



Department for Communities and Local Government

Draft Local Audit Bill

July 2012

Cm 8393

£29.00



Department for Communities and Local Government

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Presented to Parliament by the Secretary of State
for Communities and Local Government
by Command of Her Majesty

July 2012

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This publication is available for download at www.official-documents.gov.uk

This document is also available from our website at www.communities.gov.uk

ISBN: 9780101839327

Printed in the UK by The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office

ID P002499486 07/12

Printed on paper containing 75% recycled fibre content minimum.

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MINISTERIAL FOREWORD

I am delighted to present for pre-legislative scrutiny this draft Local Audit Bill, which sets out our vision for the future of local audit. It has been designed to implement our commitment to disband the Audit Commission and re-focus audit on helping local people hold their councils and other local public bodies to account for local spending decisions.

The current audit arrangements for local public bodies are inefficient and unnecessarily centralised. The Audit Commissioner acts as regulator, commissioner and provider of local audit services, creating a system with weak cost incentives that is too focused on reporting to central Government rather than to local people. The new audit regime set out in this draft Bill will be locally-focused, whilst retaining the high quality of audit we expect.

The programme to disband the Audit Commission and implement a new local audit regime is already bringing significant benefits to local bodies and taxpayers. In 2010 we put an end to the top-down regime of routine inspection and assessment of local bodies. This has reduced the burden on local public bodies so they can concentrate on service delivery and meeting the needs of local people.

The outsourcing of the Commission's in-house practice, undertaken this year, also represents a considerable saving to the taxpayer. Local bodies are already seeing the prospect of reductions of 40% on their 2011/12 audit fee, and this, together with the ending of assessment and inspection, and the slimming down and closure of the Commission, will mean savings to the public purse of more than £650m over the next five years.

We expect these reforms to bring significant long-term savings to taxpayers. By 2017-18 the saving to the public purse is estimated to be around £160m per year. The majority of this will be realised in savings to local government, representing a significant reduction that will help councils in managing their budgets during this challenging period, whilst ensuring the same high audit standards are maintained to safeguard public money.

That said, the benefits of the new audit regime stretch far wider than the immediate financial savings to taxpayers. The new regime will be more localist, allowing local bodies to appoint their own auditors, with appropriate safeguards on independence. The reforms will complement our existing initiatives to increase transparency and enable local scrutiny of public bodies. Additionally, the reforms address the fragmentation and duplication within the current regulatory regime, by merging the regulatory framework for local public audit as far as possible with the Companies Act 2006 system that governs the audit of private sector companies.

This draft Bill sets out our vision for this new local audit framework, where bodies will be able to appoint their own auditors from an open and competitive market, on the advice of an independent auditor appointment panel. The Bill gives new responsibilities to the Financial Reporting Council, which will act as the overall regulator for auditors; the National Audit Office, which will set the code of audit practice; and the professional audit bodies will also have a role in regulating and monitoring auditors.

The new framework will also include a proportionate regime for smaller local public bodies (with an annual turnover below £6.5m). The National Association of Local Councils and the Society of Local Council Clerks have come forward with a proposal to establish a sector-led body to procure and appoint audit services on behalf of smaller bodies. It's good to see the sector working together to come up with its own proposal, and I am happy to make provision for this in the new audit framework. In developing the new framework, I want to place a higher level of trust in the sector, matched with an expectation of greater openness in return.

As well as setting out our proposals, this draft Bill asks a number of questions, to which I welcome responses from any interested parties during the process of pre-legislative scrutiny. Your contribution will help us to refine this draft Bill and our proposals for smaller bodies before full legislation is introduced in Parliament in due course.

A handwritten signature in black ink, reading "Grant Shapps", followed by a period. The signature is written in a cursive, flowing style.

Rt. Hon Grant Shapps MP

1. INTRODUCTION

1. In August 2010 the Government announced its intention to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice to the private sector and put in place a new local audit framework. In this framework, local bodies would be able to appoint their own auditors from an open and competitive market. A robust regulatory framework would be established, ensuring that high standards of auditing continue to be upheld.
2. Earlier that year the Government ended the top-down regime of routine assessment and inspection of local government, as part of its commitment to replacing centralised oversight of local public bodies with greater public transparency and accountability. The Government has brought an end to centrally-imposed targets and indicators for local government, and introduced a new code of recommended practice for local authorities on data transparency. Under the code councils are encouraged to publish key data, including all spending over £500, making it accessible to taxpayers. Together these reforms have brought significant benefits to local bodies and local people. Councils no longer face the burden of compliance with this top-down regime. Instead of reporting upwards to central government, they can concentrate on delivering services to best meet local needs and ensuring that they are properly accountable to their electorate. Local people can see exactly where their money is being spent and hold local government to account.
3. The reforms to local audit complement and enhance the Government's programme to make councils more open and accountable to the electorate by increasing transparency at these bodies. Importantly, the reforms proposed in this draft Bill will protect the rights of taxpayers to inspect the accounts and raise objection to the statement of accounts if they think there are matters that the auditor should report on in the public interest, or items of unlawful spending or ensuring that local people can continue to use this mechanism to hold their local bodies to account.
4. The Government also intends to give greater force to the code of recommended practice on local authority publicity by putting compliance with the code on a statutory basis. We will publish our proposals on this separately in due course and will seek to legislate at the earliest opportunity.
5. Between March and June 2011 the Government consulted on its proposals for the new audit framework. More than 450 responses were received, and the Government response to the future of local audit consultation was published in January 2012. This set out the key themes and views that were raised by the consultation, and what the Government now proposes for the audit of principal local public bodies (bodies with an annual turnover above £6.5m). A copy of the Government response is available at:
<http://www.communities.gov.uk/publications/localgovernment/localauditgovresponse>
6. This draft Local Audit Bill abolishes the existing regime and sets out the proposed new audit framework for local public bodies which were previously covered by the Audit Commission regime. It sets out the process for the appointment of auditors, and the regulatory framework for local public audit. A full explanation of the policy content of the draft Bill can be found in Chapter 2: Policy Overview, along with

consultation questions on the clauses. The draft Bill should also be read in conjunction with the Explanatory Notes at Chapter 6. We will seek to shorten and simplify the Bill, if at all possible, before it is formally introduced to Parliament as a final Bill.

Impact Assessment

7. An impact assessment has been prepared to accompany the draft Local Audit Bill. This estimates the monetised and non-monetised impact of the proposals for principal local bodies, and estimates the savings to the public purse to be over £1bn during a ten-year period, of which £650m will be realised in the next five years. A final impact assessment will be prepared to accompany the full legislation, and will include an assessment of the impact of the reforms on smaller bodies. A summary of the draft impact assessment and consultation questions can be found in Chapter 3. The full draft impact assessment is at Annex C.

Audit of local health bodies

8. Following the Royal Assent of the Health and Social Care Act 2012, it is proposed that local health bodies will be subject to audit under the new local public audit framework.
9. The detailed audit arrangements are still under development and will cover:
 - a. The code of audit practice;
 - b. The regulation and quality assurance of audits;
 - c. The appointment of auditors; and
 - d. The scope of the audit.
10. The detail of the audit arrangements for these local health bodies will be published in time for the scrutiny of the draft Local Audit Bill by Parliament and the Government intends that the provisions on the audit arrangements for local health bodies will be included in the final Bill.

Audit of Smaller Bodies

11. The Audit Commission currently applies a lighter touch and more proportionate system of audit to smaller local public bodies (with a turnover below £6.5m). The new framework will continue to specify a proportionate regime for these bodies, with a power in the draft Bill to vary elements of the new framework for smaller local public bodies in regulations. This includes varying the regulations governing appointment of an auditor so that smaller bodies will be able to appoint an auditor using a sector-led body. Additionally, there will be a more proportionate regulatory regime. The limited assurance form of audit currently used by the Audit Commission will continue to apply to smaller bodies. The National Audit Office will produce a schedule to the code of audit practice specifying how the limited assurance audit regime will operate. These proposals, and consultation questions, are set out in detail in Chapter 4.
12. This document has been developed by the Department for Communities and Local Government. Our proposals have been discussed with a wide range of partners and bodies affected by the changes. These include the Audit Commission, the National Audit Office, the Financial Reporting Council, professional accountancy bodies, local government, other local public bodies and government departments with an interest.

2. POLICY OVERVIEW

13. This section outlines the Government's proposals for the new audit arrangements for local public bodies.
14. The proposals contained in the draft Bill have been formulated with four key design principles in mind. These are:
 - a. **Localism and decentralisation** - enabling local bodies to appoint their own independent external auditors, subject to appropriate safeguards.
 - b. **Transparency** - ensuring that results of audit are accessible to the public, enabling local bodies to be held to account for local spending decisions.
 - c. **Lower audit fees** - ensuring that the audit fees paid by local public bodies are competitive.
 - d. **High standards of auditing** - ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit.
15. In achieving the principle of high standards of auditing, regard has also been given to the principles of local public audit, which were codified in 1998 by the Public Audit Forum, but have deep historical roots. These are:
 - a. Independence of public sector auditors from the organisations being audited;
 - b. The wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money; and
 - c. The ability of public auditors to make the results of their audits available to the public, to democratically elected representatives, and other key stakeholders.
16. In setting out the Government's proposals this section follows the structure of the draft Bill, so as to facilitate cross-referencing between the two. A clause by clause explanation of the draft Bill can be found in Chapter 6: Explanatory Notes.
17. There are a number of questions posed in this section that we would welcome your views on as part of the consultation process for this draft Bill. The full list of questions and details of how to respond can be found at Annex A.

Part 1 – Abolition of existing regime

18. This section of the draft Bill abolishes the Audit Commission and repeals the Audit Commission Act 1998. It also makes provision for the transfer of the Audit Commission's property, rights and liabilities on closure (as set out in Schedule 1).
19. In the new audit framework there will be no need for a central body to appoint auditors to or oversee the audits of local public bodies, as these functions will rest with the bodies themselves. The Commission's in-house practice will have already transferred to the private sector. A new regulatory regime will govern the new public audit framework, and other functions will either end or transfer elsewhere.
20. On closure, the Audit Commission will have various outstanding liabilities, which will need to transfer to another body. The major liability being property leases running beyond the lifetime of the Commission. It is agreed in principle any

remaining liability will transfer to DCLG in late 2013 when the Commission ceases to have any estates management capability.

21. On closure, the current audit contracts that the Audit Commission has with private sector firms for carrying out the audit of local bodies will be transferred to another body. The current contracts were let in 2012 and will run until 2017 (with the possibility of extension until 2020). As it is envisaged that the Commission will have been abolished before that date, the contracts will transfer so they can run for their full duration. The Government is currently exploring options for where the contracts might transfer to be managed after the Audit Commission closes.

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

Part 2 – Basic concepts and requirements

22. Part 2 of the draft Bill sets out the general accounting and audit requirements for local public bodies. The accounting requirements have been recast in a modern form closely following the accounting provisions of the Companies Act 2006 and the Charities Act 2011. A clear distinction is drawn between the accounting records that must be maintained during the year and the annual statements of accounts that must be published after the year end. Previous legislation requiring the accounts to be made up annually was based on an outdated approach to maintaining accounts and was a source of confusion. The accounts are required to be audited by an auditor appointed by the body.
23. The draft Bill will apply to bodies in England only, and port health authorities and internal drainage boards that may be partly in England and partly in Wales. A full list of bodies that the draft Bill applies to is set out at Schedule 2 of the Bill. Schedule 2 does not yet include local health bodies, but the Government intends that these bodies will be included in full legislation.
24. In order to ensure that the new audit framework is proportionate for all bodies, the arrangements for smaller and larger local public bodies will be different in various respects. The draft Bill therefore includes a power to vary the provisions for smaller bodies in regulations. In the draft Bill, smaller bodies are defined as those with an annual turnover of less than £6.5m, as set out in the current Accounts and Audit regulations. The £6.5m threshold was set in 2011 and may be reviewed and amended by the Secretary of State.
25. In order to ensure that bodies do not move across the threshold on an annual basis, bodies are required to exceed the threshold of £6.5m for three consecutive years before they are considered to be 'larger authorities'. Detailed proposals for the audit of smaller bodies are set out in Chapter 4.

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

Part 3 – Appointment etc of auditors

26. In the new audit framework local public bodies will appoint their own auditors. This section of the draft Bill sets out the requirements of that process.
27. Independence is a key principle of public audit, and the Government believes that safeguarding independence during the process of appointing an auditor is vital. Therefore, the draft Bill sets out the requirement for local bodies to take into consideration the advice of an independent panel before making the appointment

of their auditor. This independent 'auditor panel' must consist of a majority of independent members, and have an independent chair. To be classified as independent, a panel member must not have been a member or officer of the body within the last five years, and must not at that time be a relative or close friend of a member or officer of the body.

28. Provided they meet the requirements for the auditor panels, the draft Bill will allow bodies to nominate their existing audit committee to act as its independent auditor panel. The draft Bill also aims to allow separate bodies to share auditor panels, and enable joint procurement arrangements.
29. The draft Bill includes provisions to vary these arrangements for specific bodies, to reflect their particular requirements and structures. As signalled in the Government response, we recognise that it may be appropriate to use this to strengthen safeguards for some non-elected bodies, while balancing the need for independence with minimising any additional bureaucratic burdens. For local authorities operating executive arrangements, the draft Bill ensures that the appointment is made by full council and not delegated to the executive. Similarly for the Greater London Authority it requires that the appointment is made by the Mayor and London Assembly acting jointly. Chief Constables' accounts will be audited by the auditor appointed by the Police and Crime Commissioner to audit the commissioner's own accounts.
30. The draft Bill specifies three functions of the auditor panel:
- a. To advise on the appointment of an auditor;
 - b. To advise the local body on the maintenance of an independent relationship with the auditor; and
 - c. To advise on proposals for a public interest report.

Bodies will be able to delegate further functions to the panel as they see fit. The draft Bill includes a power to provide more details on these specified functions, or to confer additional functions for the panel, by regulations. It also allows for guidance to be issued on their role and practical operation.

31. Transparency is key to the new audit framework and the arrangements for auditor appointment. The draft Bill requires bodies to publicise appointments, the advice of the auditor panel and, if that advice has not been followed, the reasons why.
32. In the event of a body failing to appoint an auditor, the Secretary of State will in these circumstances be able to direct the body to appoint an auditor, or appoint an auditor on its behalf.
33. The draft Bill includes provision for the Secretary of State to make regulations regarding the resignation or removal of an auditor from a local public body. It is envisaged that a resigning auditor would provide a statement explaining their reasons for resignation to the audited body and its independent auditor panel, and to the auditor's supervisory body. The local public body would then be required to make and publish a response to this statement.
34. In the case of removal of an auditor, the audited body would be required to give notice of its intent to remove the auditor to both the independent auditor panel and the auditor – including a statement of reasons. The auditor will be able to respond to this statement, with that response considered by the auditor panel. The body's decision to terminate the appointment will then be subject to the advice of the

auditor panel. Regulations will also set out any provisions to address any potential gap between the resignation and removal of an auditor and their replacement.

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

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

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

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

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

Part 4 – Eligibility and regulation of auditors

35. In the new local public audit framework, new arrangements will be required to ensure that those firms and individuals undertaking local public audit work have the right level of skills, qualifications and experience necessary to undertake that work. In order to assure audit quality there also needs to be appropriate arrangements in place to ensure that the work of local public auditors is reviewed on a regular basis. An appropriate system of registering local public auditors and regulating their work therefore needs to be put in place.
36. The Government has therefore proposed that, as under the Companies Act 2006, the Financial Reporting Council will be responsible for oversight of the regulation of local public audit. In Part 4 of the draft Bill, the Secretary of State takes powers allowing him to authorise professional accountancy bodies to act as recognised supervisory bodies for local public audit. In practice, the Secretary of State would delegate these powers to the Financial Reporting Council. This mirrors the arrangements under the Companies Act 2006.
37. The Financial Reporting Council will be able to authorise existing and additional professional accountancy bodies to be recognised supervisory bodies in respect of local public audit.
38. The draft Bill sets out the role of the recognised supervisory bodies in relation to registration, monitoring and discipline for local public audit. The recognised supervisory bodies will have delegated authority to put in place rules and practices covering:
- a. The eligibility of firms to be appointed as local public auditors (subject to the Financial Reporting Council's oversight, which might include guidance produced by the Council); and
 - b. The qualifications, experience and other criteria that individuals must have before being permitted to carry out a local public audit and sign off an audit report.

39. The Secretary of State will make regulations requiring the keeping of a register of those firms and individuals eligible to undertake local public audit work; it is envisaged that such a register would be held by one or more of the recognised supervisory bodies. Thus in order to be eligible for appointment as a local auditor, a firm will have to be registered to carry out local public audit with a recognised supervisory body. The recognised supervisory bodies will also hold a list of those individuals linked to each firm who are eligible to sign an audit report on behalf of that firm and able to take responsibility for local public audit work. In line with the Companies Act, the draft Bill makes it a criminal offence for a person to carry on as a local auditor if they are ineligible. It will also be an offence for auditors and regulatory bodies to provide misleading, false or deceptive information or for individuals to pretend to be an auditor or for a body to pretend to be a recognised supervisory body or recognised qualifying body.
40. The draft Bill also requires an auditor to meet particular independence requirements to be eligible for appointment to a body, for example they cannot be a member or officer of that body, or an officer or employee of an entity connected with that body (full details are given at clause 20). Connected entities are defined in the draft Bill as an entity whose financial transactions are consolidated into the group accounts of any of the main bodies covered by the new audit framework.
41. We have chosen not to replicate the criminal offence in the Companies Act that relates to lack of independence, as we consider that the current Ethical Standards and existing disciplinary powers of the recognised supervisory bodies provide sufficient safeguards for auditor independence (although it will be an offence for a person to act as a local auditor if they are not eligible to do so). Independent auditor panels will also play an important role in ensuring auditor independence. In addition, if an audit is not carried out by an eligible person, the Secretary of State will have powers to require a second audit by an appropriate person.
42. The responsibility for deciding which firms are eligible to undertake local public audit will lie with the recognised supervisory bodies. Schedule 3 of the draft Bill sets out the legal framework governing the recognised supervisory bodies.
43. Schedule 3 also specifies the arrangements for the monitoring of audits and auditors. In the new audit framework, the recognised supervisory bodies will have responsibility for monitoring the quality of audits undertaken by their member firms. This work will include:
- a. Reviews of individual audit engagements;
 - b. Reviews of the policies, procedures and internal controls of those firms licensed to carry out public sector audits;
 - c. Reporting on the quality of audit to the registration body;
 - d. Investigating complaints or disciplinary cases, as well as issues identified during their monitoring process; and
 - e. Removing a firm from the register of eligible local public auditors.
44. There will be an additional level of oversight and monitoring for audits of significant local public bodies. The Financial Reporting Council will have responsibility for monitoring the quality of what will be termed “major audits”. The draft Bill provides a power for the Secretary of State to establish which bodies would have their audits defined as ‘major audits’. The Government is currently exploring the options for which bodies’ audits would fall into this category. Bodies could then be listed in

regulations. Additionally, the Financial Reporting Council will be able to decide on an annual basis if any other public bodies should be subject to similar additional monitoring. The Financial Reporting Council will then publish the scope of its inspections, following consultation with relevant government departments and the professional accountancy bodies.

45. Under the Companies Act 2006, as well as being subject to additional monitoring, auditors of public interest entities (essentially companies listed on the main London market) are also subject to requirements for the rotation of the key audit partner and additional independence reporting requirements. The draft Bill does not include equivalent requirements around rotation of auditors, as these will be covered in Ethical Standards. The draft Bill also does not replicate the provision for the auditor to report on issues surrounding their independence to the body's audit committee at least once a year. Instead, the draft Bill includes a requirement for bodies to have an independent auditor panel to advise the body on the appointment of its auditor and on the maintenance of an independent relationship on an ongoing basis. In discharging this duty the panel will establish that the auditor is suitably independent to act as such. Further details on the role for the panel in ensuring auditor independence will be set out in statutory guidance or in regulations on the functions of the audit panel (see clause 13).
46. Significant public interest disciplinary cases, including those referred to them by the recognised supervisory bodies, will continue to be dealt with under the Financial Reporting Council's Accountancy and Actuarial Disciplinary Schemes, which can impose a range of sanctions on those auditors found to have committed misconduct.
47. In the new local public audit framework, auditors will need to be suitably qualified to carry out local public audit. Auditors will need to hold an appropriate qualification which could either be a qualification recognised under Part 42 of the Companies Act 2006, or another qualification recognised under the draft Bill. The Secretary of State will be able to make regulations setting out the minimum requirements that other qualifications will need to meet in order to be recognised for the purposes of local public audit. As well as the requirement for an auditor to hold an appropriate qualification, recognised supervisory bodies will be required to have rules in place to ensure that those eligible to sign an audit report on behalf of a firm have suitable experience.
48. Part 4 of the draft Bill also makes provision for recognised supervisory bodies and recognised qualifying bodies, and any person eligible for appointment as a local public auditor to disclose information to the Secretary of State.

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

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

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

Part 5 – Conduct of audit

49. The draft Bill sets out how, in the new audit framework the National Audit Office¹ will set a code of audit practice. The process of setting the code will have the following features:
- a. The National Audit Office will be able, should it wish, to produce more than one code of audit practice, if different codes are required for different types of accounts.
 - b. The National Audit Office will need to consult key interested parties on the code before finalising and publishing the code. The code will then be laid before Parliament, where it will be passed after 40 days as long as there have been no resolutions against it.
 - c. A new code will need to be produced and agreed by Parliament at least every five years.
50. The audit outputs and scope of the audit will remain broadly the same as they currently are. The auditor must enter onto the audited body's statement of accounts a certificate that the auditor has completed the audit in accordance with statutory requirements together with the auditor's opinion on the statement. The auditor must, by examination of the accounts and otherwise, be satisfied that:
- a. The accounts comply with the requirements of the legislative provisions that apply to them;
 - b. Proper practices have been observed in the preparation of the statement of accounts; and
 - c. The authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
51. The National Audit Office will set out more detailed requirements within the code of audit practice and related supporting guidance. The National Audit Office is committed to develop a risk based and proportionate approach which maintains audit standards.
52. A risk based and proportionate approach to the auditor's assessment of the authority's arrangements for securing economy, efficiency and effectiveness in its use of resources has the potential for a consequent decrease or increase in the level of audit work that some local public bodies might experience – but we would not expect this in itself to result in an overall increase in the total cost of audit.
53. The draft Bill retains the right of auditors to access documents and information from audited local public bodies. It also gives local auditors the right to access information from connected entities and their auditors for group accounts purposes. This will help to ensure there is proper scrutiny of the accounts of subsidiary bodies that are responsible for public money, such as local government companies.
54. The draft Bill makes it a criminal offence for an individual at an audited body, a connected entity, or the auditor of a connected entity to prevent the local auditor from having access to any information they require.

