,000	0	0	0
1,001 to 5,000	50	50	0
5,001 to 10,000	120	120	0
10,001 to 25,000	135	135	100
25,001 to 50,000	285	285	200
50,001 to 100,000	400	400	300
100,001 to 200,000	550	550	400
200,001 to 300,000	875	875	600
300,001 to 400,000	1,050	1,050	800
400,001 to 500,000	1,450	1,450	1,000
500,001 to 750,000	1,950	1,950	1,300
750,001 to 1,000,000	2,500	2,500	1,600
1,000,001 to 2,000,000	Paid fees for full audit as larger bodies.	3,000	2,000
2,000,001 to 3,000,000		3,500	2,400
3,000,001 to 4,000,000		4,000	2,800
4,000,001 to 5,000,000		4,500	3,200
5,000,001 to 6,500,000		5,000	3,600

Source: Audit Commission

Current cost of supporting the limited assurance regime:

220. The total amount of fees collected from the sector is about £1.9m per year. Of this, about £240,000 (or just under 13%) goes annually to meet the cost of the limited assurance regime. In addition, every five years there are the costs of consulting on fee levels and procuring the audit suppliers. These costs are around £250,000.

Future audit regime for smaller local public bodies:

221. Smaller local public bodies will continue to be subject to proportionate audit requirements under the new regime. The key features of this regime will be:

- The limited assurance form of audit for smaller local public bodies with a turnover under £6.5m will continue, with the National Audit Office specifying requirements through a schedule to the code of audit practice;

- A threshold of £25,000 will be introduced, below which smaller local public bodies would not be automatically subject to an external audit;

- Consistent with the new regime for principal bodies, smaller local public bodies will be responsible for appointing their own external auditors in the same way as principal authorities, and may choose to jointly procure.

- The National Association of Local Councils and Society of Local Council Clerks have proposed to set up a sector-led body to procure and appoint audit services to smaller local public bodies. The body would be funded through a top slice on audit fees and would consult on and determine fee scales for smaller bodies. It would also monitor the quality and timeliness of auditors' work as part of its contract management role.

- Increased transparency requirements for bodies with an annual turnover of less than £25,000.

222. The costs of the new audit framework for smaller local bodies will continue to be met from the sector, whether bodies procure audit services independently, jointly or via a sector-led body. However, there is potential for the sector-led body to achieve savings as it will not have to undertake the full range of activities currently undertaken by the Audit Commission. For example:

    - The sector will not be required to provide the contributions to Ministerial correspondence and Parliamentary Questions provided by the Audit Commission. This is estimated to make an annual saving of £20,000.

    - The sector will not be required to produce the "Auditing the Accounts" report (summarising audit findings across the country) published by the Audit Commission. This is estimated to make an annual saving of about £30,000.

    - Responsibility for providing guidance to auditors will be transferred from the sector to the National Audit Office.

Future audit fees for smaller local public bodies:

Establishment of a sector-led body

223. The establishment of an effective sector-led body for the purpose of procuring and appointing auditors should allow for the continuation of a more proportionate regime for smaller local public bodies, ensuring that the requirements placed on them are in line with their size. The exemption from automatic audit for smaller local public bodies with turnover less than £25,000 will reduce the total volume of audit for the sector. About 64% of bodies have turnover less than £25,000, however their smaller turnover means they only accounted for around 10% of current audit fees. It is unclear how material an impact this volume reduction might have on the unit price of audit for bodies above the £25,000 threshold. Costs for bodies above the £25,000 threshold could increase as a result of reduced buyer power or decrease to reflect the reduced burden of transaction costs, any reduction in cross-subsidy currently provided by the larger small bodies, and the reduced costs of central reporting (see 2.2 above). Despite this uncertain impact

on audit price, the volume reduction is nevertheless expected to reduce the overall audit bill. A sector-led body would need to determine for itself how to share this total bill, including whether there should be any element of cross-subsidy.

Independent procurement and appointments

224. Some smaller bodies may opt to appoint an auditor themselves with the use of an independent auditor panel. It can be assumed that any bodies opting to appoint independently (rather than through a sector-led body) would do so at the same, or lower, cost to that which could be achieved through a sector-led body. Given, however, the lower fees that a sector-led body is likely to achieve through high volume contracts as well as the costs associated with establishing an independent auditor panel and other tendering costs, independent procurement is thought unlikely to present an attractive option for any but the largest small bodies.

225. The largest small bodies constitute a small number of bodies but account for a large share of audit volume. A decision to opt out of the sector-led approach by a relatively small number of these bodies could have an impact on the effectiveness of a sector-led body and thus audit fees for the rest of the sector. Assuming, for example, that the 100 bodies with the highest turnover, which account for around 12% of current fees, chose to appoint independently: this is only 1% of all smaller bodies but would reduce turnover for the sector-led body by 12%. Recognising that any such volume reduction would be in addition to the volume reduction driven by the abolition of audit requirements for bodies with turnover less than £25,000, this calculation highlights the sensitivity of future audit fees to the successful coordination of an effective sector-led body.

226. This impact assessment is based on the policy model of a sector led approach to the procurement of auditors for smaller bodies. If an alternative approach were to be taken, further work would be needed to understand fully the impact on costs and fee levels, although it is expected that there would be a number of upward drivers on fees.

Enhanced Transparency

227. Alongside the maintenance of a proportionate audit framework, smaller authorities with an annual turnover not exceeding £25,000 per year will follow a new proportionate transparency code. Increased transparency under this code will help to improve local accountability and help identify wasteful or inefficient spending and deliver savings. We estimate that total compliance costs for smaller authorities with a turnover under £25,000 will be minimal, in the order of a one-off set up cost of about £1m and then an annual ongoing cost of about £400,000 to the sector. Furthermore, these ongoing costs are expected to be fully offset by the anticipated savings in audit fees from reduced audit requirements (assuming the successful establishment of an effective sector-led body – see above). The estimated annual ongoing benefits are about £500,000. Therefore, the annual ongoing net benefit is estimated to be about £100,000. We do not expect any change in quality between transparency and audit arrangements.

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