¹ The draft Bill clauses place all legal duties on the Comptroller and Auditor General, although references in the covering narrative are to the National Audit Office. We will review this before the final Bill.

55. The draft Bill makes provision for auditors to continue to make reports in the public interest and recommendations to local public bodies in the new audit framework, and sets out the key features of this process. Most elements will remain the same in the new framework as under the current audit regime. In the new framework:

- a. If an auditor issues a public interest report, this may be reported either immediately or at the conclusion of the audit.
- b. Auditors will also be able to make a public interest report on connected entities. Public interest reports issued on connected entities will be supplied to and considered by the relevant 'parent' body.
- c. The auditor must send a copy of public interest report and their recommendations to the appropriate Secretary of State (rather than the Audit Commission under the current framework) when they are sent to the audited body.
- d. There will be a new requirement for an audited body to publish a public interest report on their website if they have one, with the objective of improving transparency. The body must also publish a notice of the meeting at which a public interest report or auditor's recommendation is to be discussed, providing details of the meeting and the subject matter of the auditor's report or recommendation.
- e. Public interest reports and auditors' recommendations must be considered at a meeting held within one month of the report being received by the auditor. If the Greater London Authority receives a public interest report then it must be considered by the London Assembly, with the Mayor of London in attendance.
- f. Having considered the public interest report's recommendations, the audited body must notify its auditor of any decisions that have been taken relating to the report, and publish a summary of these decisions in a manner that is likely to bring them to the attention of the public.
- g. As under the current system, the auditor may charge the audited body for reasonable work involved in undertaking a public interest report.

56. Local electors will continue to be able to inspect and make copies of the statement of accounts and auditor's reports of a local body. We have removed the criminal offences relating to these requirements that are currently in the Audit Commission Act and instead have placed a duty on the audited body to ensure access to the public. Interested persons will retain the right to inspect the accounting records to be audited and documents relating to them. Local electors will also retain the ability to question the auditor about the accounts, and raise objection to the statement of accounts if they think there are matters that the auditor should report on in the public interest, or items of unlawful spending.

57. Local electors will retain the right to make objections to the accounts. However, the draft Bill provides a power for the auditor to exercise discretion and reject vexatious, repeated or frivolous objections. This is because there are now many more mechanisms by which the electorate can hold local public bodies to account than when the right to object to the accounts was introduced more than 150 years ago, and the costs of auditors investigating objections can be disproportionate to the sums involved.

58. The draft Bill retains the right for an auditor to apply to the court for a declaration if the auditor considers that an item of account is contrary to law. It also retains the ability for an auditor to issue an advisory notice if the auditor thinks that the body:
- a. is about to make or has made a decision which incurs unlawful expenditure;
 - b. is about to take or has begun to take a course of action which would be unlawful and likely to lead to loss; or
 - c. is about to enter an item of account which would be unlawful.
59. The draft Bill retains the right for an auditor to make an application for judicial review of a decision of the audited body or a failure by that body to act, which it is reasonable to believe would have an impact on the accounts of that body.
60. The draft Bill replicates the provision in the Audit Commission Act 1998 for the Secretary of State to make regulations about how local public bodies should keep their accounts (Accounts and Audit Regulations).

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

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

Part 6 – Data matching

61. The Audit Commission Act 1998 gives powers to the Audit Commission to require data to be provided by local public bodies for the purposes of data matching. The Audit Commission exercises these powers through a data-matching service for local public bodies called the National Fraud Initiative. These powers are used to match data provided by local public sector bodies, with potential fraud matches returned to the bodies that provided the data for further investigation. The National Fraud Initiative has been very successful, enabling participants to detect £919m in fraud, errors and overpayments since 1996.
62. The draft Bill transfers the Commission's current data-matching powers to the Secretary of State, who in practice will delegate them to the new operational owner of the National Fraud Initiative which will transfer to a new organisation. The National Fraud Authority (an executive agency of the Home Office), the Department for Work and Pensions and the Cabinet Office (ERG) have expressed an interest in taking on operational ownership of the National Fraud Initiative and discussions are on-going.
63. Local public bodies will continue to be required to provide data for data matching purposes. The draft Bill removes the criminal offence relating to this provision in the Audit Commission Act, instead placing a duty on local public bodies to provide this information. The results of data matching will be returned to those from which the matches came, and it will be up to individual bodies to follow up their matches. There will still be a requirement to publish a fee scale and a code of data matching practice, both of which will be formally consulted on. The draft Bill also retains the restrictions and protections around the disclosure of personal information, making it a criminal offence to disclose information obtained through a data matching exercise.

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

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

Part 7 – Inspections, studies and information

64. The draft Bill contains amendments to provisions in Section 10 of the Local Government Act 1999. Currently, under that Act, the Secretary of State can require the Audit Commission to carry out an inspection of a local authority. The provision in the draft Bill gives the Secretary of State a similar power to appoint an inspector to carry out such an inspection, following the abolition of the Audit Commission. We envisage that this power would be rarely used, only where there are concerns about significant governance failure in a local authority.
65. Schedule 5 sets out that the person appointed as inspector would have the same powers of access to an authority's documents that an Audit Commission inspector currently has.
66. As it plans for closure, the Audit Commission is winding down its programme of national 'value for money' studies looking at how local public bodies have used the resources available to them. Remaining studies will focus on summarising the results of audits and on material drawn from the support and information provided to auditors. The Government would like to see a smaller, coherent and complementary programme of value for money studies on local issues.
67. Whilst not directly replacing the Audit Commission's work, there is an opportunity for the National Audit Office to enhance the assurance it provides to Parliament by developing gradually its own value for money programme to include a small number of studies which more explicitly take in local delivery, 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. It will not have a locus to assess the performance of individual councils nor to hold them to account in the way it does central government departments. The National Audit Office believes these studies will be useful in its role in holding central government to account for the money it provides to local public bodies. This work will also support and encourage improved performance locally, by identifying examples of what works in different circumstances.
68. The draft Local Audit Bill includes new powers for the National Audit Office to undertake these studies and access information held by local government. We are exploring the case for the National Audit Office to be able to undertake thematic value for money studies regarding all local public sectors whose bodies are subject to audit under the new audit framework.
69. The National Audit Office recognises that it will need to take account of the work of others when taking forward a future work programme, including sector-led improvement programmes led by the Local Government Association and the work of relevant inspectorates and regulators such as the Care Quality Commission and Her Majesty's Inspectorate of Constabulary (if the powers were to be provided for it to undertake studies within the police sector).
70. The National Audit Office envisages undertaking a small programme of local studies - increasing to six studies in 2014/15. It is committed to working collaboratively regarding its programme of work with local government. With agreement from the sector, the National Audit Office has already established a local government reference panel comprising representatives from local government. The panel provides insight, challenge and advice to help inform the Comptroller and Auditor General's consideration of the programme including

testing whether the overall programme is useful to the sector, scope of individual studies, sources of evidence, types of output and reporting arrangements.

71. The draft Bill also restricts the disclosure of information relating to an individual or a body that is obtained by an auditor or inspector through an audit or inspection, or that is provided to other specified bodies in connection with the exercise of their functions, making it a criminal offence to disclose this information, except in specified circumstances.

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

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

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

Part 8 – General provisions

72. This section sets out the process by which the Secretary of State can make regulations or amend primary legislation using the powers contained in the draft Bill, the territorial extent of the provisions and how various terms in the draft Bill should be interpreted.

3. SUMMARY OF IMPACT ASSESSMENT

73. This section summarises the consultation stage impact assessment that has been prepared alongside the draft Local Audit Bill. The full consultation stage impact assessment is published at Annex C of this document.

74. The Government intends to work closely with partners in the coming months to ensure that the figures in the impact assessment which would be presented alongside any final Bill are as accurate as possible.

Methodology

75. The draft impact assessment sets out the costs and benefits of the programme to disband the Audit Commission and implement a new local audit regime programme over ten years, starting in 2010/11.

76. The draft impact assessment estimates the full cost of the regime as it changes over each of these ten years, and compares this with the full cost of the regime in the baseline year, which is taken to be 2009/10, as this was the last year of the full Audit Commission regime before the reforms were announced. The difference between the baseline year and each subsequent year is taken to be the net benefit (avoided cost).

Total savings

77. The draft impact assessment estimates that, by the time the new framework is fully operational in 2017-18, the savings produced by the reforms will be around £164m per annum. The savings in previous years are less than this, and so the average saving of the ten-year period is £137m per year. The net present value of the total savings over ten years is estimated as £1,151m, with £650m worth of savings realised over the next five years.

78. The savings can be divided into the saving to local government, and the saving to central government. Once the new framework is fully implemented local government will see a saving of around £140m per year.

The Audit Commission framework

79. The costs of the Audit Commission framework have been broken down into key strands. The table below details the total costs in the baseline year (2009/10) and in the final year of the residual Audit Commission (2014/15).

Type of cost	Total cost in baseline year (2009/10)	Forecast costs in 2014/15 (final year of residual Audit Commission)
Paid to firms for outsourced audit work	£40.15m	£73.80m
Paid to researchers, contractors and consultants	£14.31m	-
Costs of in-house auditors (minus overhead)	£97.27m	-
Cost of assessment/inspection (minus overhead)	£21.31m	-
Audit Commission statutory responsibilities, support and overhead costs	£48.00m	£9.00m
Transitional liabilities	-	£1.20m
Surplus: contribution to reserves	-	-£0.70m
Cost to local bodies of compliance	£25.50m	-
Total costs	£246.54m	£83.30m

Note: these are estimates and forecasts, and their limitations as estimates must be acknowledged.

80. In effect, these costs are covered by the audit fees charged to local public bodies, with a small contribution from central government for undertaking particular workstreams, such as Comprehensive Area Assessment. In 2009/10, the Audit Commission's fee income was £175.53m. By 2014/15 it is estimated that this will have reduced to around £81.3m.

81. The Government recognises that these figures are estimates, and will continue to work with the Audit Commission to ensure that the figures published in the full impact assessment alongside any full legislation are as accurate as possible.

The new audit framework

82. The costs in the new audit framework have been identified as the cost to local bodies of their external audit services, the cost of regulating local public audit, the cost of other continuing non-audit functions that will transfer elsewhere following the disbandment of the Audit Commission, and local bodies' compliance costs.

Type of cost	Total annual cost from 2017/18
Cost of external audit service	£74.50m
Cost of National Audit Office regulation and of non-audit functions transferred elsewhere	£3.80m
Local Bodies' Compliance costs	£4.43m
Total costs	£83.23

Note: these are estimates and forecasts, and their limitations as estimates must be acknowledged.

83. The cost of external audit will be the fees paid by local public bodies directly to their auditors. The price of audit in the final year of the outsourced contracts plus an estimate for regulation (£74.5m) is taken to be the baseline cost of audit for when bodies begin to procure their own auditors, as this will set the benchmark for fee negotiations.

84. The draft impact assessment recognises that there are a number of external drivers that could impact on audit fees. Section G sets out fourteen potential drivers of local bodies' audit fees, some of which may act as upward pressures, others as downward pressures, and others with an unidentifiable effect.

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

85. In the new system, regulatory costs will be shared between those bodies who take on the Audit Commission's regulatory functions. These are the Financial Reporting Council, the National Audit Office, and the professional bodies. The draft impact assessment estimates that the regulatory costs will remain the same as under the Audit Commission regime, which are estimated at £4m. The costs to the National Audit Office will be scrutinised and agreed by Parliament, and funded by the Exchequer, whereas those from other regulatory bodies are likely to be passed on to firms and ultimately factored into audit fees, as currently. As an estimate of costs, the draft impact assessment splits the £4m equally between the National Audit Office and the other regulatory bodies.

86. The Government recognises that local bodies will face some costs in order to comply with the new audit framework. As commissioners of audit, local public bodies will face procurement costs, and the costs of recruiting and remunerating an independent auditor panel. The total cost of compliance is estimated to be around £4.43m per year. A full explanation of this figure is given at section H of the draft impact assessment. These figures are estimates, and we would welcome any views as to their accuracy.

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

87. The Government also recognises that audit firms will face increased tendering costs in the new audit regime, as they will tender to individual bodies or groups of bodies rather than to one organisation. However, audit firms will also benefit from the opening up of the audit market to competition, as they will have increased opportunity to realise profits. Firms will also no longer surrender part of the audit fee charged to local bodies to the Audit Commission. Instead they may have to contribute a small regulatory charge, although it is likely that this too will be included in fees.

88. The costs and benefits to businesses of the new regime are considered to be indirect, as only firms that choose to participate in the market will have access to benefits and incur any costs. Full details of how we have calculated the changing costs and benefits during the period of the reforms are given in section I of the draft impact assessment. However, we recognise that these are rough estimates, and would welcome any further information about the costs and benefits of the reforms to businesses.

89. It is also envisaged that the new system will bring important non-monetised benefits, including increased localism, transparency and accountability.

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

4. PROPOSALS FOR THE AUDIT OF SMALLER LOCAL PUBLIC BODIES

90. Since 2002 the Audit Commission has operated a separate 'limited assurance' framework for the c.10,000 smaller local public bodies with an annual turnover below £6.5m.² Limited assurance is a lighter touch form of audit, conducted off-site, reviewing limited financial and other information provided by the body in an annual return to the auditor, and is thus proportionate to the small amounts of public money they control.
91. The Future of Local Audit consultation document, published in March 2011, proposed that different arrangements for smaller bodies would apply in the new audit framework. It also recognised the burden on smaller bodies of the local auditor appointment models proposed for larger public bodies and outlined different options for auditor appointment. In the Government response to the consultation, published in January 2012, we proposed to do further work with the sector to explore and build consensus around the options for smaller bodies before firming up proposals and setting out our preferred approach.
92. Clause 5 in the draft Local Audit Bill makes provision for bodies to be defined as 'smaller authorities', and includes a power for the Secretary of State to make regulations as to how the new framework will apply to these bodies. This will 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. 'Smaller authorities' are defined in the draft Bill as bodies with a turnover below £6.5m, which is in line with the current definition in the Accounts and Audit regulations. This definition may be amended by regulations, should this threshold need to be altered at a future date.
93. The key features of the new framework for the audit of smaller local public bodies are:
- A threshold below which smaller local public bodies would not be automatically subject to an external audit, coupled with increased transparency requirements. A mechanism will be retained for auditor-led scrutiny of these bodies if problems are identified.
 - A proportionate regulatory regime, and the limited assurance form of audit maintained and specified in a schedule to the code of audit practice produced by the National Audit Office.
 - Procurement and appointment: smaller local public bodies will have the option to have their auditors procured and appointed by a sector-owned and sector-managed body. If bodies do not wish to use the sector-led body they can procure and appoint audit services individually or jointly, with the use of an independent auditor panel.

² Parish and town councils and meetings, internal drainage boards, and other small bodies including charter trustees, conservation and harbour boards, port health authorities, and joint committees.

Threshold below which smaller local public bodies will not be subject to an external audit

94. The Future of Local Audit consultation proposed that those smaller local public bodies with an annual turnover below £1,000 should not be subject to an external audit, as this would be disproportionate given the low level of public money for which these bodies are responsible. During the consultation, a number of respondents expressed the view that this threshold was too low. We have therefore assessed the case for raising the threshold above this level and propose to raise it to £25,000, while increasing the transparency requirements for those bodies to strengthen local accountability, and maintaining a mechanism for auditor-led scrutiny. This threshold will be reviewed at a later date with a view to considering whether it could be increased further if it has worked well.
95. While setting the threshold at £25,000 would remove around 64% of smaller local public bodies from the requirement to have an external audit, these bodies are responsible for just 7% of the total money within the smaller bodies sector. Removing the requirement for an automatic annual audit for these bodies would be more proportionate, with greater openness and local pressure a more appropriate safeguard, and a mechanism retained for auditor involvement if necessary. Additionally, as some smaller bodies have received qualified opinions on their accounts several years in a row, external scrutiny by an auditor is not proving to be an effective way of holding these bodies to account.
96. Strengthening the transparency requirements will provide a more effective way to ensure that smaller bodies are accountable to the electorate. This is in line with the Government's wider agenda to move away from bureaucratic accountability towards democratic accountability. We therefore propose a new, proportionate, transparency code for all smaller bodies with an annual turnover below £200,000. The code would require publication of:
- a. All items of expenditure and end of year accounts;
 - b. Minutes, agendas and papers of formal meetings;
 - c. Internal audit report;
 - d. List of councillor/board responsibilities (or their equivalent);
 - e. Annual governance statement; and
 - f. Location of public land and building assets.
97. We consider that publication of these items would provide the electorate with a clear picture of the activities of a smaller body. In addition, these documents are already produced by the majority of bodies with turnover below £200,000 and we therefore consider that compliance with a new transparency code would not place a significant burden on smaller bodies.
98. The code would also recommend that these documents are published online, either on the smaller bodies' websites or those of their billing authorities. We propose that compliance with the code is mandatory for all smaller local public bodies below £200,000. The Government will undertake a statutory consultation with the bodies affected before the transparency code is made mandatory.
99. Alongside this, other protections will remain in place: the electorate will still be able to inspect the accounts of a body below the £25,000 threshold and make complaints to the auditor; and all smaller local public bodies will be required to

have an auditor appointed to whom local people can report problems. The auditor will not carry out any work, unless problems are reported by the electorate, and deemed worth investigating. In addition, any newly formed smaller bodies with turnover below the £25,000 threshold will be required to have a limited assurance review for their first three years. If the audit opinion is qualified within that time the limited assurance review will continue for a further two years.

100. The proposal for a threshold below which bodies would not be subject to external audit could be implemented through clause 3 of the draft Bill. Provisions for the proposed increased transparency requirements have not been included at this time, but will be incorporated in full legislation.

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

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

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

Type of audit to which smaller bodies will be subject

101. The Future of Local Audit consultation proposed that smaller local public bodies should be subject to independent examination, similar to that applied to small charities, rather than a full audit, or the limited assurance regime operated by the Audit Commission. During the consultation, representative bodies were clear that continuation of the limited assurance regime was their preferred option. Under limited assurance, auditors undertake a review of a proforma, the 'annual return,' submitted by the audited body. Unlike independent examination, limited assurance reviews take place 'off site,' and benefit from bulk delivery and are broader in scope.
102. While both the independent examination and limited assurance regimes have strengths, we consider that limited assurance provides for a higher standard of 'audit' and, as it is broader in scope, is more transparent. The establishment of a sector-led procurement and appointment body will also make limited assurance easier to facilitate and more effective. We therefore propose that limited assurance remains the most appropriate form of 'audit' for smaller local public bodies.
103. The National Audit Office will specify the approach to limited assurance through a schedule attached to the code of audit practice, in the same way that the Audit Commission does now. It has also agreed in principle to work with auditors of smaller bodies to produce guidance for limited assurance reviewers. It is envisaged that the proforma used in limited assurance reviews, the 'annual return', will be designed and issued by the Joint Practitioners' Advisory Group (see glossary).

Eligibility and regulation of auditors of smaller bodies

104. The power to vary arrangements for smaller bodies will enable us to ensure that there is a proportionate regulatory regime in place. We envisage that much of the regulatory regime will be consistent with the proposed arrangements for principal bodies, with some more proportionate elements.
105. The provisions in the draft Bill relating to public interest reports will apply equally to smaller bodies. The right of electors to object to the accounts will also be retained.
106. In the new framework auditors will continue to be members of a professional body and will still be subject to the remit of that body.
107. In order to be eligible for appointment to carry out limited assurance reviews, auditors will need to hold an appropriate qualification, which could either be a qualification recognised under the Part 42 of the Companies Act 2006, or another qualification recognised under the draft Bill. This mirrors the approach for larger bodies. However, auditors and audit firms undertaking limited assurance audit would not need to be included on any register of public auditors which will be required to be held by the recognised supervisory bodies for principal bodies in the draft Bill. This is because this requirement would be disproportionate and may preclude smaller firms from entering the market.
108. The audits of smaller bodies would not be subject to the same monitoring regime as larger bodies, as this would be disproportionate. Instead, the sector-led body would monitor the quality and timeliness of limited assurance reviews as part of its contracts management role for those bodies to which it appointed. For those bodies who appointed separately, the monitoring of reviews would fall to the individual bodies and their independent auditor panels.

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

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

Procurement and appointment of auditors to smaller bodies

109. On 31 May 2012, the Minister for Housing and Local Government, Rt Hon Grant Shapps MP, received a proposal from the National Association of Local Councils and Society of Local Council Clerks to set up a sector-led body to procure and appoint audit services to smaller local public bodies. This represents a bottom-up approach, with the sector working together to establish and run the body itself. Central government would play no role in the ownership or management of this body.
110. The proposal outlined that the body would be owned and managed by the smaller bodies' sector, with a management board including one member from each representative body and three independent members (a total of ten members). The body would be funded through a top slice on audit fees, and would consult on and determine fee scales for smaller bodies every five years. The body would also monitor the quality and timeliness of auditors' work as part of its contract management role.

111. The Government considers this a good proposal, which meets the objective of localism for the new framework. While there would be a minority of wholly independent members, the Government considers, given the arms-length nature of the body and the diversity of its members, that this would provide sufficient independence when procuring and appointing audit services. Using the sector-led body would be one way of enabling the efficiencies of bulk buying, and would decrease the administrative burden on those who wanted to use it.
112. Using the power in clause 5 of the draft Local Audit Bill to vary the arrangements for smaller bodies, it is intended that in the new framework smaller bodies will have the option of using the sector-led body to procure and appoint audit services on their behalf. Using the sector-led body will be voluntary, with the option for smaller bodies to procure and appoint individually, or jointly with other smaller bodies, with the use of an independent auditor panel.

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

5. DRAFT LOCAL AUDIT BILL

The following pages contain the clauses of the draft Local Audit Bill.

Local Audit Bill

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TO

Make provision for and in connection with the abolition of the Audit Commission for Local Authorities and the National Health Service in England; to make provision about the accounts of local and certain other public authorities and the auditing of those accounts; to make provision about the appointment, functions and regulation of local auditors; to make provision about data matching; to make provision about examinations by the Comptroller and Auditor General relating to English local authorities; and for connected purposes.

BE IT ENACTED by the Queen’s most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

PART 1

ABOLITION OF EXISTING AUDIT REGIME

1 Abolition of existing audit regime

- (1) The Audit Commission ceases to exist.
- (2) The Audit Commission Act 1998 is repealed.
- (3) Schedule 1 (abolition of Audit Commission: supplementary provision) has effect.
- (4) In this section and that Schedule “the Audit Commission” means the Audit Commission for Local Authorities and the National Health Service in England.

PART 2

BASIC REQUIREMENTS AND CONCEPTS

2 General requirements for accounts

- (1) A relevant authority must keep adequate accounting records.

- (2) “Adequate accounting records” means records that are sufficient –
 - (a) to show and explain the relevant authority’s transactions,
 - (b) to disclose at any time, with reasonable accuracy, the financial position of the authority at that time, and
 - (c) to enable the authority to ensure that any statements of accounts required to be prepared by the authority comply with the requirements imposed by or under this Act.
- (3) A relevant authority must prepare a statement of accounts in respect of each financial year.
- (4) In this Act “financial year” means a period of 12 months ending with 31 March.
- (5) The Secretary of State may by regulations –
 - (a) make provision for a relevant authority’s financial year for the purposes of this Act to be such period as is specified in the regulations;
 - (b) make provision for any requirement in this section not to apply, or to apply with modifications, in relation to the relevant authorities specified or described in the regulations.
- (6) Regulations under subsection (5)(a) may make provision in relation to –
 - (a) all relevant authorities,
 - (b) the relevant authorities specified or described in the regulations.
- (7) In the application of this section to the Common Council, the requirements it imposes apply only in relation to –
 - (a) the collection fund of the Common Council,
 - (b) the City Fund, and
 - (c) the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239).
- (8) References in this Act to accounting records or statements of account in relation to the Common Council are to be read accordingly.
- (9) Section 82 enables the Secretary of State by regulations to make further provision about accounting records and statements of account.

3 General requirements for audit

- (1) The accounts of a relevant authority for a financial year must be audited –
 - (a) in accordance with this Act, and
 - (b) by an auditor appointed by that authority in accordance with this Act.
- (2) In this Act “accounts”, in relation to a relevant authority, means –
 - (a) the authority’s accounting records, and
 - (b) the authority’s statement of accounts.
- (3) The Secretary of State may by regulations make provision for a requirement in this section not to apply, or to apply with modifications, in relation to the relevant authorities specified or described in the regulations.
- (4) In the application of this section to the Common Council, the requirements it imposes apply only in relation to –
 - (a) the collection fund of the Common Council,
 - (b) the City Fund, and

- (c) the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239).
- (5) References in this Act to accounts in relation to the Common Council are to be read accordingly.
- (6) This section is subject to section 9 (accounts of chief officers of police).

4 Relevant authorities

- (1) In this Act “relevant authority” means a person listed in Schedule 2.
- (2) The Secretary of State may by regulations amend Schedule 2 by adding, modifying or removing a reference to a relevant authority.
- (3) Regulations under subsection (2) may add a reference to a person to Schedule 2 only if that person exercises functions of a public nature in relation to an area which is—
 - (a) wholly in England, or
 - (b) partly in England and partly in Wales.
- (4) The power in section 100 in its application to regulations under subsection (2) includes power to make amendments that make provision in relation to a relevant authority added to Schedule 2 that is different to the provision made by or under this Act in relation to other relevant authorities.

5 Application of Act to smaller authorities

- (1) The Secretary of State may by regulations provide for any provision of or made under this Act not to apply, or to apply with modifications, in relation to smaller authorities.
- (2) Regulations under subsection (1) may, in particular—
 - (a) provide for the appointment, by a person specified by the Secretary of State, of an auditor to audit the accounts of a smaller authority;
 - (b) make provision about the eligibility of a person to be appointed as such an auditor;
 - (c) make provision about the audit of such accounts.
- (3) For the purposes of this section, a relevant authority is a “smaller authority” for a financial year if—
 - (a) where that year is the year in which the authority was established, the qualifying condition is met for that year,
 - (b) where that year is the year following that in which the authority was established, the qualifying condition is met for that year or the previous year, and
 - (c) where that year is the second or any subsequent year following that in which the authority was established, the qualifying condition is met for that year or either of the two previous years.
- (4) The qualifying condition is met for a relevant authority and a financial year if the higher of the authority’s gross income for the year and its gross expenditure for the year does not exceed £6.5 million.

- (5) For the purpose of determining, at a time when a relevant authority's gross income or expenditure for a financial year cannot be accurately determined, whether subsection (4) applies or will apply to the authority, that subsection is to be read as referring to the authority's estimated gross income or expenditure (as the case may be).
- (6) The Secretary of State may by regulations make provision about the application of this Act (including in its application by virtue of this section) or any provision made under it in a case where –
 - (a) an authority is treated as a smaller authority for a financial year, and
 - (b) the authority was not in fact a smaller authority for that year.
- (7) The Secretary of State may by regulations amend any of subsections (3) to (5).

PART 3

APPOINTMENT ETC OF AUDITORS

Duty to appoint auditor

6 Appointment of auditors: general

- (1) A relevant authority must appoint an auditor to audit its accounts for a financial year not later than 31 December in the preceding financial year.
- (2) A relevant authority may appoint an auditor to audit its accounts for more than one financial year; but the authority must make a further appointment of an auditor at least once every 5 years.
- (3) Subsection (2) does not prevent the relevant authority from re-appointing an auditor.
- (4) The Secretary of State may by regulations amend subsection (2) so as to alter the period for the time being specified in it.
- (5) An auditor appointed under this section –
 - (a) must be eligible for appointment as a local auditor (see Part 4), and
 - (b) must not be prohibited from acting as a local auditor of the relevant authority by virtue of section 20(1) (independence requirement).
- (6) This section is subject to section 9 (accounts of chief officers of police).

7 Appointment of auditors: procedure

- (1) A relevant authority must consult and take into account the views of its auditor panel on the selection and appointment of an auditor under section 6.
- (2) The relevant authority must, within the period of 28 days beginning with the day on which the appointment is made, publish a notice that –
 - (a) states that it has made the appointment,
 - (b) identifies the auditor that has been appointed,
 - (c) sets out the advice of its auditor panel about the appointment, and
 - (d) if it has not followed that advice, sets out the reasons why it has not done so.
- (3) The notice must be published –

- (a) if the relevant authority has a website, on its website;
 - (b) otherwise, in such manner as the authority thinks is likely to bring the notice to the attention of persons who live in its area.
- (4) The relevant authority must exclude from the notice information whose disclosure the authority reasonably considers would prejudice commercial confidentiality.
- (5) This section is subject to section 9 (accounts of chief officers of police).

8 Appointment of auditors: certain local authorities

- (1) If a relevant authority is a local authority operating executive arrangements, the function of appointing an auditor to audit its accounts is not the responsibility of an executive of the authority under those arrangements.
- (2) If a relevant authority is a local authority within the meaning of section 101 of the Local Government Act 1972 (arrangements for discharge of functions), that section does not apply to the authority's function of appointing an auditor to audit its accounts.
- (3) An auditor appointed to audit the accounts of the Greater London Authority must be appointed by the Mayor of London and the London Assembly acting jointly on behalf of the Authority.

9 Appointment of auditors: chief officers of police

- (1) Subsections (2) to (4) apply to the accounts for a financial year of a chief constable for an area.
- (2) The chief constable must not appoint an auditor to audit the accounts.
- (3) The accounts must be audited by the auditor appointed by the police and crime commissioner for the area to audit the commissioner's accounts for the financial year.
- (4) The police and crime commissioner must consult and take into account the views of the commissioner's auditor panel on the selection and appointment of the auditor.
- (5) Subsections (6) to (8) apply to the accounts for a financial year of the Commissioner of Police of the Metropolis.
- (6) The Commissioner of Police of the Metropolis must not appoint an auditor to audit the accounts.
- (7) The accounts must be audited by the auditor appointed by the Mayor's Office for Policing and Crime to audit the Office's accounts for the financial year.
- (8) The Mayor's Office for Policing and Crime must consult and take into account the views of the Office's auditor panel on the selection and appointment of the auditor.

10 Appointment of auditors: other authorities

- (1) The Secretary of State may by regulations make provision about the appointment of an auditor to audit the accounts of a relevant authority –
 - (a) which is not an authority to which section 8 or 9 applies, and

- (b) which is specified, or of a description specified, in the regulations.
- (2) Regulations under this section may, in particular –
 - (a) make further provision about the operation of this Act or any provision made under it in relation to a relevant authority to which the regulations apply;
 - (b) provide for any provision of or made under this Act not to apply, or to apply with modifications, in relation to a relevant authority to which the regulations apply.

Auditor panels

11 Requirement to have auditor panel

- (1) Each relevant authority must have an auditor panel to exercise the functions conferred on auditor panels by or under this Act.
- (2) The auditor panel of a relevant authority (“R”) must be –
 - (a) a panel appointed as an auditor panel by R,
 - (b) a panel appointed as an auditor panel by R and one or more other relevant authorities,
 - (c) a committee of R to which subsection (3) applies, or
 - (d) a panel to which subsection (4) applies.
- (3) This subsection applies to a committee of R (however described) which has not been appointed as an auditor panel if –
 - (a) R determines that the committee should be R’s auditor panel,
 - (b) the committee agrees to be R’s auditor panel, and
 - (c) the committee complies with the provision applying to auditor panels made by or under section 12.
- (4) This subsection applies to a panel if –
 - (a) the panel is (by virtue of any of paragraphs (a) to (c) of subsection (2)) the auditor panel for a relevant authority other than R,
 - (b) R determines that the panel should be R’s auditor panel,
 - (c) the panel agrees to be R’s auditor panel, and
 - (d) the panel complies (as regards R) with the provision applying to auditor panels made by or under section 12.
- (5) References in subsections (2) and (3) to a committee of R include a sub-committee of a committee of R.
- (6) The function of appointing a panel or making a determination under this section is to be exercised in the case of the Greater London Authority by the Mayor of London and the London Assembly acting jointly on behalf of the Authority.
- (7) This section does not apply to –
 - (a) a chief constable, or
 - (b) the Commissioner of Police of the Metropolis.

12 Constitution of auditor panel

- (1) A relevant authority’s auditor panel –

- (a) must consist of a majority of independent members (or wholly of independent members), and
 - (b) must be chaired by an independent member.
- (2) A member of a relevant authority's auditor panel is "independent" at any given time if—
 - (a) the panel member has not been a member or officer of the authority within the period of 5 years ending with that time, and
 - (b) the panel member is not at that time a relative or close friend of a member or officer of the authority.
- (3) In the application of subsection (2) to a corporation sole, the reference to a member is a reference to a holder of that office.
- (4) For the purposes of subsection (2), a person ("R") is a relative of another person ("P") if R is—
 - (a) P's partner,
 - (b) P's parent or grandparent,
 - (c) P's son, daughter, stepson, stepdaughter or grandchild,
 - (d) P's brother or sister,
 - (e) P's uncle, aunt, nephew or niece,
 - (f) a parent, son, daughter, brother or sister of P's partner, or
 - (g) a partner of any person within paragraphs (b) to (f),and for this purpose "partner" means a spouse, civil partner or someone a person lives with as if they were husband and wife or civil partners.
- (5) The Secretary of State may by regulations amend subsection (2), (3) or (4).
- (6) The Secretary of State may by regulations make provision about the constitution of an auditor panel.
- (7) This includes further provision about the matters in mentioned in subsection (1) and provision about—
 - (a) the number of members of an auditor panel;
 - (b) the appointment of members of an auditor panel (including to fill casual vacancies);
 - (c) the term of office of members of an auditor panel;
 - (d) the removal or resignation of members of an auditor panel, or of the chair;
 - (e) the payment of remuneration or allowances to members of an auditor panel;
 - (f) the proceedings and validity of proceedings of an auditor panel.
- (8) The regulations may provide for any of those matters to be determined for a relevant authority's auditor panel by the authority.
- (9) A relevant authority must meet the reasonable expenses of its auditor panel incurred by the panel when acting as such.

13 Functions of auditor panel

- (1) A relevant authority's auditor panel must advise the authority on the maintenance of an independent relationship with the auditor appointed to audit its accounts.

- (2) The auditor panel of a relevant authority must advise the authority on the selection and appointment of an auditor to audit its accounts.
- (3) Advice under subsection (1) or (2) must be given –
 - (a) if the relevant authority asks for it, and
 - (b) at other times, if the auditor panel thinks it is appropriate to do so.
- (4) A relevant authority's auditor panel must advise –
 - (a) the authority on any proposal by the authority to enter into a liability limitation agreement (see section 16);
 - (b) the authority's auditor on any proposal to make a public interest report in relation to the authority or any entity connected with the authority.
- (5) Advice under subsection (4) must be given if the auditor asks for it.
- (6) The Secretary of State may by regulations –
 - (a) provide more details about an auditor panel's functions under any of subsections (1) to (5);
 - (b) confer or impose other functions on a relevant authority's auditor panel in relation to the audit of the authority's accounts;
 - (c) enable a relevant authority to confer or impose other functions on its auditor panel in relation to the audit of its accounts.
- (7) A relevant authority must publish advice from its auditor panel in such manner as it considers likely to bring the advice to the attention of persons who live in its area.
- (8) An auditor panel must have regard to any guidance issued by the Secretary of State in exercising, or deciding whether to exercise, its functions.
- (9) A relevant authority must have regard to any guidance issued by the Secretary of State in exercising, or deciding whether to exercise, its functions in relation to its auditor panel.

14 Relationship with relevant authority

- (1) A relevant authority must, if asked to do so by its auditor panel, supply to the panel any documents or information held by the authority and required by the panel for the exercise of its functions.
- (2) A relevant authority's auditor panel may require a member or officer of the authority to come to a meeting of the panel to answer its questions.
- (3) A person mentioned in subsection (2) must comply with a requirement imposed by an auditor panel under that subsection.
- (4) This does not require the person to answer any questions which the person would be entitled to refuse to answer in or for the purposes of proceedings in a court in England and Wales.

Failure to appoint auditor

15 Failure to appoint auditor

- (1) If it appears to the Secretary of State that a relevant authority has failed to appoint an auditor in accordance with this Part, the Secretary of State may –

- (a) direct the authority to appoint an auditor named in the direction, or
 - (b) appoint an auditor on behalf of the authority.
- (2) An appointment under subsection (1)(b) takes effect –
 - (a) as if it had been made by the relevant authority, and
 - (b) on the terms specified by the Secretary of State in the direction.
- (3) The Secretary of State must –
 - (a) inform the relevant authority of the intention to give a direction or appoint an auditor under subsection (1) not less than 28 days before the direction is given or the appointment made, and
 - (b) consider any representations made by the relevant authority regarding the proposed direction or appointment.
- (4) But the Secretary of State may give a direction or make an appointment under subsection (1) without having complied with subsection (3) if the Secretary of State thinks it is likely that an auditor would have to exercise a function under this Act in relation to a relevant authority within the period of 60 days beginning with the day on which the direction is given or the appointment is made.

Limitation of auditor's liability

16 Limitation of auditor's liability

- (1) This section applies to an agreement (a “liability limitation agreement”) that purports to limit the amount of a liability owed to a relevant authority by its auditor in respect of any negligence, default, breach of duty or breach of trust occurring in the course of the audit of accounts, of which the auditor may be guilty in relation to the authority.
- (2) A liability limitation agreement must comply with regulations made by the Secretary of State.
- (3) Regulations under subsection (2) may, in particular, –
 - (a) make provision about the duration of a liability limitation agreement;
 - (b) make provision as to the amount to which an auditor's liability may be limited by a liability limitation agreement.
- (4) Regulations under subsection (2) may –
 - (a) require a liability limitation agreement to contain provisions, or provisions of a description, specified in the regulations;
 - (b) prohibit a liability limitation agreement from containing provisions, or provisions of a description, specified in the regulations.
- (5) Regulations under subsection (2) may provide –
 - (a) that a liability limitation agreement that does not comply with the regulations is void;
 - (b) that a liability limitation agreement is effective only to the extent that it complies with the regulations;
 - (c) that, in the circumstances specified in the regulations, a provision of a liability limitation agreement that does not comply with the regulations is to have effect as if it complied with the regulations.

- (6) The power to make regulations under subsection (2) may in particular be exercised with a view to preventing adverse effects on competition.
- (7) A liability limitation agreement that complies with regulations under subsection (2) is not subject to section 2(2) or 3(2)(a) of the Unfair Contract Terms Act 1977.
- (8) Before entering into a liability limitation agreement, a relevant authority must consult and take into account the views of its auditor panel.

Resignation and removal of auditor

17 Resignation and removal of auditor

- (1) The Secretary of State may by regulations make provision about –
 - (a) the resignation of a local auditor from that office;
 - (b) the removal of a local auditor from that office before the expiry of the term of that office.
- (2) Regulations under subsection (1)(a) may, in particular, make provision about –
 - (a) the steps that must be taken by a person who is a local auditor to resign from that office;
 - (b) the time at which the resignation takes effect;
 - (c) the steps that must be taken in connection with the resignation by the relevant authority for which the person is or was a local auditor;
 - (d) the role of the authority’s auditor panel or of a recognised supervisory body in connection with the resignation.
- (3) Regulations under subsection (1)(b) may, in particular, make provision about –
 - (a) the steps that must be taken to remove a local auditor from that office;
 - (b) the person or persons by whom those steps must be taken and the way in which they must be taken;
 - (c) the steps that may be taken by the local auditor in connection with the local auditor’s removal from that office;
 - (d) the role of a relevant authority’s auditor panel or of a recognised supervisory body in connection with the removal of the authority’s local auditor from that office;
 - (e) the steps that must be taken by the relevant authority after the removal of the local auditor from that office.
- (4) Regulations under subsection (1) that confer functions on a recognised supervisory body may make provision about the supply to the body by a relevant authority of documents or information relating to the resignation or removal of a local auditor.
- (5) In this Act “local auditor” means a person appointed under this Act as auditor of a relevant authority.

PART 4

ELIGIBILITY AND REGULATION OF AUDITORS

Eligibility for appointment as local auditor

18 Eligibility for appointment as local auditor

A person is eligible for appointment as a local auditor only if the person –

- (a) is a member of a recognised supervisory body (see section 23 and Schedule 3), and
- (b) is eligible for appointment under the rules of that body.

19 Effect of ineligibility

- (1) A person may not act as a local auditor of a relevant authority if the person is ineligible for appointment as a local auditor.
- (2) If, at any time during a local auditor's term of office, the auditor becomes ineligible for appointment, the auditor must immediately –
 - (a) resign that office (with immediate effect), and
 - (b) give notice in writing to the relevant authority of the resignation and the reasons for it.
- (3) A person is guilty of an offence if the person –
 - (a) acts as a local auditor in breach of subsection (1), or
 - (b) fails to give the notice mentioned in paragraph (b) of subsection (2) in accordance with that subsection.
- (4) A person guilty of an offence under subsection (3) is liable –
 - (a) on conviction on indictment, to a fine;
 - (b) on summary conviction, to a fine not exceeding the statutory maximum.
- (5) A person is guilty of an offence if the person –
 - (a) has been convicted of an offence under subsection (3)(a) or this subsection, and
 - (b) continues to act as a local auditor in breach of subsection (1) after the conviction.
- (6) A person is guilty of an offence if –
 - (a) the person has been convicted of an offence under subsection (3)(b) or this subsection, and
 - (b) after the conviction, the person continues to fail to give the notice mentioned in subsection (2)(b).
- (7) A person guilty of an offence under subsection (5) or (6) is liable –
 - (a) on conviction on indictment, to a fine;
 - (b) on summary conviction, to a fine not exceeding 10% of the statutory maximum for each day on which the act or failure continues.
- (8) In proceedings against a person ("P") for an offence under this section, it is a defence for P to show that P did not know and had no reason to believe that P was, or had become, ineligible for appointment as a local auditor.

*Independence requirement***20 Independence requirement**

- (1) A person (“P”) may not act as local auditor of a relevant authority if one or more of subsections (2), (3) and (4) apply to P.
- (2) This subsection applies if –
 - (a) P is a member or officer of the relevant authority,
 - (b) where the relevant authority is an office that is a corporation sole, P is the holder of that office, or
 - (c) P is a partner or employee of a person within paragraph (a) or (b), or a partnership of which such a person is a partner.
- (3) This subsection applies if –
 - (a) P is an officer or employee of an entity connected with the relevant authority, or
 - (b) P is a partner or employee of a person within paragraph (a), or a partnership of which such a person is a partner.
- (4) This subsection applies if there exists a connection of a prescribed description between –
 - (a) P or an associate of P, and
 - (b) the relevant authority or an entity connected with the relevant authority.
- (5) In subsection (4) “prescribed” means prescribed by regulations made by the Secretary of State.
- (6) A local auditor of P is not to be regarded as an officer of P for the purposes of subsections (2) and (3).
- (7) For the purposes of this Act, an entity (“E”) is connected with a relevant authority at any time if –
 - (a) it is an entity other than the relevant authority, and
 - (b) in accordance with proper practices in force at that time, the financial transactions of E must be consolidated into the relevant authority’s statement of accounts for the financial year in which that time falls.
- (8) In subsection (7) “entity” means any entity, whether or not a legal person.
- (9) The Secretary of State may by regulations amend subsection (7) or (8).

21 Effect of lack of independence

If, at any time during the term of office of a local auditor of a relevant authority, the local auditor becomes prohibited from acting by section 20(1), the local auditor must immediately –

- (a) resign that office (with immediate effect), and
- (b) give notice in writing to the relevant authority of the resignation and the reasons for it.

Effect of appointment of partnership

22 Effect of appointment of a partnership

- (1) This section applies where a partnership within subsection (2) is appointed as the local auditor of a relevant authority.
- (2) A partnership is within this subsection if it is constituted under the law of—
 - (a) England and Wales,
 - (b) Northern Ireland, or
 - (c) any other country or territory in which a partnership is not a legal person.
- (3) The appointment is an appointment of the partnership as such and not of the partners.
- (4) Subsection (3) does not apply if any document making the appointment or setting out its terms makes provision to the contrary.
- (5) Where the partnership ceases, the appointment is to be treated as extending to—
 - (a) any appropriate partnership which succeeds to the practice of that partnership, or
 - (b) any other appropriate person who succeeds to that practice having previously carried it on in partnership.
- (6) For the purposes of subsection (5) —
 - (a) a partnership (“P2”) is to be regarded as succeeding to the practice of another partnership (“P1”) only if the members of P2 are substantially the same as those of P1, and
 - (b) a partnership (“P2”) or other person (“A”) is to be regarded as succeeding to the practice of another partnership (“P1”) only if P2 or A succeeds to the whole or substantially the whole of P1’s business.
- (7) Where the partnership ceases and subsection (5) does not apply, the appointment may with the consent of the relevant authority be treated as extending to an appropriate partnership, or any other appropriate person, who succeeds to—
 - (a) the business of the former partnership, or
 - (b) the part of it that the relevant authority agrees is to be treated as comprising the appointment.
- (8) For the purposes of this section, a partnership or other person is appropriate if—
 - (a) the partnership or person is eligible for appointment as a local auditor by virtue of this Part, and
 - (b) the partnership or person is not prohibited by section 20(1) from acting as the local auditor of the relevant authority.

*Supervisory bodies***23 Supervisory bodies**

- (1) In this Part, a “supervisory body” means a body established in the United Kingdom (whether a body corporate or an unincorporated association) which maintains and enforces rules which—
 - (a) deal with the eligibility of persons for appointment as a local auditor and with the conduct of local audit work, and
 - (b) are binding on persons seeking appointment or acting as a local auditor because they are members of that body.
- (2) In this Part, references to the members of a supervisory body are to the persons who, whether or not members of the body, are subject to its rules in seeking appointment or acting as a local auditor.
- (3) In this Part, references to the rules of a supervisory body are to the rules (whether or not laid down by the body itself) which—
 - (a) the body has power to enforce, and
 - (b) are relevant for the purposes of this Part.
- (4) This includes rules relating to the admission or expulsion of members of the body, so far as relevant for the purposes of this Part.
- (5) Schedule 3 (recognition of supervisory bodies) has effect.
- (6) For the purposes of this Act a supervisory body is “recognised” if an order under paragraph 1(1) of that Schedule is for the time being in force in relation to the body.

24 Exemption from liability for damages

- (1) No person within subsection (2) is to be liable in damages for anything done or omitted in the discharge or purported discharge of functions to which this subsection applies.
- (2) The persons within this subsection are—
 - (a) any recognised supervisory body,
 - (b) any officer or employee of a recognised supervisory body, and
 - (c) any member of the governing body of a recognised supervisory body.
- (3) Subsection (1) applies to the functions of a recognised supervisory body so far as relating to, or to matters arising out of, any of the following—
 - (a) rules, practices, powers and arrangements of the body to which the requirements of Part 2 of Schedule 3 apply;
 - (b) the obligations with which paragraph 22 of that Schedule requires the body to comply;
 - (c) any guidance issued by the body;
 - (d) the obligations imposed on the body by or by virtue of this Part.
- (4) The reference in subsection (3)(c) to guidance issued by a recognised supervisory body is a reference to any guidance or recommendation which is—
 - (a) issued or made by it to all or any class of its members or persons seeking to become members, and
 - (b) relevant for the purposes of this Part.

- (5) This includes any guidance or recommendation relating to the admission or expulsion of members of the body, so far as relevant for the purposes of this Part.
- (6) Subsection (1) does not apply –
 - (a) if the act or omission is shown to have been in bad faith, or
 - (b) so as to prevent an award of damages in respect of the act or omission on the ground that it was unlawful as a result of section 6(1) of the Human Rights Act 1998 (acts of public authorities incompatible with Convention rights).

Appropriate qualifications

25 Appropriate qualifications

- (1) A person holds an appropriate qualification for the purposes of this Part only if –
 - (a) the person holds a qualification that is an appropriate qualification in accordance with regulations under this section, or
 - (b) the person holds an appropriate qualification for the purposes of Chapter 2 of Part 42 (statutory audit) of the Companies Act 2006 (see sections 1219 to 1221 of and Schedule 11 to that Act).
- (2) The Secretary of State may by regulations provide for a qualification to be an appropriate qualification for the purposes of this Part if –
 - (a) it is a professional qualification in accountancy,
 - (b) it is obtained from a body established in the United Kingdom, and
 - (c) it meets, or the Secretary of State thinks that it meets, specified requirements.
- (3) Regulations under this section may in particular provide for a qualification to be an appropriate qualification if –
 - (a) it is offered by a body (a “qualifying body”) established in the United Kingdom (whether a body corporate or an unincorporated association), and
 - (b) it is recognised by the Secretary of State in accordance with the regulations.
- (4) Regulations under this section that contain provision under subsection (3) may in particular –
 - (a) provide for the Secretary of State to make an order (a “recognition order”) recognising a qualification offered by a qualifying body;
 - (b) make provision about the application by a qualifying body for a recognition order;
 - (c) provide for the Secretary of State to give directions or impose requirements in connection with the application;
 - (d) make provision about the circumstances in which the Secretary of State may or must make or refuse to make a recognition order;
 - (e) make provision about the steps to be taken by the Secretary of State on making or refusing to make a recognition order;
 - (f) provide for a recognition order to be revoked by a further order (a “revocation order”);

- (g) make provision about the circumstances in which a revocation order may or must be made;
 - (h) make provision about the date on which a revocation order may or must take effect;
 - (i) provide for a revocation order to contain transitional provision;
 - (j) make provision about the steps to be taken by the Secretary of State before or on making a revocation order.
- (5) The requirements that may be specified for a qualification to be an appropriate qualification or to be the subject of a recognition order include, in particular, requirements as to –
 - (a) the persons to whom the qualification is open;
 - (b) the course of instruction undertaken by persons to whom the qualification is awarded;
 - (c) the professional experience of such persons;
 - (d) the examinations passed by such persons;
 - (e) the practical training undertaken by such persons;
 - (f) the rules and arrangements of the body offering the qualification for ensuring or monitoring compliance with other specified requirements.
- (6) Regulations under this section may in particular –
 - (a) provide for exceptions to a specified requirement;
 - (b) confer power on the Secretary of State to give or withhold recognition or approval for the purposes of a specified requirement.
- (7) For provisions about the holding of an appropriate qualification, see paragraphs 6(2) and (3)(a) and 7(2)(a) of Schedule 3.
- (8) In this section “specified” means specified in regulations under this section.
- (9) In this Part “recognised professional qualification” means a professional qualification that is –
 - (a) offered by a qualifying body, and
 - (b) recognised by the Secretary of State in accordance with regulations under this section.
- (10) In this Act “recognised qualifying body” means a qualifying body offering a recognised professional qualification.

Information

26 Matters to be notified to the Secretary of State

- (1) The Secretary of State may require a recognised supervisory body or a recognised qualifying body –
 - (a) to notify the Secretary of State immediately of the occurrence of specified events,
 - (b) to give the Secretary of State specified information about those events, and
 - (c) to give the Secretary of State specified information at specified times or in respect of specified periods.
- (2) The notices and information must be notices and information that the Secretary of State reasonably requires for the exercise of functions under this Part.

- (3) The Secretary of State may require information given under this section to be given in a specified form or verified in a specified manner.
- (4) Any notice or information required to be given under this section must be given in writing unless some other manner is specified.
- (5) In this section “specified” means specified by the Secretary of State in writing.

27 Secretary of State’s power to call for information

- (1) The Secretary of State may by notice in writing require a person within subsection (2) to give the Secretary of State information that the Secretary of State reasonably requires for the exercise of functions under this Part.
- (2) The persons within this subsection are –
 - (a) any recognised supervisory body,
 - (b) any recognised qualifying body, and
 - (c) any person eligible for appointment as a local auditor by virtue of this Part.
- (3) The Secretary of State may require any information required under this section to be given within a reasonable period, and verified in a manner, that is specified by the Secretary of State.

28 Provision of documents to the Secretary of State

- (1) For the purpose of assisting a person listed in subsection (2) to maintain proper standards in the auditing of the accounts of a relevant authority, the person may require the authority to make available for inspection by that person –
 - (a) the accounts concerned, and
 - (b) the other documents relating to the relevant authority that might reasonably be required by a local auditor for the purposes of the audit.
- (2) Those persons are –
 - (a) the Secretary of State,
 - (b) a body designated by order under section 43 (delegation of Secretary of State’s functions under this Part), and
 - (c) a recognised supervisory body.

Enforcement

29 Enforcement: general

- (1) This section applies if at any time it appears to the Secretary of State –
 - (a) in the case of a recognised supervisory body, that any requirement of Part 2 or 3 of Schedule 3 is not satisfied,
 - (b) in the case of a recognised professional qualification offered by a recognised qualifying body, that any requirement under regulations under section 25 applying to the qualification is not satisfied, or
 - (c) that a recognised supervisory body or a recognised qualifying body has not complied with an obligation imposed on it by or by virtue of this Part (other than an obligation to pay a financial penalty under section 33).

- (2) The Secretary of State may do any one or more of the following –
 - (a) give a direction to the body under section 30;
 - (b) make an application to the court in respect of the body under section 32;
 - (c) impose a financial penalty on the body under section 33.
- (3) Subsection (2) is without prejudice to –
 - (a) the powers of the Secretary of State under paragraph 3 of Schedule 3 (revocation of recognition order);
 - (b) any power of the Secretary of State to make a revocation order under regulations under section 25(4).

30 Directions: general

- (1) A direction under this section is one directing a body to take such steps as the Secretary of State considers will –
 - (a) secure that the requirement in question is satisfied or the obligation in question is complied with, or
 - (b) mitigate the effect, or prevent the recurrence, of the failure to satisfy the requirement or comply with the obligation.
- (2) A direction under this section –
 - (a) may only require a body to take steps which it has power to take;
 - (b) may require a body to refrain from taking a particular course of action.
- (3) The power to give a direction under this section is subject to any provision made by or under any other enactment.
- (4) The Secretary of State may take such steps as the Secretary of State considers appropriate to monitor the extent to which a direction under this section is being, or has been, complied with.

31 Directions: supplementary

- (1) Before giving a direction to a body under section 30, the Secretary of State must give the body a notice (a “notice of proposed direction”) accompanied by a copy of the proposed direction.
- (2) A notice of proposed direction must –
 - (a) state that the Secretary of State proposes to give the body a direction in the form of the accompanying draft,
 - (b) identify the requirement or obligation in question and state why it appears to the Secretary of State that the requirement is not satisfied or the obligation has not been complied with,
 - (c) specify a period within which the body may make written representations with respect to the proposal.
- (3) The period specified under subsection (2)(c) –
 - (a) must begin with the date on which the notice of proposed direction is given to the body, and
 - (b) must not be less than 14 days.
- (4) Written representations made by the body within the period specified under subsection (2)(c) must be considered by the Secretary of State.

- (5) After considering any such representations or, in their absence, on the expiry of the period specified under subsection (2)(c), the Secretary of State must decide whether to give the body the proposed direction.
- (6) The Secretary of State must give notice of the decision (a “direction decision notice”) to the body.
- (7) Where the Secretary of State decides to give the proposed direction, the direction decision notice must –
 - (a) contain the direction,
 - (b) state the time at which the direction is to take effect, and
 - (c) specify the Secretary of State’s reasons for the decision to give the direction.
- (8) Where the Secretary of State decides to give the proposed direction, the Secretary of State must publish the direction decision notice in such manner as the Secretary of State considers appropriate for bringing the direction to the attention of persons likely to be affected.
- (9) The Secretary of State may revoke a direction given to a body under section 30 and, where doing so, must –
 - (a) give the body notice of the revocation, and
 - (b) publish the notice in the same manner as the direction decision notice was published.

32 Compliance orders

- (1) If on an application under this section in respect of a body, the court decides that a requirement is not satisfied or an obligation has not been complied with, the court may, subject to subsection (2), order the body to take such steps as it considers will secure that the requirement is satisfied or the obligation is complied with.
- (2) Where the obligation is an obligation to comply with a direction under section 30, the court may not order compliance with the direction unless it also decides that –
 - (a) the requirement in respect of which the direction was given is not satisfied, or
 - (b) the obligation in respect of which the direction was given has not been complied with.
- (3) In this section, “the court” means the High Court.

33 Financial penalties: general

- (1) A financial penalty imposed on a body under this section is a financial penalty of such amount as the Secretary of State considers appropriate, subject to subsection (2).
- (2) In deciding what amount is appropriate the Secretary of State –
 - (a) must have regard to the nature of the requirement which is not satisfied or the obligation which has not been complied with, and
 - (b) must not take into account the Secretary of State’s costs in discharging functions under this Part.
- (3) A financial penalty under this section is payable to the Secretary of State.

- (4) In sections 34 to 36, references to a penalty are to a financial penalty under this section.

34 Financial penalties: supplementary

- (1) Before imposing a penalty on a body, the Secretary of State must give the body a notice (a “notice of proposed penalty”) –
 - (a) stating that the Secretary of State proposes to impose a penalty and the amount of the penalty proposed,
 - (b) identifying the requirement or obligation in question and stating why it appears to the Secretary of State that the requirement is not satisfied or the obligation has not been complied with, and
 - (c) specifying a period within which the body may make written representations with respect to the proposed penalty.
- (2) The period specified under subsection (1)(c) –
 - (a) must begin with the date on which the notice of proposed penalty is given to the body, and
 - (b) must not be less than 21 days.
- (3) Written representations made by the body before the end of the period specified under subsection (1)(c) must be considered by the Secretary of State.
- (4) After considering any such representations or, in their absence, on the expiry of the period specified under subsection (1)(c), the Secretary of State must decide –
 - (a) whether to impose a penalty, and
 - (b) where the Secretary of State decides to do so, whether to reduce the proposed amount of the penalty.
- (5) The Secretary of State must give notice of the decision (a “penalty decision notice”) to the body.
- (6) Where the Secretary of State decides to impose a penalty, the penalty decision notice must –
 - (a) state that the Secretary of State has imposed a penalty on the body and its amount,
 - (b) identify the requirement or obligation in question and state –
 - (i) why it appears to the Secretary of State that the requirement is not satisfied or the obligation has not been complied with, or
 - (ii) where, by that time, the requirement is satisfied or the obligation has been complied with, why it appeared to the Secretary of State when giving the notice of proposed penalty that the requirement was not satisfied or the obligation had not been complied with, and
 - (c) specify a time by which the penalty is required to be paid.
- (7) The time specified under subsection (6)(c) must be at least 3 months after the date on which the penalty decision notice is given to the body.
- (8) Where the Secretary of State decides to impose a penalty, the Secretary of State must publish the penalty decision notice and must do so in such manner as the Secretary of State considers appropriate for bringing the penalty to the attention of persons likely to be affected.

- (9) The Secretary of State may rescind a penalty imposed on a body under section 33 and, where doing so, must –
 - (a) give the body notice of the rescission, and
 - (b) publish the notice in the same manner as the penalty decision notice was published.

35 Appeals against financial penalties

- (1) A body on which a penalty is imposed may appeal to the court on one or more of the appeal grounds.
- (2) The appeal grounds are –
 - (a) that, before the giving of the notice under section 34(1), the requirement in respect of which the penalty was imposed was satisfied or the obligation in respect of which the penalty was imposed had been complied with;
 - (b) that, where the penalty was imposed in respect of a failure to comply with a direction under section 30, before the giving of the notice under section 31(6), the requirement in respect of which the direction was given was satisfied or the obligation in respect of which the direction was given had been complied with;
 - (c) that any of the requirements of section 34 have not been complied with in relation to the imposition of the penalty and the interests of the body have been substantially prejudiced by the non-compliance;
 - (d) that the amount of the penalty is unreasonable;
 - (e) that it was unreasonable of the Secretary of State to require the penalty imposed to be paid by the time specified in the notice under section 34(5).
- (3) An appeal under subsection (1) must be made within the period of 3 months beginning with the day on which the notice under section 34(5) is given to the body in respect of the penalty.
- (4) On any such appeal, where the court considers it appropriate to do so in all the circumstances of the case and is satisfied of one or more of the appeal grounds, the court may –
 - (a) quash the penalty,
 - (b) substitute a penalty of such lesser amount as the court considers appropriate, or
 - (c) in the case of the appeal ground in subsection (2)(e), substitute a later time for the time specified in the notice under section 34(5).
- (5) Where the court substitutes a penalty of a lesser amount it may require the payment of interest on the substituted penalty, accruing from the time specified in the notice under section 34(5) or such later time as the court considers just and equitable.
- (6) Where the court substitutes a later time for the time specified in the notice under section 34(5), it may require the payment of interest on the penalty, accruing from the substituted time or such later time as the court considers just and equitable.
- (7) Where the court dismisses the appeal, it may require the payment of interest on the penalty, accruing from the time specified in the notice under section 34(5).

- (8) Where the court requires the payment of interest under this section, the interest is payable at such rate as the court considers just and equitable.
- (9) Except as provided by this section, the validity of a penalty is not to be questioned by any legal proceedings whatever.
- (10) In this section “the court” means the High Court.

36 Recovery of financial penalties

- (1) If the whole or any part of a penalty is not paid by the time by which it is required to be paid, the unpaid balance from time to time carries interest at the rate for the time being specified in section 17 of the Judgments Act 1838 (unless a different rate is specified by the court under section 35(8)).
- (2) If an appeal is made under section 35 in relation to a penalty, the penalty is not required to be paid until the appeal is determined or withdrawn.
- (3) Subsection (2) does not prevent the court from specifying that interest is to accrue from an earlier date under section 35.
- (4) Subsection (5) applies where a penalty, or any portion of it, has not been paid by the time when it is required to be paid and—
 - (a) no appeal relating to the penalty has been made under section 35 during the period within which such an appeal can be made, or
 - (b) an appeal has been made under that section and has been determined or withdrawn.
- (5) The Secretary of State may recover from the body, as a debt due to the Secretary of State, any of the penalty and any interest which has not been paid.

Registration of auditors etc

37 The register of auditors

- (1) The Secretary of State must make regulations requiring the keeping of a register of the persons eligible for appointment as a local auditor.
- (2) The regulations must require each person’s entry in the register to contain—
 - (a) the person’s name and address,
 - (b) the name or names of the recognised supervisory body or bodies of which the person is a member,
 - (c) in the case of an individual eligible for appointment as a local auditor, the specified information relating to any firm on whose behalf the individual is responsible for local audit work,
 - (d) in the case of a firm eligible for appointment as a local auditor, the specified information relating to the individuals responsible for local audit work on its behalf, and
 - (e) in the case of a firm eligible for appointment as a local auditor, the information mentioned in subsection (3).
- (3) That information is—
 - (a) in relation to a body corporate other than a limited liability partnership, the name and address of each person who is a director of the body or holds any shares in it;

- (b) in relation to a limited liability partnership, the name and address of each member of the partnership;
 - (c) in relation to a corporation sole, the name and address of the individual for the time being holding the office by the name of which the person is the corporation sole;
 - (d) in relation to a partnership, the name and address of each partner.
- (4) The regulations may require each person's entry in the register to contain other specified information.
- (5) The regulations may provide that different parts of the register are to be kept by different persons.
- (6) The regulations may provide for the register to be kept with the register under regulations under section 1239(1)(a) of the Companies Act 2006 (register of statutory auditors).
- (7) The regulations may impose the obligations that the Secretary of State thinks fit on –
 - (a) recognised supervisory bodies,
 - (b) recognised supervisory bodies for the purposes of Part 42 of the Companies Act 2006,
 - (c) any body designated by order under section 43 (delegation of Secretary of State's functions under this Part),
 - (d) any body designated by order under section 1252 of the Companies Act 2006 (delegation of Secretary of State's functions under Part 42 of that Act),
 - (e) persons eligible for appointment as a local auditor,
 - (f) persons eligible for appointment as a statutory auditor in accordance with Part 42 of the Companies Act 2006,
 - (g) any person with whom arrangements are made by one or more recognised supervisory bodies, or by any body designated by order under section 43, with respect to the keeping of the register, or
 - (h) any person with whom arrangements are made by one or more recognised supervisory bodies for the purposes of Part 42 of the Companies Act 2006, or by any body designated by order under section 1252 of that Act, with respect to the keeping of the register under regulations under section 1239 of that Act.
- (8) The regulations may include –
 - (a) provision requiring that specified entries in the register be open to inspection at times and places specified or determined in accordance with the regulations;
 - (b) provision enabling a person to require a certified copy of specified entries in the register;
 - (c) provision authorising the charging of fees for inspection or for the provision of copies of a reasonable amount that is specified or determined in accordance with the regulations.
- (9) Obligations imposed by regulations under this section on persons mentioned in subsection (7)(c), (d), (g) or (h) are enforceable on the application of the Secretary of State by injunction.
- (10) In this section –
 - “address” means –

- (a) in relation to an individual, the individual’s usual residential or business address;
 - (b) in relation to a firm, its registered or principal office in the United Kingdom;
- “specified” means specified in regulations under this section.

38 Information to be made available to public

- (1) The Secretary of State may make regulations requiring a person eligible for appointment as a local auditor, or a member of a specified class of such persons, to keep and make available to the public specified information.
- (2) This includes information regarding –
 - (a) the person’s ownership and governance,
 - (b) the person’s internal controls with respect to the quality and independence of its local audit work,
 - (c) the person’s turnover, and
 - (d) the relevant authorities of whom the person has acted as a local auditor.
- (3) Regulations under this section may –
 - (a) impose the obligations that the Secretary of State thinks fit on persons eligible for appointment as a local auditor;
 - (b) require the information to be made available to the public in a specified manner.
- (4) In this section “specified” means specified in regulations under this section.

Power to require second audit

39 Secretary of State’s power to require second audit

- (1) This section applies where a person appointed as a local auditor of a relevant authority (“the first auditor”) was not an appropriate person for any part of the period during which the audit was conducted.
- (2) For the purposes of this section a person is “appropriate” if the person –
 - (a) is eligible for appointment as a local auditor, and
 - (b) is not prohibited by section 20(1) (independence requirement) from acting as a local auditor of the relevant authority.
- (3) The Secretary of State may direct the relevant authority to retain an appropriate person –
 - (a) to conduct a second audit of the accounts in question, or
 - (b) to review the first audit and to report (giving the appropriate person’s reasons) whether a second audit of those accounts is needed.
- (4) The Secretary of State must send a copy of a direction under subsection (3) to the recognised supervisory body (if any) of which the first auditor is or was a member.
- (5) A direction under subsection (3) is, on the application of the Secretary of State, enforceable by injunction.
- (6) The relevant authority must –

- (a) send a copy of a report under subsection (3)(b) to the recognised supervisory body (if any) of which the first auditor is or was a member, and
 - (b) if the report states that a second audit is needed, take the steps that are necessary for the carrying out of that audit.
- (7) If a person accepts an appointment, or continues to act, as a local auditor of a relevant authority at a time when the person knows the person is not appropriate, the relevant authority may recover from the person any costs incurred by it in complying with the requirements of this section.
- (8) Where a second audit is carried out under this section, any statutory or other provision applying in relation to the first audit applies also, in so far as practicable, in relation to the second audit.

Misleading, false and deceptive statements

40 Misleading, false and deceptive statements

- (1) A person is guilty of an offence if, for the purposes of or in connection with any application under this Part, the person knowingly or recklessly furnishes information which is misleading, false or deceptive in a material particular.
- (2) A person is guilty of an offence if, in purported compliance with any requirement imposed by or by virtue of this Part, the person knowingly or recklessly furnishes information which is misleading, false or deceptive in a material particular.
- (3) It is an offence for a person whose name does not appear on the register of auditors kept under regulations under section 37 –
 - (a) to describe himself or herself as a registered auditor, or
 - (b) to hold himself or herself out in a way that indicates, or may reasonably be understood to indicate, that he or she is a registered auditor.
- (4) It is an offence for a body which is not a recognised supervisory body or a recognised qualifying body –
 - (a) to describe itself as a recognised supervisory body or a recognised qualifying body, or
 - (b) to describe itself or hold itself out in a way that indicates, or may reasonably be understood to indicate, that it is a recognised supervisory body or a recognised qualifying body.
- (5) A person guilty of an offence under subsection (1) or (2) is liable –
 - (a) on conviction on indictment, to imprisonment for a term not exceeding 2 years, to a fine or to both;
 - (b) on summary conviction, to imprisonment for a term not exceeding 12 months, to a fine not exceeding the statutory maximum or to both.
- (6) In relation to an offence committed before the commencement of section 154(1) of the Criminal Justice Act 2003, the reference in subsection (5)(b) to 12 months is to be read as a reference to 6 months.
- (7) Subject to subsection (9), a person guilty of an offence under subsection (3) or (4) is liable on summary conviction to imprisonment for a term not exceeding 51 weeks, to a fine not exceeding level 5 on the standard scale or to both.

- (8) In relation to an offence committed before the commencement of section 281(5) of the Criminal Justice Act 2003, the reference in subsection (7) to 51 weeks is to be read as a reference to 6 months.
- (9) Where a breach of subsection (3) or (4) involves a public display of the offending description, the maximum fine that may be imposed is an amount equal to level 5 on the standard scale multiplied by the number of days for which the display has continued.
- (10) It is a defence for a person charged with an offence under subsection (3) or (4) to show that the person took all reasonable precautions and exercised all due diligence to avoid the commission of the offence.

Fees

41 Fees

- (1) An applicant for a recognition order under Schedule 3 or under regulations under section 25(4) must pay the fee that the Secretary of State prescribes by regulations for the application.
- (2) No application is to be regarded as duly made unless subsection (1) is complied with.
- (3) The Secretary of State may by regulations prescribe periodical fees to be paid by –
 - (a) every recognised supervisory body, and
 - (b) every recognised qualifying body.
- (4) Fees received by the Secretary of State by virtue of this Part are to be paid into the Consolidated Fund.

Duty of Secretary of State to report on inspections

42 Duty of Secretary of State to report on inspections

The Secretary of State must, at least once every calendar year, publish a report containing a summary of the results of the inspections that are delivered to the Secretary of State by a recognised supervisory body under paragraph 15(9) of Schedule 3.

Delegation of Secretary of State's functions

43 Delegation of Secretary of State's functions

- (1) The Secretary of State may make an order under this section (a “delegation order”) for the purpose of enabling functions of the Secretary of State under this Part to be exercised by a body designated by the order.
- (2) The body designated by a delegation order may be either –
 - (a) a body corporate which is established by the order, or
 - (b) subject to section 44, a body (whether a body corporate or an unincorporated association) which is already in existence (“an existing body”).

- (3) A delegation order has the effect of transferring to the body designated by it all functions of the Secretary of State under this Part –
 - (a) subject to any exceptions and reservations specified in the order, and
 - (b) except the Secretary of State’s functions in relation to the body itself.
- (4) A delegation order may confer on the body designated by it other supplementary or incidental functions that the Secretary of State thinks are appropriate to be conferred on the body.
- (5) Any transfer of functions under the following provisions must be subject to the reservation that the functions remain exercisable concurrently by the Secretary of State –
 - (a) section 27 (power to call for information from recognised bodies etc);
 - (b) section 45 (directions to comply with international obligations).
- (6) A delegation order may provide that it has the effect of making the body designated under section 5 of the Freedom of Information Act 2000 (further power to designate public authorities), subject to subsection (7).
- (7) A delegation order may only provide that the body is so designated to the extent that it is exercising functions transferred or conferred by the order (so that nothing in Parts 1 to 5 of that Act applies by virtue of the order to information held by the body which does not relate to the exercise of those functions).
- (8) A delegation order may be amended by a further order under this section.
- (9) A delegation order may be revoked by a further order under this section if it appears to the Secretary of State that it is no longer in the public interest that the order should remain in force.
- (10) Where a delegation order is made, Schedule 4 has effect with respect to –
 - (a) the status of the body designated by the order in exercising functions of the Secretary of State under this Part,
 - (b) the constitution and proceedings of the body where it is established by the order,
 - (c) the exercise by the body of certain functions transferred to it, and
 - (d) other supplementary matters.

44 Delegation of functions to an existing body

- (1) The Secretary of State’s power to make a delegation order under section 43 which designates an existing body is exercisable in accordance with this section.
- (2) The Secretary of State may make the delegation order if it appears to the Secretary of State that –
 - (a) the body is able and willing to exercise the functions that would be transferred by the order, and
 - (b) the body has arrangements in place relating to the exercise of those functions which are likely to ensure that the conditions in subsection (3) are met.
- (3) The conditions are –
 - (a) that the functions in question will be exercised effectively, and

- (b) where the delegation order is to contain any requirements or other provisions specified under subsection (4), that those functions will be exercised in accordance with any of those requirements or provisions.
- (4) The delegation order may contain requirements or other provisions relating to the exercise of the functions by the designated body that the Secretary of State thinks appropriate.
- (5) An existing body may be designated by a delegation order, and exercise functions of the Secretary of State under the order, despite the body's involvement in the exercise of any functions under arrangements within any of paragraphs 23 to 26 of Schedule 3.

International obligations

45 Directions to comply with international arrangements

- (1) This section applies if it appears to the Secretary of State –
 - (a) that any action proposed to be taken by a recognised supervisory body or a recognised qualifying body, or a body designated by order under section 43, would be incompatible with EU obligations or any other international obligations of the United Kingdom, or
 - (b) that any action which that body has power to take is required for the purpose of implementing EU obligations or any other international obligations of the United Kingdom.
- (2) The Secretary of State may direct the body not to take or, as the case may be, to take the action in question.
- (3) A direction may include the supplementary or incidental requirements that the Secretary of State thinks necessary or expedient.
- (4) A direction under this section given to a body designated by order under section 43 is enforceable on the application of the Secretary of State by injunction.

Provisions about offences

46 Offences by bodies corporate, partnerships and unincorporated associations

- (1) Subsection (2) applies where an offence under this Part committed by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, an officer of the body, or a person purporting to act in any such capacity.
- (2) The officer or person as well as the body corporate is guilty of the offence and is liable to be proceeded against and punished accordingly.
- (3) Subsection (4) applies where an offence under this Part committed by a partnership is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, a partner.
- (4) The partner as well as the partnership is guilty of the offence and liable to be proceeded against and punished accordingly.

- (5) Subsection (6) applies where an offence under this Part committed by an unincorporated association (other than a partnership) is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any officer of the association or any member of its governing body.
- (6) The officer or member as well as the association is guilty of the offence and is liable to be proceeded against and punished accordingly.

47 Time limits for prosecution of offences

- (1) An information relating to an offence under this Part which is triable by a magistrates' court may be tried by the court if it is laid at any time within –
 - (a) the period of 12 months beginning with the date on which evidence sufficient in the opinion of the Director of Public Prosecutions to justify the proceedings comes to the Director's knowledge, or
 - (b) the period of 12 months beginning with the date on which evidence sufficient in the opinion of the Secretary of State to justify the proceedings comes to the Secretary of State's knowledge.
- (2) Subsection (1) does not authorise the trial of an information laid more than three years after the commission of the offence.
- (3) For the purposes of this section –
 - (a) a certificate of the Director of Public Prosecutions as to the date on which evidence referred to in subsection (1)(a) came to the Director's knowledge is conclusive evidence;
 - (b) a certificate of the Secretary of State as to the date on which evidence referred to in subsection (1)(b) came to the Secretary of State's knowledge is conclusive evidence.
- (4) Nothing in this section affects proceedings within the time limits prescribed by section 127(1) of the Magistrates' Courts Act 1980.

48 Jurisdiction and procedure in respect of offences

- (1) Summary proceedings for an offence under this Part may be taken –
 - (a) against a body corporate or unincorporated association at any place in England and Wales at which it has a place of business, and
 - (b) against an individual at any place in England and Wales where the individual is for the time being.
- (2) Subsection (1) does not affect any jurisdiction exercisable apart from that subsection.
- (3) Proceedings for an offence alleged to have been committed under this Part by an unincorporated association must be brought in the name of the association (and not in that of any of its members).
- (4) For the purposes of those proceedings any rules of court relating to the service of documents apply as in relation to a body corporate.
- (5) Section 33 of the Criminal Justice Act 1925 and Schedule 3 to the Magistrates' Courts Act 1980 (procedure on charge of offence against a corporation) apply in a case in which an unincorporated association is charged with an offence under this Part as they apply in the case of a corporation.

- (6) A fine imposed on an unincorporated association on its conviction of an offence under this Part must be paid out of the funds of the association.

Notices etc

49 Service of notices

- (1) This section has effect in relation to any notice, direction or other document required or authorised by or by virtue of this Part to be given to or served on any person other than the Secretary of State.
- (2) The document may be given to or served on the person –
- (a) by delivering it to the person,
 - (b) by leaving it at the person's proper address, or
 - (c) by sending it by post to the person at that address.
- (3) The document may –
- (a) in the case of a body corporate, be given to or served on an officer of that body;
 - (b) in the case of a partnership, be given to or served on any partner;
 - (c) in the case of an unincorporated association other than a partnership, be given to or served on any member of the governing body of that association.
- (4) For the purposes of this section and section 7 of the Interpretation Act 1978 (service of documents by post) in its application to this section, the proper address of any person ("P") is P's last known address (whether of P's residence or of a place where P carries on business or is employed) and also –
- (a) in the case of a person who is eligible under the rules of a recognised supervisory body for appointment as a local auditor and who does not have a place of business in the United Kingdom, the address of that body;
 - (b) in the case of a body corporate or an officer of that body, the address of the body's registered or principal office in the United Kingdom;
 - (c) in the case of an unincorporated association other than a partnership or a member of its governing body, its principal office in the United Kingdom.

50 Documents in electronic form

- (1) This section applies where –
- (a) section 49 authorises the giving or sending of a notice, direction or other document by its delivery to a particular person ("the recipient"), and
 - (b) the notice, direction or other document is transmitted to the recipient electronically.
- (2) In subsection (1)(b) "electronically" means –
- (a) by means of an electronic communications network, or
 - (b) by other means, but in a form that requires the use of apparatus by the recipient to render it intelligible.
- (3) The transmission has effect for the purposes of this Part as a delivery of the notice, direction or other document to the recipient only if the recipient has

indicated to the person making the transmission that the recipient is willing to receive the notice, direction or other document in the form and manner used.

- (4) An indication to a person for the purposes of subsection (2) –
 - (a) must be given to the person in a manner required by that person,
 - (b) may be a general indication or an indication that is limited to notices, directions or other documents of a particular description,
 - (c) must state the address to be used,
 - (d) must be accompanied by the information that the person requires for making the transmission, and
 - (e) may be modified or withdrawn at any time by a notice given to the person in a manner required by the person.
- (5) In this section “electronic communications network” has the same meaning as in the Communications Act 2003.

Interpretation

51 Meaning of associate

- (1) In this Part “associate”, in relation to a person, is to be construed as follows.
- (2) In relation to an individual, “associate” means –
 - (a) that individual’s spouse, civil partner or minor child or step-child,
 - (b) any body corporate of which that individual is a director, and
 - (c) any employee or partner of that individual.
- (3) In relation to a body corporate, “associate” means –
 - (a) any body corporate of which that body is a director,
 - (b) any body corporate in the same group as that body, and
 - (c) any employee or partner of that body or of any body corporate in the same group.
- (4) In relation to a partnership constituted under the law of Scotland, or any other country or territory in which a partnership is a legal person, “associate” means –
 - (a) any body corporate of which that partnership is a director,
 - (b) any employee of or partner in that partnership, and
 - (c) any person who is an associate of a partner in that partnership.
- (5) In relation to a partnership constituted under the law of England and Wales or Northern Ireland, or the law of any other country or territory in which a partnership is not a legal person, “associate” means any person who is an associate of any of the partners.
- (6) In subsection (2)(b), (3)(a) and (4)(a), in the case of a body corporate which is a limited liability partnership, “director” is to be read as “member”.

52 Interpretation of Part 4

- (1) In this Part, unless a contrary intention appears –
 - “appropriate qualification” is to be construed in accordance with section 25(1);
 - “associate” is to be construed in accordance with section 51;

- “the Audit Directive” means Directive 2006/43/EC of the European Parliament and of the Council on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC;
- “delegation order” has the meaning given by section 43(1);
- “director”, in relation to a body corporate, includes any person occupying in relation to it the position of a director (by whatever name called) and any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of the body are accustomed to act;
- “EEA auditor” means an individual or firm approved in accordance with the Audit Directive by an EEA competent authority to carry out audits of annual accounts or consolidated accounts required by European Union law;
- “EEA competent authority” means a competent authority, as defined in Article 2.10 of the Audit Directive, of an EEA State other than the United Kingdom;
- “existing body” has the meaning given by section 43(2);
- “firm” means any entity, whether or not a legal person, which is not an individual and includes a body corporate, a corporation sole and a partnership or other unincorporated association;
- “group”, in relation to a body corporate, means the body corporate, any other body corporate which is its holding company or subsidiary and any other body corporate which is a subsidiary of that holding company;
- “holding company” and “subsidiary” are to be read in accordance with section 1159 of and Schedule 6 to the Companies Act 2006;
- “local audit” means an audit under this Act of a relevant authority;
- “local audit work” means work in connection with the audit under this Act of a relevant authority;
- “officer”, in relation to a body corporate other than a relevant authority, includes a director, a manager, a secretary or, where the affairs of the body are managed by its members, a member;
- “recognised professional qualification” has the meaning given by section 25(9);
- “supervisory body” has the meaning given by section 23(1).

- (2) For the purposes of this Part a body is to be regarded as “established in the United Kingdom” only if –
 - (a) it is incorporated or formed under the law of the United Kingdom or a part of the United Kingdom, or
 - (b) its central management and control are exercised in the United Kingdom.
- (3) References in this Part to the members of a supervisory body are to be construed in accordance with section 23(2).
- (4) References in this Part to the rules of a supervisory body are to be construed in accordance with section 23(3).
- (5) For the purposes of this Part, Gibraltar is to be treated as if it were an EEA State.

- (6) The Secretary of State may by regulations provide for this Part to apply with modifications in relation to any firm, or description of firm, which is not a body corporate or a partnership.

Powers to amend

53 Power to make provision in consequence of changes affecting accountancy bodies

The Secretary of State may by regulations make the amendments of enactments that appear to the Secretary of State to be necessary or expedient in consequence of any change of name, merger or transfer of engagements affecting –

- (a) a recognised supervisory body or recognised qualifying body, or
- (b) a body of accountants referred to in, or approved, authorised or otherwise recognised for the purposes of, any other enactment.

54 Power to amend Part following changes to companies regime

The Secretary of State may by regulations amend this Part for the purpose of keeping it broadly in step with Part 42 of the Companies Act 2006 (statutory auditors of companies etc).

PART 5

CONDUCT OF AUDIT

General provisions about audit

55 Codes of audit practice

- (1) The Comptroller and Auditor General must prepare a code or codes of audit practice prescribing the way in which local auditors are to carry out their functions under this Act.
- (2) Different codes may be prepared with respect to the audit of different types of accounts.
- (3) A code may contain different provision for different types of accounts.
- (4) A code must embody what the Comptroller and Auditor General considers to be the best professional practice with respect to the standards, procedures and techniques to be adopted by local auditors.
- (5) Before preparing a code, the Comptroller and Auditor General must consult –
 - (a) such associations or representatives of relevant authorities as the Comptroller and Auditor General thinks appropriate,
 - (b) the recognised supervisory bodies,
 - (c) the persons appearing on the register of auditors kept under regulations under section 37,
 - (d) the Secretary of State,
 - (e) the Treasury,
 - (f) each body to whom the Secretary of State has delegated functions under section 43, and

- (g) such other bodies or persons as the Comptroller and Auditor General thinks appropriate.

56 Procedure for codes

- (1) After preparing a code of audit practice, the Comptroller and Auditor General must—
 - (a) publish the code (as a draft) in such manner as the Comptroller and Auditor General thinks appropriate, and
 - (b) send the code to a Minister of the Crown.
- (2) The Minister must lay the code before Parliament.
- (3) If, within the 40-day period, either House of Parliament resolves not to approve the code, the code must not be issued by the Comptroller and Auditor General.
- (4) In this section and section 57 “the 40-day period” means the period of 40 days beginning with—
 - (a) the day on which the code is laid before Parliament, or
 - (b) if it is not laid before each House of Parliament on the same day, the later of the 2 days on which it is laid.
- (5) In calculating that period, no account is to be taken of any period during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than 4 days.
- (6) If no resolution under subsection (3) is made within that period, the Comptroller and Auditor General must issue the code.
- (7) If a resolution is made under subsection (3), the Comptroller and Auditor General must prepare another code of audit practice, unless one or more codes of audit practice are in force that make provision for each type of accounts required to be audited under this Act.

57 Re-publication of codes

- (1) The Comptroller and Auditor General must re-publish, in such manner as the Comptroller and Auditor General thinks appropriate, every code of audit practice issued under section 56—
 - (a) not later than the 5th anniversary of the date on which it was issued, and
 - (b) thereafter, not later than the 5th anniversary of the date on which it was last re-published under this subsection.
- (2) Subsection (1) does not apply if the code—
 - (a) has been replaced under section 58 (but see subsections (4) and (5) of that section), or
 - (b) has ceased to have effect under this section.
- (3) The Comptroller and Auditor General must send the code as re-published under this section to a Minister of the Crown, who must lay it before Parliament.
- (4) The code ceases to have effect if—

- (a) either House of Parliament resolves that it should cease to have effect, and
 - (b) that resolution is passed within the 40 day period.
- (5) If a resolution is passed under subsection (4), the Comptroller and Auditor General must prepare another code of audit practice, unless one or more codes of audit practice are in force that make provision for each type of accounts required to be audited under this Act.

58 Alteration and replacement of codes

- (1) The Comptroller and Auditor General –
 - (a) must keep each code of audit practice under review, and
 - (b) may prepare an alteration to that code or a replacement code of audit practice.
- (2) The provisions mentioned in subsection (3) apply to an alteration to a code of audit practice as they apply to a code of audit practice.
- (3) Those provisions are –
 - (a) section 55(5) (consultation), and
 - (b) section 56(1) to (6) (procedures for code).
- (4) The provisions mentioned in subsection (5) apply to a replacement code of audit practice prepared under subsection (1) as they apply to a code of audit practice.
- (5) Those provisions are –
 - (a) section 55(2) to (5) (content of code and consultation),
 - (b) section 56(1) to (6) (procedures for code),
 - (c) section 57 (further publication of code),
 - (d) subsections (1) to (3) of this section (alteration and replacement of code), and
 - (e) section 59(1) and (2) (publication of code and alterations).

59 Supplementary provisions about codes

- (1) The Comptroller and Auditor General must publish each code of audit practice issued under section 56.
- (2) Where a code of audit practice is altered, the Comptroller and Auditor General must publish –
 - (a) the alteration, or
 - (b) the code as altered by it.
- (3) A relevant authority must provide the Comptroller and Auditor General with the information that the Comptroller and Auditor General reasonably requires for the purposes of any of sections 55 to 58.

60 General duties of local auditors

- (1) In auditing the accounts of a relevant authority, a local auditor must, by examination of the accounts and otherwise, be satisfied –
 - (a) that the accounts comply with the requirements of the legislative provisions that apply to them,

- (b) that proper practices have been observed in the preparation of the statement of accounts, and
 - (c) that the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- (2) The local auditor must comply with the code of audit practice applicable to the accounts that is for the time being in force.
- (3) In subsection (1)(a) “legislative provisions” means the provisions of an Act or an instrument made under an Act.

61 Local auditors’ right to document and information

- (1) A local auditor has a right of access at all reasonable times to every document (an “audit document”) that—
 - (a) relates to a relevant authority or an entity connected with a relevant authority, and
 - (b) the auditor thinks is necessary for the purposes of the auditor’s functions under this Act.
- (2) This includes power to inspect, copy or take away an audit document.
- (3) A local auditor may—
 - (a) require a person holding or accountable for an audit document to provide such information or explanation as the auditor thinks is necessary for the purposes of this Act, and
 - (b) if the auditor thinks it necessary, require the person to meet the auditor to give the information or explanation or to produce the document.
- (4) Where an audit document is in an electronic form, the power to require a person to produce the document includes power to require it to be produced in a form in which it is legible and can be taken away.
- (5) For the purpose of inspecting an audit document which is in an electronic form, a local auditor—
 - (a) may have access to, and inspect and check the operation of, any computer and associated apparatus or material which the auditor thinks is or has been used in connection with the document, and
 - (b) may require a person within subsection (6) to give the auditor the reasonable assistance that the auditor needs for that purpose.
- (6) A person is within this subsection who—
 - (a) is the person by whom or on whose behalf the computer is or has been used, or
 - (b) is a person in charge of, or otherwise involved in operating, the computer, apparatus or material.
- (7) A local auditor may—
 - (a) require any person to whom this subsection applies to provide the information or explanation that the auditor thinks is necessary for the purposes of this Act, and
 - (b) if the auditor thinks it necessary, require the person to meet the auditor to give the information or explanation.
- (8) Subsection (7) applies to—
 - (a) a member or officer of a relevant authority,

- (b) an officer or employee of an entity connected with a relevant authority, or
 - (c) an auditor of such an entity.
- (9) A relevant authority or an entity connected with a relevant authority must provide a local auditor with the facilities and information that the auditor reasonably requires for the purposes of the auditor's functions under this Act.

62 Offences relating to section 61

- (1) A person is guilty of an offence if, without reasonable excuse, the person –
 - (a) obstructs the exercise of any power conferred by section 61, or
 - (b) fails to comply with any requirement of a local auditor under section 61.
- (2) A person guilty of an offence under subsection (1) is liable on summary conviction –
 - (a) to a fine not exceeding level 3 on the standard scale, and
 - (b) to an additional fine of not more than £20 for each day on which the offence continues after conviction for that offence.
- (3) Any expenses incurred by a local auditor in connection with proceedings for an offence under subsection (1) alleged to have been committed in relation to the audit of the accounts of a relevant authority are recoverable from that authority so far as they are not recovered from any other source.

Reports and recommendations

63 Public interest reports

- (1) A local auditor must, in auditing the accounts of a relevant authority, consider whether, in the public interest, the auditor should make a report on any matter coming to the auditor's notice during the audit and relating to the authority or an entity connected with the authority, so it can be considered in accordance with section 65, 67 or 68 or brought to the public's attention.
- (2) A report under subsection (2) is referred to in this Act as a public interest report.
- (3) If a local auditor thinks a public interest report should be made on a matter, the auditor must consider whether the public interest requires an immediate report rather than a report at the end of the audit.
- (4) A local auditor must consult a relevant authority's auditor panel before making a public interest report relating to the authority or an entity connected with it.
- (5) A local auditor may recover the reasonable costs of preparing a public interest report from the authority or entity to whom it relates.

64 General reports and recommendations

- (1) This section applies when a local auditor has completed an audit of the accounts of a relevant authority.
- (2) The local auditor must enter on the statement of accounts –

- (a) a certificate that the auditor has completed the audit in accordance with this Act, and
 - (b) the auditor’s opinion on the statement.
- (3) The local auditor may make a written recommendation relating to the relevant authority or an entity connected with the authority, so it can be considered under section 67 or 68.
- (4) A recommendation may not be made under subsection (3) in relation to –
 - (a) charter trustees,
 - (b) a port health authority, or
 - (c) an internal drainage board.
- (5) A recommendation under subsection (3) must be sent at the same time –
 - (a) to the Secretary of State,
 - (b) where the relevant authority is itself a connected entity, to its related authority or authorities,
 - (c) where the relevant authority is the Commissioner of Police of the Metropolis, to the Greater London Authority, and
 - (d) where the relevant authority is a functional body or the London Pensions Fund Authority, to the Mayor of London.
- (6) In this Act “related authority”, in relation to a connected entity, means the relevant authority with which the entity is connected.

65 Supply of public interest reports

- (1) If a local auditor makes a public interest report in the course of or following the audit of the accounts of a relevant authority, the auditor must send the report to –
 - (a) the authority, and
 - (b) if the report relates to an entity connected with the authority, to that entity.
- (2) If the relevant authority is a parish meeting, the report must instead be sent to its chairman.
- (3) The local auditor must also send the report –
 - (a) to the Secretary of State,
 - (b) where the relevant authority is itself a connected entity, to its related authority or authorities,
 - (c) where the relevant authority is the Commissioner of Police of the Metropolis, to the Greater London Authority, and
 - (d) where the relevant authority is the London Pensions Fund Authority, to the Mayor of London.
- (4) The report must be sent –
 - (a) if it is an immediate report, as soon as is reasonably practicable after it is made, and
 - (b) if it is not an immediate report, within the period of 15 days beginning with the day on which the audit is concluded.
- (5) If section 67 applies to a relevant authority to which a report is sent under this section, it must take the report into consideration in accordance with that section.

- (6) If a relevant authority to which a report is sent under this section is the Greater London Authority, it must take the report into consideration in accordance with section 68.
- (7) Subject to subsection (8), a relevant authority to which a report is sent under this section, other than an authority mentioned in subsection (5) or (6), must take the report into consideration as soon as is reasonably practicable after receiving it.
- (8) Subsection (7) does not apply to a relevant authority which is itself a connected entity.

66 Publicity for public interest reports

- (1) Subject to subsection (3), subsections (4) to (6) apply to a relevant authority if a local auditor has made a public interest report in respect of the authority or an entity connected with it.
- (2) Subsections (4) to (6) also apply to the Greater London Authority if a local auditor has made a public interest report in respect of an entity connected with Transport for London.
- (3) Subsections (4) to (6) do not apply to a relevant authority which is itself a connected entity unless the authority is the Mayor's Office for Policing and Crime and the report relates to the Commissioner of Police of the Metropolis (but those subsections do apply to the connected entity's related authority).
- (4) As soon as is practicable after receiving the report, the relevant authority must publish the report and a notice that –
 - (a) identifies the subject matter of the report, and
 - (b) states that any member of the public may inspect the report and make a copy of it or any part of it between the times and at the place or places specified in the notice.
- (5) As soon as is practicable after receiving the report, the relevant authority must supply a copy of the report to –
 - (a) each of its members (if it has members), and
 - (b) its audit panel.
- (6) From the time when the report is received, the relevant authority must ensure that any member of the public may –
 - (a) inspect the report at all reasonable times without payment,
 - (b) make a copy of it, or any part of it, and
 - (c) be supplied with a copy of it, or any part of it, on payment of a reasonable sum.
- (7) A local auditor who makes a public interest report may –
 - (a) notify any person the auditor thinks fit of the fact that the auditor has made the report, and
 - (b) supply a copy of it or any part of it to any person the auditor thinks fit.
- (8) Where this section requires a relevant authority to publish a notice or report, it must be published –
 - (a) if the authority has a website, on its website;
 - (b) otherwise, in such manner as the authority thinks is likely to bring the notice or report to the attention of persons who live in its area.

- (9) In the case of a relevant authority that is a parish meeting, references in this section to the authority (other than references to its area or members) are to its chairman.
- (10) Nothing in this section affects the operation of section 71.

67 Consideration of report or recommendation

- (1) Subject to subsections (2) and (3), this section applies to a relevant authority if—
 - (a) a local auditor has made a public interest report in respect of the authority or an entity connected with it, or
 - (b) a local auditor has made a recommendation to the authority or an entity connected with it.
- (2) This section does not apply to a relevant authority which is itself a connected entity unless the authority is the Mayor’s Office for Policing and Crime and the report or recommendation relates to the Commissioner of Police of the Metropolis (but this section does apply to the connected entity’s related authority unless it is the Greater London Authority).
- (3) This section does not apply to—
 - (a) the Greater London Authority (but see section 68),
 - (b) charter trustees,
 - (c) a port health authority, or
 - (d) an internal drainage board.
- (4) The relevant authority must consider the report or recommendation at a meeting held before the end of the period of one month beginning with the day on which it was sent to the authority or, in the case of a parish meeting, its chairman.
- (5) At that meeting the relevant authority must decide—
 - (a) whether the report requires the authority to take any action or whether the recommendation is to be accepted, and
 - (b) what, if any, action to take in response to the report or recommendation.
- (6) Where the relevant authority is a police and crime commissioner or the Mayor’s Office for Policing and Crime, the authority must, before the end of the period of one month beginning with the day on which the report or recommendation was sent to the authority, decide—
 - (a) whether the report requires the authority to take any action or whether the recommendation is to be accepted, and
 - (b) what, if any, action to take in response to the report or recommendation.
- (7) If the local auditor is satisfied that it is reasonable to allow more time for the relevant authority to comply with subsection (4) or (6), the auditor may extend or further extend the period of one month mentioned in that subsection.
- (8) This section does not affect any duties (so far as they relate to the subject-matter of a report or recommendation sent to a relevant authority) which are imposed by or under—
 - (a) this Act,

- (b) sections 114 to 116 of the Local Government Finance Act 1988 (functions and reports of finance officers),
 - (c) section 5 of the Local Government and Housing Act 1989 (functions of monitoring officers), or
 - (d) any other enactment.
- (9) The Secretary of State may by regulations provide for this section to apply with modifications in relation to the relevant authorities specified or described in the regulations.

68 Consideration of report or recommendation at meeting: Greater London Authority

- (1) This section applies if –
 - (a) a local auditor has made a public interest report in respect of the Greater London Authority (“the Authority”) or an entity connected with it,
 - (b) a local auditor has made a recommendation to the Authority or an entity connected with it or
 - (c) a local auditor has made a public interest report or a recommendation in respect of an entity connected with Transport for London.
- (2) The London Assembly (“the Assembly”) must consider the report or recommendation at a meeting.
- (3) The Mayor of London (“the Mayor”) must attend the meeting.
- (4) At the meeting, the Assembly must decide what recommendations to make to the Mayor about the decisions to be made under subsection (5).
- (5) Having considered the report or recommendation, and the Assembly’s recommendations under subsection (4), the Mayor must decide –
 - (a) whether the report requires the Authority to take any action or whether the recommendation is to be accepted, and
 - (b) what, if any, action to take in response to the report or recommendation.
- (6) The Mayor and the Assembly must comply with subsections (2) to (5) before the end of the period of one month beginning with the day on which the report or recommendation was sent to the Authority.
- (7) If the local auditor is satisfied that it is reasonable to allow more time for the Mayor or the Assembly to comply with subsections (2) to (5), the auditor may extend or further extend the period of one month mentioned in subsection (6).
- (8) This section does not affect any duties (so far as they relate to the subject-matter of a report or recommendation sent to the Authority) which are imposed by or under –
 - (a) this Act,
 - (b) sections 114 to 116 of the Local Government Finance Act 1988 (functions and reports of finance officers),
 - (c) section 5 of the Local Government and Housing Act 1989 (functions of monitoring officers), or
 - (d) any other enactment.

69 Bar on delegation of functions relating to meetings

- (1) If a relevant authority is a local authority operating executive arrangements, the authority's functions under section 67 are not the responsibility of an executive of the authority under those arrangements.
- (2) If a relevant authority is a local authority within the meaning of section 101 of the Local Government Act 1972 (arrangements for discharge of functions), that section does not apply to its functions under section 67.
- (3) Any functions of the Mayor of London under section 68 must be exercised by the Mayor personally.
- (4) Section 54 of the Greater London Authority Act 1999 (discharge of London Assembly functions by committees etc) does not apply in relation to any function of the London Assembly under section 68.

70 Publicity for meetings

- (1) If a relevant authority is required to hold a meeting under section 67, it must publish a notice in compliance with subsections (2) to (4).
- (2) The notice must be published –
 - (a) if the relevant authority has a website, on its website;
 - (b) otherwise, in such manner as the authority thinks is likely to bring the notice to the attention of persons who live in its area.
- (3) The notice must –
 - (a) state the time and place of the meeting,
 - (b) indicate that the meeting is to be held to consider a local auditor's report or recommendation (as the case may be), and
 - (c) describe the subject matter of the report or recommendation.
- (4) The notice must be published before the beginning of the period of 8 days ending with the day of the meeting.
- (5) If the meeting is held to consider a report, the agenda supplied to the members of the relevant authority for that meeting must be accompanied by a copy of the report.
- (6) If the London Assembly is required to hold a meeting under section 68, the Greater London Authority must publish on its website a notice in compliance with subsections (3) and (4).
- (7) If that meeting is held to consider a report, the agenda supplied to the members of the London Assembly for that meeting must be accompanied by a copy of the report.
- (8) This section applies in addition to any provision made in relation to the relevant authority in question by or under the Public Bodies (Admission to Meetings) Act 1960, the Local Government Act 1972 or any other enactment.

71 Access to meetings and documents

- (1) Where a public interest report is to be considered under section 67 by a relevant authority to which the Public Bodies (Admission to Meetings) Act 1960 applies, the report is not to be excluded from the matter supplied under section 1(4)(b) of that Act (supply of agenda etc to newspapers).

- (2) Part 5A (access to meetings and documents) of the Local Government Act 1972 applies to a meeting of the London Pensions Fund Authority under section 67 as if the Authority were a principal council.
- (3) Subsections (4) to (6) apply in relation to the consideration under section 67 or 68 of a public interest report by a relevant authority to which Part 5A (access to meetings and documents) of the Local Government Act 1972 applies.
- (4) Information contained in the report is not to be treated as exempt information for the purposes of that Part.
- (5) The report is not to be excluded –
 - (a) from the documents open to inspection under section 100B(1) of that Act (public access to agenda and reports before meetings), or
 - (b) from the matter supplied under section 100B(7) of that Act (supply of agenda etc to newspapers).
- (6) Part 5A of the Local Government Act 1972 has effect in relation to the report as if section 100C(1)(d) of that Act (public access to copies of reports for six years after meeting) were not limited to so much of the report as relates to an item during which the meeting was open to the public.
- (7) Information contained in a public interest report is not to be treated as exempt information for the purposes of any Act or instrument made under an Act that applies in relation to exempt information within the meaning of Part 5A of the Local Government Act 1972.

72 Publicity for decisions following meetings

- (1) As soon as is practicable after making decisions under section 67(5) or (6) or 68(5), a relevant authority must –
 - (a) notify the local auditor of its accounts of those decisions, and
 - (b) publish a notice containing a summary of those decisions approved by the auditor.
- (2) The notice under subsection (1)(b) must be published –
 - (a) if the relevant authority has a website, on its website;
 - (b) otherwise, in such manner as the authority thinks is likely to bring the notice to the attention of persons who live in its area.
- (3) The notice required by subsection (1)(b) in relation to a meeting need not summarise any decision made while the public were excluded from the meeting –
 - (a) as the result of a resolution under section 1(2) of the Public Bodies (Admission to Meetings) Act 1960 (protection of public interest),
 - (b) under section 100A(2) of the Local Government Act 1972 (confidential matters), or
 - (c) as the result of a resolution under section 100A(4) of that Act (exempt information).
- (4) If sections 100C and 100D of the Local Government Act 1972 (availability for inspection after meetings of minutes etc) apply in relation to a meeting under section 67 or 68, the notice required by subsection (1)(b) must indicate the documents in relation to the meeting that are open for inspection in accordance with those sections.

- (5) This section applies in addition to any provision made in relation to the relevant authority by or under the Public Bodies (Admission to Meetings) Act 1960, the Local Government Act 1972 or any other enactment.

Public inspection etc and action by the auditor

73 Inspection of statements of accounts and auditors' reports

- (1) A relevant authority must ensure that a local government elector for its area may –
- (a) inspect and make copies of the statement of accounts prepared by the authority,
 - (b) inspect and make copies of any report, other than an immediate report, made to the authority by a local auditor, and
 - (c) have copies of any statement within paragraph (a) or report within paragraph (b) delivered to the elector on payment of a reasonable sum for each copy.
- (2) The relevant authority must ensure that a local government elector may inspect a document within subsection (1)(a) or (b) at all reasonable times and without payment.
- (3) References in this section to copies of a document include a reference to copies of any part of it.

74 Inspection of documents

- (1) At each audit of accounts under this Act, any persons interested may –
- (a) inspect the accounting records for the financial year to which the audit relates and the supporting documents for those records, and
 - (b) make copies of all or any part of those records or documents.
- (2) At the request of a local government elector for any area to which the accounts relate, the local auditor must give the elector, or any representative of the elector, an opportunity to question the auditor about the accounting records.
- (3) This section does not entitle a person –
- (a) to inspect any part of any record or document containing personal information within the meaning of subsections (4) to (6), or
 - (b) to require any personal information to be disclosed in answer to any question.
- (4) Information is personal information if –
- (a) it identifies a particular individual or enables a particular individual to be identified (but see subsection (5)), and
 - (b) the local auditor thinks that it should not be inspected or disclosed.
- (5) Information is not personal information merely because it relates to a business carried on by an individual as a sole trader.
- (6) Information is personal information if it is information about an officer of the relevant authority which relates specifically to a particular individual and is available to the authority because –
- (a) the individual holds or has held an office or employment with that authority, or

- (b) payments or other benefits in respect of an office or employment under any other person are or have been made or provided to that individual by that authority.
- (7) For the purposes of subsection (6) –
 - (a) “the relevant authority” means the relevant authority whose accounts are being audited, and
 - (b) payments made or benefits provided to an individual in respect of an office or employment include any payment made or benefit provided in respect of the individual ceasing to hold the office or employment.

75 Right to make objections at audit

- (1) This section applies if, at an audit of accounts under this Act, a local government elector for an area to which the accounts relate makes an objection to the local auditor which meets the requirements in subsection (2) and which –
 - (a) concerns a matter in respect of which the auditor could make a public interest report, or
 - (b) concerns a matter in respect of which the auditor could apply for a declaration under section 76.
- (2) The requirements are that –
 - (a) the objection is made in writing, and
 - (b) a copy of the objection is sent to the relevant authority whose accounts are being audited.
- (3) The local auditor must decide –
 - (a) whether to consider the objection, and
 - (b) if the auditor does so, whether to take action within paragraph (a) or (b) of subsection (1) in response.
- (4) The local auditor may decide not to consider the objection if, in particular, the auditor thinks that the objection –
 - (a) is frivolous or vexatious, or
 - (b) repeats an objection considered by the auditor on a previous occasion.
- (5) If the local auditor decides not to take action within paragraph (a) or (b) of subsection (1), the auditor may recommend that the relevant authority should instead take action in response to the objection.

76 Declaration that item of account is unlawful

- (1) If a local auditor carrying out an audit under this Act thinks that an item of account is contrary to law, the auditor may apply to the court for a declaration to that effect.
- (2) On an application under this section, the court –
 - (a) may make or refuse to make the declaration, and
 - (b) if it makes the declaration, may also order rectification of the statement of accounts or accounting records.
- (3) A person who has objected under section 75(1)(b) and is aggrieved by a decision of the local auditor not to consider the objection or not apply for a

declaration under this section may, within the period of 6 weeks beginning with the date on which the person was notified of the decision –

- (a) require the auditor to provide written reasons for the decision, and
 - (b) appeal against the decision to the court.
- (4) On an appeal under subsection (3), the court has the same powers in relation to the item of account to which the objection relates as it would have on an application by the local auditor for the declaration.
 - (5) On an application or appeal under this section, the court may make an order for the payment by the relevant authority to which the application or appeal relates of expenses incurred in connection with it by the local auditor or the person by whom the appeal is brought.
 - (6) The High Court and the county courts have jurisdiction for the purposes of this section.
 - (7) In this Act “item of account”, in relation to a relevant authority, means an item in the authority’s accounting records or statement of account.

Prevention of unlawful expenditure etc

77 Advisory notice

- (1) A local auditor of the accounts of a relevant authority may issue a notice under this section (“an advisory notice”) if the auditor thinks that the authority or an officer of the authority –
 - (a) is about to make or has made a decision which involves or would involve the authority incurring unlawful expenditure,
 - (b) is about to take or has begun to take a course of action which, if followed to its conclusion, would be unlawful and likely to cause a loss or deficiency, or
 - (c) is about to enter an item of account, the entry of which is unlawful.
- (2) An advisory notice is a notice which –
 - (a) is addressed to the authority or officer concerned,
 - (b) specifies the paragraph of subsection (1) which is relevant and the decision, course of action or item of account to which the notice relates,
 - (c) specifies that the notice will take effect on the day on which a copy of the notice is served on the person to whom it is addressed, and
 - (d) requires the authority or officer to give the local auditor of the authority’s accounts at least the specified number of days’ notice in writing of the intention of the authority or officer to –
 - (i) make or implement the decision,
 - (ii) take or continue to take the course of action, or
 - (iii) enter the item of account,
 (as the case may be).
- (3) In subsection (2)(d) “the specified number” means the number of days specified in the notice, which may not be more than 21.
- (4) Where two or more local auditors are appointed in relation to the accounts of a relevant authority –

- (a) the power to issue an advisory notice may be exercised by the local auditors acting jointly or by such one of them as they may determine, and
 - (b) in relation to such a notice, references in subsections (5) and (6) to the local auditor are references to the local auditor or auditors by whom the notice is issued.
- (5) A copy of an advisory notice –
 - (a) in the case of a notice addressed to a relevant authority, must be served on the relevant authority,
 - (b) in the case of a notice addressed to an officer, must be served on the relevant authority concerned and the officer, and
 - (c) may be served on any other person the local auditor thinks appropriate.
- (6) The local auditor must serve a statement of the auditor's reasons for the belief referred to in subsection (1) on the relevant authority concerned and on any officer on whom a copy of the notice was served under subsection (5)(b).
- (7) The statement must be served before the end of the period of 7 days beginning with the day on which a copy of the notice was served on the person to whom it is addressed.
- (8) Where this section requires a document to be served on an officer of a relevant authority, it must be served by addressing it to the officer and delivering it to the officer or leaving it at, or sending it by post to, the office where the officer is employed.
- (9) An advisory notice may at any time be withdrawn by the local auditor of the accounts of the relevant authority to which, or to an officer of which, the notice was addressed.
- (10) The local auditor must give notice in writing of the withdrawal to any person on whom a copy of the advisory notice was served under subsection (5).
- (11) For the purposes of this section and section 78 the actions of the following are to be treated as actions of the relevant authority itself –
 - (a) a committee or sub-committee of the authority;
 - (b) any other person (other than an officer) authorised to act on behalf of the authority.

78 Effect of an advisory notice

- (1) While an advisory notice has effect, it is not lawful for the relevant authority concerned or any officer of that authority –
 - (a) if the notice relates to a decision, to make or implement the decision,
 - (b) if the notice relates to a course of action, to take or continue to take the course of action, or
 - (c) if the notice relates to an item of account, to enter the item of account.
- (2) Subsection (1) does not apply if –
 - (a) the relevant authority has considered, in the light of the advisory notice and the statement under section 77(6), the consequences of doing the thing mentioned in the paragraph of subsection (1) which is relevant,
 - (b) the relevant authority or officer has given the local auditor of the authority's accounts the period of notice in writing required by the advisory notice under section 77(2)(d), and

- (c) that period has expired.
- (3) An advisory notice takes effect on the day on which a copy of the notice is served on the person to whom it is addressed, and ceases to have effect –
 - (a) if a statement of reasons is not served in accordance with subsection (6) of section 77, at the end of the period specified in subsection (7) of that section, or
 - (b) when it is withdrawn under section 77(9).
- (4) Any expenses reasonably incurred by a local auditor in connection with the issue of an advisory notice are recoverable by the auditor from the relevant authority concerned.
- (5) In this section “the relevant authority concerned”, in relation to an advisory notice, means the relevant authority to which, or to any officer of which, the notice is addressed.

79 Further provisions about advisory notices

- (1) Subsection (2) applies if –
 - (a) before an advisory notice is served, a relevant authority enters into a contract to dispose of or acquire an interest in land, and
 - (b) before the disposal or acquisition is completed, an advisory notice takes effect as a result of which it is unlawful for the authority to complete the disposal or acquisition.
- (2) The existence of the advisory notice does not affect any remedy in damages which may be available to any person by reason of the relevant authority’s failure to complete the contract.
- (3) No action lies against a local auditor in respect of loss or damage alleged to have been caused by reason of the issue of an advisory notice which was issued in good faith.

80 Power of local auditor to apply for judicial review

- (1) A local auditor appointed to audit the accounts of a relevant authority may make an application for judicial review of a decision of that authority, or of a failure by that authority to act, which it is reasonable to believe would have an effect on the accounts of that body.
- (2) Subsection (1) does not affect the requirement in section 31(3) of the Senior Courts Act 1981 to obtain the leave of the High Court to make the application.
- (3) The existence of the powers conferred on a local auditor under this Act is not a ground for refusing an application within subsection (1) (or an application for leave to make the application).
- (4) On an application for judicial review made as mentioned in subsection (1), the court may make such order as it thinks fit for the payment by the relevant authority of expenses incurred by the local auditor in connection with the application.

Miscellaneous

81 Audit of accounts of officers

- (1) If an officer of a relevant authority receives money or other property on behalf of the authority, or for which the officer ought to account to the authority, the accounts of the officer must be audited by the local auditor of the authority's accounts.
- (2) Sections 2, 60 to 63, 64(1) to (3), 65 to 76 and 82 apply (with necessary modifications) to the accounts and audit.

82 Accounts and audit regulations

- (1) The Secretary of State may by regulations applying to relevant authorities make provision about—
 - (a) the form and contents of accounting records;
 - (b) the form, contents, preparation and approval of statements of accounts;
 - (c) the preservation of accounting records or statements of accounts;
 - (d) the publication of accounting records, statements of accounts or other information;
 - (e) the exercise of any rights of objection or inspection conferred by section 73, 74 or 75 and the steps to be taken by any authority to enable those rights to be exercised;
 - (f) the financial management of relevant authorities;
 - (g) the maintenance by relevant authorities of systems of internal control (including arrangements for the management of risk).
- (2) Regulations under subsection (1)(b) may in particular make provision about any information to be provided by way of notes to the accounts.
- (3) Regulations under this section may make different provision in relation to authorities of different kinds.
- (4) Before making regulations under this section, the Secretary of State must consult—
 - (a) the Comptroller and Auditor General,
 - (b) such representatives of relevant authorities as the Secretary of State thinks appropriate, and
 - (c) the recognised supervisory bodies.
- (5) Section 14(1)(a) of the Transport Act 1968 (accounts and other records of Passenger Transport Executives) is subject to regulations under this section.

83 Requirement to observe proper practices

- (1) In section 21 of the Local Government Act 2003 (accounting practices), for subsection (6) (local authorities to which the section applies) substitute—
 - “(6) In this section, “local authority” includes—
 - (a) a parish council,
 - (b) a parish meeting of a parish which does not have a separate parish council,
 - (c) a community council,

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- (d) a committee of a county council in England, a district council, a London borough council or a parish council, including a joint committee of two or more such councils,
 - (e) a Passenger Transport Executive,
 - (f) the London Waste and Recycling Board,
 - (g) charter trustees,
 - (h) a port health authority for a port health district –
 - (i) wholly in England, or
 - (ii) partly in England and partly in Wales,
 - (i) a conservation board established by order of the Secretary of State under section 86 of the Countryside and Rights of Way Act 2000,
 - (j) a chief constable for a police area in England,
 - (k) the Commissioner of Police of the Metropolis, and
 - (l) an internal drainage board for an internal drainage district –
 - (i) wholly in England, or
 - (ii) partly in England and partly in Wales.”
- (2) In section 22 of that Act (meaning of “revenue account” for the purposes of certain enactments), for subsection (3) (local authorities to which the section applies) substitute –
- “(3) In this section, “local authority” includes –
- (a) a parish council,
 - (b) a parish meeting of a parish which does not have a separate parish council,
 - (c) a community council,
 - (d) a committee of a county council in England, a district council, a London borough council or a parish council, including a joint committee of two or more such councils,
 - (e) a Passenger Transport Executive,
 - (f) the London Waste and Recycling Board,
 - (g) charter trustees,
 - (h) a port health authority for a port health district –
 - (i) wholly in England, or
 - (ii) partly in England and partly in Wales,
 - (i) a conservation board established by order of the Secretary of State under section 86 of the Countryside and Rights of Way Act 2000,
 - (j) a chief constable for a police area in England,
 - (k) the Commissioner of Police of the Metropolis, and
 - (l) an internal drainage board for an internal drainage district –
 - (i) wholly in England, or
 - (ii) partly in England and partly in Wales.”

PART 6

DATA MATCHING

84 Power to conduct data matching exercises

- (1) The Secretary of State may conduct data matching exercises or arrange for them to be conducted on the Secretary of State's behalf.
- (2) A data matching exercise is an exercise involving the comparison of sets of data to determine how far they match (including the identification of any patterns and trends).
- (3) The power in subsection (1) is exercisable for the purpose of assisting in the prevention and detection of fraud.
- (4) A data matching exercise may not be used to identify patterns and trends in an individual's characteristics or behaviour which suggest nothing more than the individual's potential to commit fraud in the future.
- (5) In this Part, any reference to a data matching exercise is to an exercise conducted or arranged to be conducted under this section.

85 Mandatory provision of data

- (1) The Secretary of State may require a person within subsection (2) to provide the Secretary of State or a person acting on the Secretary of State's behalf with such data (and in such form) as the Secretary of State or that person may reasonably require for the purpose of conducting data matching exercises.
- (2) The persons within this subsection are –
 - (a) a relevant authority,
 - (b) a best value authority which is not a relevant authority.
- (3) "Best value authority" has the meaning given by section 1 of the Local Government Act 1999.

86 Voluntary provision of data

- (1) If the Secretary of State thinks it appropriate to conduct a data matching exercise using data held by or on behalf of a body or person in England who is not subject to section 85, the data may be disclosed to the Secretary of State or a person acting on the Secretary of State's behalf.
- (2) But subsection (1) does not authorise –
 - (a) a disclosure which contravenes the Data Protection Act 1998, or
 - (b) a disclosure prohibited by Part 1 of the Regulation of Investigatory Powers Act 2000.
- (3) A disclosure under subsection (1) does not breach –
 - (a) any obligation of confidence owed by a person making the disclosure, or
 - (b) any other restriction on the disclosure of information (however imposed).
- (4) This section does not limit the circumstances in which data may be disclosed apart from this section.

- (5) Data matching exercises may include data provided by a body or person outside England and Wales.

87 Disclosure of results of data matching etc

- (1) This section applies to the following information –
 - (a) information relating to a particular body or person obtained by or on behalf of the Secretary of State for the purpose of conducting a data matching exercise, and
 - (b) the results of any such exercise.
- (2) Information to which this section applies may be disclosed by or on behalf of the Secretary of State if the disclosure –
 - (a) is for or in connection with a purpose for which the data matching exercise is conducted,
 - (b) is in pursuance of a duty imposed by or under a statutory provision, or
 - (c) is within subsection (3).
- (3) A disclosure is within this subsection if it is –
 - (a) to a relevant audit authority or a related party, and
 - (b) for or in connection with a function of the relevant audit authority corresponding or similar to –
 - (i) the functions of a local auditor, or
 - (ii) the functions of the Secretary of State under this Part.
- (4) “Relevant audit authority” means –
 - (a) the Auditor General for Wales;
 - (b) the Auditor General for Scotland;
 - (c) the Accounts Commission for Scotland;
 - (d) Audit Scotland;
 - (e) the Comptroller and Auditor General for Northern Ireland;
 - (f) a person designated as a local government auditor under Article 4 of the Local Government (Northern Ireland) Order 2005 (S.I. 2005/1968 (N.I.18)).
- (5) The related parties in relation to a relevant audit authority are –
 - (a) a body or person acting on the authority’s behalf,
 - (b) a body whose accounts are required to be audited by the authority or by a person appointed by the authority, and
 - (c) a person appointed by the authority to audit those accounts.
- (6) Information disclosed under subsection (2) may not be further disclosed except –
 - (a) in the case of information disclosed under subsection (2)(a), for or in connection with the purpose for which it was disclosed under that subsection,
 - (b) in the case of information disclosed under subsection (2)(c) and (3), for or in connection with the function for which it was disclosed under those subsections,
 - (c) for the investigation or prosecution of an offence (so far as the disclosure does not fall within paragraph (a) or (b)), or
 - (d) in pursuance of a duty imposed by or under a statutory provision.

- (7) A person who discloses information to which this section applies, except so far as that disclosure is authorised by subsection (2) or (6), is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (8) Section 95 (restriction on disclosure of information obtained under this Act) does not apply to information to which this section applies.

88 Publication

- (1) Nothing in section 87 prevents the Secretary of State from publishing a report on a data matching exercise (including on the results of the exercise).
- (2) But the report may not include information relating to a particular body or person if—
 - (a) the body or person is the subject of any data included in the data matching exercise,
 - (b) the body or person can be identified from the information, and
 - (c) the information is not otherwise in the public domain.
- (3) A report published under this section may be published in such manner as the Secretary of State considers appropriate for bringing it to the attention of those members of the public who may be interested.

89 Fees for data matching

- (1) The Secretary of State must prescribe a scale or scales of fees in respect of data matching exercises.
- (2) A person within section 85(2) who is required under that section to provide data for a data matching exercise must pay to the Secretary of State the fee applicable to that exercise in accordance with the appropriate scale.
- (3) But if it appears to the Secretary of State that the work involved in the exercise was substantially more or less than that envisaged by the appropriate scale, the Secretary of State may charge the person a fee which is larger or smaller than that referred to in subsection (2).
- (4) Before prescribing a scale of fees under this section, the Secretary of State must consult—
 - (a) the persons within section 85(2), and
 - (b) such other bodies or persons as the Secretary of State thinks appropriate.
- (5) In addition to the power under subsection (2), the Secretary of State may charge a fee to any other body or person providing data for or receiving the results of a data matching exercise
- (6) A fee under subsection (5) is payable in accordance with terms agreed between the Secretary of State and that body or person.

90 Code of data matching practice

- (1) The Secretary of State must prepare, and keep under review, a code of practice with respect to data matching exercises.

- (2) Regard must be had to the code in conducting and participating in any data matching exercise.
- (3) Before preparing or altering the code, the Secretary of State must consult—
 - (a) the persons within section 85(2),
 - (b) such representatives of persons within section 85(2) as the Secretary of State thinks appropriate,
 - (c) the Information Commissioner, and
 - (d) such other bodies or persons as the Secretary of State thinks appropriate.
- (4) The Secretary of State must—
 - (a) lay a copy of the code, and of any alterations made to it, before Parliament, and
 - (b) from time to time publish the code as for the time being in force.

91 Powers to amend this Part

- (1) The Secretary of State may by regulations amend this Part—
 - (a) to add a purpose to the purposes for which data matching exercises may be conducted (see section 84(3));
 - (b) to modify the application of this Part in relation to a purpose so added.
- (2) Before making regulations under subsection (1), the Secretary of State must consult—
 - (a) the persons within section 85(2),
 - (b) such representatives of persons within section 85(2) as the Secretary of State thinks appropriate, and
 - (c) such other bodies or persons as the Secretary of State thinks appropriate.
- (3) The Secretary of State may by regulations amend this Part—
 - (a) to add a public body to the persons within section 85(2);
 - (b) to modify the application of this Part in relation to a body so added;
 - (c) to remove a person within section 85(2) or a body so added.
- (4) Before making regulations under subsection (3), the Secretary of State must consult—
 - (a) the body or person who is to be the subject of the regulations,
 - (b) such representatives of persons within section 85(2) as the Secretary of State thinks appropriate, and
 - (c) such other bodies or persons as the Secretary of State thinks appropriate.
- (5) In this section, “public body” means a body or person whose functions—
 - (a) are functions of a public nature, or
 - (b) include functions of that nature,
 but, in the latter case, the body or person is a public body only to the extent of those functions.

PART 7

INSPECTIONS, STUDIES AND INFORMATION

92 Inspections: transfer of role of inspector

- (1) For section 10 of the Local Government Act 1999 substitute –

“10 Inspections

- (1) The Secretary of State may appoint a person to carry out an inspection of a specified best value authority’s compliance with the requirements of this Part in relation to specified functions.
 - (2) The Secretary of State may appoint assistant inspectors for the purposes of the inspection.
 - (3) The appointment of an assistant inspector must be made on the recommendation of the inspector, unless the Secretary of State thinks that the urgency of the inspection makes it necessary to dispense with this requirement.
 - (4) In carrying out an inspection, the inspector and any assistant inspector must –
 - (a) have regard to any guidance issued by the Secretary of State generally in relation to inspections, and
 - (b) comply with any directions issued by the Secretary of State in relation to that inspection.”
- (2) Schedule 5 (amendments consequential on subsection (1)) has effect.

93 Transitional provision relating to social security references and reports

- (1) A local auditor may refer to the Secretary of State any matter arising from an audit under this Act if it appears that the matter may be relevant for the purposes of any of the functions of the Secretary of State relating to social security.
- (2) In section 139D(1)(b) of the Social Security Administration Act 1992, for “to an authority under section 10(1) of the Audit Commission Act 1998 and to the Secretary of State under section 39 of that Act” substitute “to the Secretary of State under section 65 of the Local Audit Act 2012”.
- (3) This section has effect until the coming into force of the repeal (by the Welfare Reform Act 2012) of section 139D of the Social Security Administration Act 1992.

94 Examinations by the Comptroller and Auditor General

- (1) After section 7 of the National Audit Act 1983 insert –

“7ZA Local authorities

- (1) The Comptroller and Auditor General may carry out examinations into the economy, efficiency and effectiveness with which English local authorities have used their resources in discharging their functions.
- (2) An examination under this section must relate to –

- (a) all English local authorities, or
 - (b) particular descriptions of English local authorities.
- (3) An examination under this section is to be carried out for the purposes of—
 - (a) ensuring that the use of resources by a department to which section 6 applies to fund English local authorities represents an economical, efficient and effective use of those resources, and
 - (b) identifying improvements that may be made by all English local authorities, or all English local authorities of a particular description, in the economy, efficiency and effectiveness with which they use resources in the discharge of their functions.
- (4) An examination under this section may be combined with another examination under this Part.
- (5) This section does not entitle the Comptroller and Auditor General to question—
 - (a) the merits of the policy objectives of any English local authority in respect of which an examination is carried out, or
 - (b) the merits of government policy.
- (6) Subsection (7) applies if the Comptroller and Auditor General—
 - (a) proposes to carry out an examination under this section, and
 - (b) considers that the work of the Auditor General for Wales is relevant to the examination.
- (7) Before carrying out the examination, the Comptroller and Auditor General must—
 - (a) consult the Auditor General for Wales, and
 - (b) take into account any relevant work done or being done by the Auditor General for Wales.
- (8) In carrying out an examination under this section, the Comptroller and Auditor General must have regard to any other examinations (by whatever name) being undertaken by other persons.
- (9) The Comptroller and Auditor General may publish the results of an examination under this section in such manner as the Comptroller and Auditor General considers appropriate.
- (10) In this Act “English local authority” means—
 - (a) a county council in England,
 - (b) a district council,
 - (c) a London borough council,
 - (d) the Council of the Isles of Scilly,
 - (e) the Common Council of the City of London in its capacity as a local authority,
 - (f) a metropolitan county fire and rescue authority,
 - (g) the London Fire and Emergency Planning Authority, or
 - (h) a fire and rescue authority in England constituted by a scheme under section 2 of the Fire and Rescue Services Act 2004 or a scheme to which section 4 of that Act applies.”

- (2) Section 8 (rights to obtain documents and information) of that Act is amended as follows.
- (3) In subsection (1) (right to access documents etc for purposes of examination under section 6 or 7), for “or 7” substitute “, 7 or 7ZA”.
- (4) In subsection (2) (application of subsection (1) rights), at the beginning insert “Subject to subsection (2A),”.
- (5) After subsection (2) insert –
 - “(2A) In the case of an examination under this Part that relates to the relationship between –
 - (a) a department, authority or body, and
 - (b) English local authorities or a description of English local authority,subsection (1) applies also to documents in the custody or under the control of an English local authority or of that department, authority or body.”

95 Disclosure of information

- (1) This section applies to information relating to a particular body or other person –
 - (a) that is obtained by a local auditor, or a person acting on behalf of a local auditor, under this Act or in the course of an audit under this Act, or
 - (b) that is obtained by an inspector or an assistant inspector, or a person acting on behalf of an inspector or an assistant inspector, under Part 1 of the Local Government Act 1999 (inspection of best value authorities) or in the course of an inspection under that Part.
- (2) This section also applies to information relating to a particular body or other person that is obtained by an authority within subsection (3) in connection with the exercise of the authority’s functions under this Act.
- (3) Those authorities are –
 - (a) a recognised supervisory body,
 - (b) a recognised qualifying body,
 - (c) a body performing functions for the purposes of arrangements within paragraph 25(1) (independent monitoring of certain audits) or 26(1) (independent investigation of public interest cases) of Schedule 3,
 - (d) the Secretary of State, and
 - (e) a body designated by the Secretary of State under section 43 (delegation of the Secretary of State’s functions).
- (4) Information to which this section applies may not be disclosed except –
 - (a) with the consent of the body or person to whom the information relates,
 - (b) for the purposes of any functions of a person under this Act or Part 1 of the Local Government Act 1999,
 - (c) for the purposes of any function of a person under Chapter 2 of Part 42 of the Companies Act 2006,
 - (d) to Her Majesty’s Chief Inspector of Education, Children’s Services and Skills for the purposes of the Chief Inspector’s functions under Chapter 4 of Part 8 of the Education and Inspections Act 2006,

- (e) for the purposes of the functions of the Regulator of Social Housing under Part 2 of the Housing and Regeneration Act 2008,
 - (f) for the purposes of the functions of the Secretary of State relating to social security,
 - (g) for the purposes of any function of the Auditor General for Wales under the Public Audit (Wales) Act 2004,
 - (h) to the Mayor of London, where the information relates to the Greater London Authority or a functional body,
 - (i) for the purposes of the functions of the Public Services Ombudsman for Wales under Part 3 of the Local Government Act 2000,
 - (j) for the purposes of the functions of a monitoring officer under that Part or regulations made under that Part, or
 - (k) for the purposes of any criminal proceedings.
- (5) Subsection (4) does not prohibit the disclosure of information if the information is or has been available to the public from any other source.
- (6) A person who is, or acts on behalf of a person who is, a public authority for the purposes of the Freedom of Information Act 2000, may also disclose information to which this section applies unless the disclosure would, or would be likely to, prejudice the effective performance of a function imposed or conferred on the person by or under an enactment.
- (7) A local auditor, or a person acting on the auditor's behalf, may also disclose information to which this section applies except where the disclosure would, or would be likely to, prejudice the effective performance of a function imposed or conferred on the auditor by or under an enactment.
- (8) A person who does not fall within subsection (6) or (7) may also disclose information to which this section applies in accordance with consent given by a local auditor.
- (9) Section 96 makes further provision about consent for the purposes of subsection (8).
- (10) A person who discloses information in breach of this section is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (11) In this section “enactment” includes –
- (a) an enactment contained in subordinate legislation as defined in section 21(1) of the Interpretation Act 1978,
 - (b) an enactment contained in, or in an instrument made under, a Measure or Act of the National Assembly for Wales,
 - (c) an enactment contained in, or in an instrument made under, an Act of the Scottish Parliament, and
 - (d) an enactment contained in, or in an instrument made under Northern Ireland legislation as defined in section 24(5) of the Interpretation Act 1978.
- (12) In Part 1 of Schedule 11A to the Companies Act 2006 (specified persons for the purposes of the disclosure provisions in section 1224A of that Act), after paragraph 17 insert –
- “18 A recognised supervisory body within the meaning of the Local Audit Act 2012 (see section 23(6) of that Act).

- 19 A recognised qualifying body within the meaning of that Act (see section 25(10) of that Act).
- 20 A body designated by the Secretary of State under section 43 of that Act (delegation of the Secretary of State’s functions under Part 4 of that Act).
- 21 A body with which a recognised supervisory body within the meaning of that Act is participating in arrangements for the purposes of paragraph 25 (independent monitoring of audits) or 26 (independent investigation for disciplinary purposes) of Schedule 3 to that Act.”

96 Consent under section 95

- (1) Consent for the purposes of section 95(8) must be obtained in accordance with this section.
- (2) A person requesting consent (“the applicant”) must make a request for consent which –
 - (a) is in writing,
 - (b) states the name of the applicant and an address for correspondence,
 - (c) describes the information in relation to which consent is requested, and
 - (d) identifies the person to whom the information will be disclosed.
- (3) Consent must be given except where the disclosure would, or would be likely to, prejudice the effective performance of a function imposed or conferred on a local auditor by or under an enactment.
- (4) Consent may be given or refused orally or in writing; but where it is given or refused orally the consent or refusal must be confirmed in writing.
- (5) A refusal (or, where the refusal is given orally, the confirmation of the refusal) must contain the reasons for the refusal.
- (6) A local auditor to whom a request for consent is made must give or refuse consent not later than the twentieth working day following the day on which the request is received.
- (7) “Working day” means any day other than a Saturday, a Sunday, Christmas Day, Good Friday or a day which is a bank holiday under the Banking and Financial Dealings Act 1971 in any part of the United Kingdom.

97 Provision of information to Auditor General for Wales

- (1) The persons mentioned in subsection (2) must, on request, provide the Auditor General for Wales with any information the Auditor General may reasonably require for the purpose of making comparisons, in the exercise of functions under sections 41 and 42 of the Public Audit (Wales) Act 2004, between local government bodies in Wales and other relevant authorities.
- (2) Those persons are –
 - (a) a local auditor,
 - (b) the Secretary of State in the exercise of functions under Part 6 (data matching), and
 - (c) a person who is exercising or has exercised functions under that Part on the Secretary of State’s behalf.

PART 8

GENERAL PROVISIONS

98 Orders and regulations

- (1) Any power of the Secretary of State to make an order or regulations under this Act is exercisable by statutory instrument.
- (2) Any power of the Secretary of State to make an order or regulations under this Act includes –
 - (a) power to make different provision for different cases;
 - (b) power to make incidental, supplementary, consequential, transitional or transitory provision or savings.
- (3) A statutory instrument containing an order or regulations to which subsection (4) applies (whether alone or with other provision) may not be made unless a draft of the instrument has been laid before and approved by a resolution of each House of Parliament.
- (4) This subsection applies to –
 - (a) regulations under section 4(2) (power to amend list of relevant authorities in Schedule 2),
 - (b) regulations under section 5(7) (power to amend definition of “smaller authority”),
 - (c) regulations under section 6(4) (power to amend intervals at which local auditor must be appointed),
 - (d) regulations under section 12(5) (power to amend definition of “independent” member of auditor panel),
 - (e) regulations under section 20(9) (power to amend definition of “connected entity”),
 - (f) an order under section 43 (delegation of Secretary of State’s functions under Part 4) which has the effect of transferring or returning functions,
 - (g) regulations under section 53 (power to make provision in consequence of changes affecting accountancy bodies) which amend or repeal any provision of an Act,
 - (h) regulations under section 54 (power to amend Part 4 for consistency with Companies Act 2006),
 - (i) regulations under section 91 (power to amend data-matching provisions), and
 - (j) regulations under section 100 (power to make consequential provision) which amend or repeal any provision of an Act.
- (5) Any other statutory instrument containing an order or regulations under this Act is subject to annulment in pursuance of a resolution of either House of Parliament.
- (6) Subsections (2) to (5) do not apply to an order under section 102 (commencement).
- (7) This section is subject to paragraph 7 of Schedule 4 (effect of transfer of legislative functions under Part 4).

99 Interpretation of Act

- (1) In this Act (unless the context otherwise requires) –
- “accounts” has the meaning given by section 3(2);
 - “area”, in relation to a chief constable, means the police area of the chief constable’s police force;
 - “charter trustees” means charter trustees constituted –
 - (a) under section 246 of the Local Government Act 1972,
 - (b) by the Charter Trustees Regulations 1996 (SI 1996/263), or
 - (c) under Part 1 of the Local Government and Public Involvement in Health Act 2007;
 - “chief constable” means a chief constable for a police force for a police area;
 - “code of audit practice” means a code of audit practice under section 55;
 - “combined authority” means a combined authority established under section 103 of the Local Democracy, Economic Development and Construction Act 2009;
 - “the Common Council” means the Common Council of the City of London;
 - “enactment” includes an enactment contained in subordinate legislation as defined in section 21(1) of the Interpretation Act 1978;
 - “executive” and “executive arrangements” have the same meaning as in Part 1A of the Local Government Act 2000;
 - “financial year” has the meaning given by section 2(4);
 - “functional body” has the same meaning as in the Greater London Authority Act 1999 (see section 424(1) of that Act);
 - “immediate report” has the meaning given by section 63(3);
 - “item of account” has the meaning given by section 76(7);
 - “local auditor” has the meaning given by section 17(4);
 - “local government elector” means a person registered as a local government elector in the register of electors in accordance with the Representation of the People Acts (but see subsection (4));
 - “officer”, in relation to a relevant authority, includes a member of the staff of the authority;
 - “police area” means a police area listed in Schedule 1 to the Police Act 1996 (police areas outside London);
 - “public interest report” has the meaning given by section 63(2);
 - “recognised qualifying body” has the meaning given by section 25(10);
 - “recognised supervisory body” is to be construed in accordance with section 23(6);
 - “related authority” has the meaning given by section 64(6);
 - “relevant authority” has the meaning given by section 4(1);
 - “Welsh NHS body” has the meaning given by section 12(1) of the Public Audit (Wales) Act 2004.
- (2) References in this Act to a function under this Act or a Part of this Act include a function under regulations under this Act or that Part.
- (3) References in this Act to an entity connected with a relevant authority are to be construed in accordance with section 20(7).
- (4) A reference in this Act to a local government elector for any area –

- (a) in relation to a Passenger Transport Executive, is a reference to a local government elector for the area of the Integrated Transport Authority or combined authority for the area for which the Executive is established;
 - (b) in relation to the Broads Authority, is a reference to a local government elector for the area of any participating authority (as defined by section 25 of the Norfolk and Suffolk Broads Act 1988);
 - (c) in relation to a National Park authority which is the local planning authority for a National Park, is a reference to a local government elector for any area the whole or any part of which is comprised in that Park.
- (5) Any function conferred or imposed on the Greater London Authority under or by virtue of this Act is exercisable by the Mayor of London acting on behalf of the Authority.
- (6) Subsection (5) does not apply in relation to any function expressly conferred on –
- (a) the London Assembly, or
 - (b) the Mayor of London and the London Assembly acting jointly on behalf of the Greater London Authority.

100 Power to make consequential provision

- (1) The Secretary of State may by regulations make such consequential, incidental or supplementary provision as the Secretary of State considers appropriate in connection with any provision of, or made under, this Act.
- (2) The power in subsection (1) includes power to amend, repeal or revoke –
 - (a) any provision of or made under this Act,
 - (b) any provision of any Act passed before, or in the same Session as, this Act, and
 - (c) any provision made under an Act before, or in the same Session as, this Act.

101 Extent

- (1) This Act extends to England and Wales only, subject to subsection (2).
- (2) An amendment, repeal or revocation made by this Act has the same extent as the relevant part of the Act or instrument amended, repealed or revoked.

102 Commencement

- (1) The provisions of this Act come into force on such day as the Secretary of State may by order appoint, subject to subsection (2).
- (2) This Part comes into force on the day on which this Act is passed.
- (3) An order under this section may –
 - (a) appoint different days for different purposes or different areas;
 - (b) make transitional, transitory or saving provision.
- (4) Provision under subsection (3)(b) may, in particular, enable a function of the Audit Commission under a provision that is amended or repealed by this Act

to be exercised by a person or body specified in the order for a period specified in or determined under the order.

- (5) In subsection (4) “the Audit Commission” means the Audit Commission for Local Authorities and the National Health Service in England.

103 Short title

This Act may be cited as the Local Audit Act 2012.

SCHEDULES

SCHEDULE 1

Section 1

ABOLITION OF AUDIT COMMISSION: SUPPLEMENTARY PROVISION

Transfer of property, rights and liabilities

- 1 (1) The Secretary of State may make a scheme for the transfer of property, rights and liabilities to a person or persons specified in the scheme.
- (2) The things that may be transferred under a transfer scheme include—
 - (a) property, rights and liabilities that could not otherwise be transferred;
 - (b) property acquired, and rights and liabilities arising, after the making of the scheme.
- (3) A transfer scheme may make consequential, supplementary, incidental or transitional provision and may in particular—
 - (a) create rights, or impose liabilities, in relation to property or rights transferred;
 - (b) make provision about the continuing effect of things done by the transferor in respect of anything transferred;
 - (c) make provision about the continuation of things (including legal proceedings) in the process of being done by, on behalf of or in relation to the transferor in respect of anything transferred;
 - (d) make provision for references to the transferor in an instrument or other document in respect of anything transferred to be treated as references to the transferee;
 - (e) make provision for the shared ownership or use of property;
 - (f) if the TUPE regulations do not apply in relation to the transfer, make provision which is the same or similar.
- (4) A transfer scheme may provide—
 - (a) for modification by agreement;
 - (b) for modifications to have effect from the date when the original scheme came into effect.
- (5) In this paragraph—
 - (a) “TUPE regulations” means the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246), and
 - (b) references to rights and liabilities include rights and liabilities under a contract of employment.

Reduction in membership pending abolition

- 2 Until the coming into force of section 1, in section 1(2) of the Audit Commission Act 1998 (Audit Commission to consist of not less than 10 nor more than 15 members) there is omitted the words “less than 10 nor”.

Final accounts

- 3 (1) As soon as is reasonably practicable after the abolition date, the Secretary of State must prepare –
- (a) a statement of account for the Audit Commission for the last financial year to end before the abolition date, and
 - (b) a statement of account for the Audit Commission for the period (if any) beginning immediately after the end of that financial year and ending immediately before the abolition date.
- (2) A statement of account under this paragraph must be prepared in accordance with the last direction given by the Secretary of State to the Audit Commission under paragraph 11(1) of Schedule 1 to the Audit Commission Act 1998.
- (3) The Secretary of State must, as soon as is reasonable practicable after preparing a statement of account under this paragraph, send a copy of it to the Comptroller and Auditor General.
- (4) The Comptroller and Auditor General must –
- (a) examine, certify and report on the statement of account, and
 - (b) make arrangements for a copy of the statement and the report to be laid before Parliament.
- (5) Sub-paragraph (1)(a) does not apply if the Audit Commission has already sent a copy of the statement of account for that year to the Comptroller and Auditor General.
- (6) In that case, the repeal of paragraph 11 of Schedule 1 to the Audit Commission Act 1998 does not remove the obligation of the Comptroller and Auditor General to take the steps specified in that paragraph in relation to the statement of account if the Comptroller has not already done so.
- (7) In this paragraph “financial year” means the period of 12 months ending with 31st March in any year.

Final annual report

- 4 (1) As soon as is reasonably practicable after the abolition date, the Secretary of State must publish a report on the discharge of the functions of the Audit Commission.
- (2) The report must relate to the period –
- (a) beginning immediately after the period covered by the last annual report published by the Audit Commission, and
 - (b) ending immediately before the abolition date.
- (3) The Secretary of State must lay an annual report published under this paragraph before Parliament.

- (4) The repeal of paragraph 14(2) of Schedule 1 to the Audit Commission Act 1998 does not remove the obligation of the Secretary of State to lay copies of an annual report received from the Audit Commission before each House of Parliament if the Secretary of State has not already done so.

Payments in respect of pension liabilities

- 5 The Secretary of State may make payments to any person to enable that person to meet—
- (a) liabilities arising as the result of provision made under paragraph 5(2) of Schedule 1 to the Audit Commission Act 1998 for the payment of sums by way of pension, allowances or gratuities, or
 - (b) liabilities under the pension scheme established under paragraph 7(4)(c) of that Schedule.

Meaning of “abolition date”

- 6 In this Schedule “the abolition date” means the date on which section 1(1) (abolition of Audit Commission) comes into force.

SCHEDULE 2

Section 4

RELEVANT AUTHORITIES

- 1 A county council in England.
- 2 A district council.
- 3 A London borough council.
- 4 A parish council.
- 5 A committee of a council within any of paragraphs 1 to 4, including a joint committee of two or more such councils.
- 6 A joint authority established under Part 4 of the Local Government Act 1985.
- 7 A Passenger Transport Executive.
- 8 The Greater London Authority.
- 9 A functional body.
- 10 The London Pensions Fund Authority.
- 11 The London Waste and Recycling Board.
- 12 The Common Council.
- 13 A parish meeting of a parish which does not have a separate parish council.
- 14 The Council of the Isles of Scilly.
- 15 Charter trustees.
- 16 A port health authority for a port health district—
 - (a) wholly in England, or

- (b) partly in England and partly in Wales.
- 17 The Broads Authority.
- 18 A National Park authority for a National Park in England.
- 19 A conservation board established by order of the Secretary of State under section 86 of the Countryside and Rights of Way Act 2000.
- 20 A police and crime commissioner for a police area in England.
- 21 A chief constable for an area in England.
- 22 The Commissioner of Police of the Metropolis.
- 23 A fire and rescue authority in England constituted by a scheme under section 2 of the Fire and Rescue Services Act 2004 or a scheme to which section 4 of that Act applies.
- 24 An authority established for an area in England by an order under section 207 of the Local Government and Public Involvement in Health Act 2007 (joint waste authorities).
- 25 An internal drainage board for an internal drainage district –
 - (a) wholly in England, or
 - (b) partly in England and partly in Wales.
- 26 An economic prosperity board established under section 88 of the Local Democracy, Economic Development and Construction Act 2009.
- 27 A combined authority.

SCHEDULE 3

Section 23

RECOGNISED SUPERVISORY BODIES

PART 1

GRANT AND REVOCATION OF RECOGNITION

Application for recognition

- 1 (1) A supervisory body may apply to the Secretary of State for an order (a “recognition order”) declaring it to be a recognised supervisory body for the purposes of this Act.
- (2) Each application must be –
 - (a) made in the manner directed by the Secretary of State, and
 - (b) accompanied by the information that the Secretary of State reasonably requires for the purposes of deciding on the application.
- (3) At any time between receiving and deciding on an application, the Secretary of State may require the applicant to provide further information.
- (4) Different directions or requirements may be given or imposed under this paragraph in relation to different applications.

- (5) The Secretary of State may require information provided under this paragraph to be in a form, or verified in a manner, specified by the Secretary of State.
- (6) Each application must be accompanied by –
 - (a) a copy of the applicant's rules, and
 - (b) a copy of any guidance issued by the applicant in writing.
- (7) The reference in sub-paragraph (6)(b) to guidance issued by the applicant is a reference to any guidance or recommendation –
 - (a) issued or made by it to all or any class of its members or persons seeking to become members,
 - (b) relevant for the purposes of this Part of this Act, and
 - (c) intended to have continuing effect.
- (8) This includes any guidance or recommendation relating to the admission or expulsion of members of the body, so far as relevant for the purposes of this Part of this Act.

Grant and refusal of application

- 2 (1) This paragraph applies if –
 - (a) an application is made in accordance with paragraph 1, and
 - (b) the applicant provides the Secretary of State with the information required by the Secretary of State under that paragraph.
- (2) The Secretary of State must make or refuse to make a recognition order in respect of the applicant.
- (3) The Secretary of State may make a recognition order only if the Secretary of State thinks that the requirements of Part 2 of this Schedule are met by the applicant.
- (4) A decision under sub-paragraph (3) must be made on the basis of the information provided by the applicant and having regard to any other information in the Secretary of State's possession.
- (5) Where the Secretary of State makes a recognition order, the order must state the date on which it takes effect.
- (6) The Secretary of State may refuse to make a recognition order if the Secretary of State thinks the order is unnecessary given that there are one or more other bodies that –
 - (a) maintain and enforce rules dealing with the appointment and conduct of local auditors, and
 - (b) have been or are likely to be recognised.
- (7) Where the Secretary of State refuses to make a recognition order, the Secretary of State must give the applicant a written notice to that effect.
- (8) The notice must –
 - (a) specify which requirements the Secretary of State thinks are not met, or
 - (b) state that the application has been refused on the ground mentioned in sub-paragraph (6).

Revocation of recognition

- 3 (1) A recognition order may be revoked by a further order (a “revocation order”) made by the Secretary of State.
- (2) A revocation order may be made at the request of, or with the consent of, the body to which it relates.
- (3) Otherwise a revocation order may be made only if the Secretary of State thinks that –
- (a) any requirement of Part 2 or 3 of this Schedule is not met by the body to which it relates,
 - (b) the body has failed to comply with any obligation imposed on it by or by virtue of this Part of this Act, or
 - (c) the continued recognition of the body is undesirable given that there are one or more other bodies which have been or are to be recognised.
- (4) A revocation order must state the date on which it takes effect, which must fall after the end of the period of 3 months beginning with the date on which it is made.
- (5) A revocation order may take effect before the end of that period if –
- (a) the revocation order is made at the request or with the consent of the body to which the recognition order relates, or
 - (b) the Secretary of State thinks that it is essential in the public interest for the order to take effect before the end of that period.
- (6) A revocation order may contain the transitional provision that the Secretary of State thinks is necessary or expedient.

Steps to be taken in connection with revocation

- 4 (1) Before making a revocation order, the Secretary of State must –
- (a) give written notice of the Secretary of State’s intention to do so to the body to which it relates,
 - (b) take the steps that the Secretary of State thinks are reasonably practicable to bring the notice to the attention of members of the body, and
 - (c) publish the notice in the manner the Secretary of State thinks is appropriate for bringing it to the attention of any other persons the Secretary of State thinks are likely to be affected.
- (2) A notice under sub-paragraph (1) must –
- (a) state the reasons for which the Secretary of State proposes to act, and
 - (b) give particulars of the rights conferred by sub-paragraph (3).
- (3) A person within sub-paragraph (4) may, within the period of 3 months beginning with the date of service or publication of the notice under sub-paragraph (1) or a longer period allowed by the Secretary of State –
- (a) make written representations to the Secretary of State, and
 - (b) if desired, make oral representations to a person appointed for that purpose by Secretary of State.
- (4) The persons within this sub-paragraph are –
- (a) the body to which the revocation order relates,

- (b) any member of that body, and
 - (c) any other person who the Secretary of State thinks is affected.
- (5) The Secretary of State must have regard to any representations made in accordance with sub-paragraph (3) in determining whether to make the revocation order.
- (6) The Secretary of State may make a revocation order without complying with sub-paragraphs (1) to (5) if –
 - (a) the order is made at the request or with the consent of the body to which it relates, or
 - (b) the Secretary of State thinks that it is essential in the public interest to do so.
- (7) The Secretary of State may make a revocation order before the end of the period for making representations mentioned in sub-paragraph (3) if the Secretary of State thinks that it is essential in the public interest to do so.
- (8) On making a revocation order the Secretary of State must –
 - (a) give written notice of the making of the order to the body to which it relates,
 - (b) take the steps that the Secretary of State thinks are reasonably practicable to bring the making of the order to the attention of the members of the body, and
 - (c) publish a notice of the making of the order in the manner that the Secretary of State thinks is appropriate for bringing it to the attention of any other persons the Secretary of State thinks are likely to be affected.

Orders not to be made by statutory instrument

- 5 Orders under this Part of this Schedule are not to be made by statutory instrument.

PART 2

REQUIREMENTS FOR RECOGNITION

Holding of appropriate qualification

- 6 (1) The body must have rules to the effect that a person is not eligible for appointment as a local auditor unless –
- (a) in the case of an individual other than an EEA auditor, the individual meets the condition in sub-paragraph (2),
 - (b) in the case of an individual who is an EEA auditor, the individual meets any one of the conditions in sub-paragraph (3), and
 - (c) in the case of a firm, the firm meets both of the conditions in sub-paragraph (4).
- (2) The condition mentioned in sub-paragraph (1)(a) is that the individual holds an appropriate qualification.
- (3) The conditions mentioned in sub-paragraph (1)(b) are –
- (a) that the individual holds an appropriate qualification,

- (b) that the individual has been authorised on or before 5 April 2008 to practise the profession of company auditor pursuant to the European Communities (Recognition of Professional Qualifications) (First General System) Regulations 2005 (SI 2005/18) and has fulfilled any requirements imposed pursuant to regulation 6 of those Regulations, and
 - (c) that the individual has passed an aptitude test in accordance with sub-paragraph (5), unless an aptitude test is not required (see sub-paragraph (6)).
- (4) The conditions mentioned in sub-paragraph (1)(c) are –
 - (a) that each individual responsible for local audit work on behalf of the firm is eligible for appointment as a local auditor, and
 - (b) that the firm is controlled by qualified persons (see paragraph 7).
- (5) The aptitude test mentioned in sub-paragraph (3)(c) –
 - (a) must test the person’s knowledge of subjects –
 - (i) that are covered by a recognised professional qualification (if there are any such qualifications),
 - (ii) that are not covered by the professional qualification already held by the person, and
 - (iii) the knowledge of which is essential for the pursuit of the profession of local auditor,
 - (b) may test the person’s knowledge of rules of professional conduct, and
 - (c) must not test the person’s knowledge of any other matters.
- (6) No aptitude test is required if the subjects that are covered by a recognised professional qualification (if there are any such qualifications) and the knowledge of which is essential for the pursuit of the profession of local auditor are covered by the professional qualification already held by the person.
- (7) A firm which has ceased to comply with the conditions in sub-paragraph (4) may be permitted to remain eligible for appointment as a local auditor for a period of not more than 3 months.
- (8) Section 25 makes provision about appropriate qualifications.

Control by qualified persons

- 7
- (1) This paragraph explains what is meant in paragraph 6(4)(b) by a firm being “controlled by qualified persons”.
 - (2) In this paragraph, references to a person being qualified, in relation to an individual, are to the person holding –
 - (a) an appropriate qualification, or
 - (b) a corresponding qualification to audit accounts under the law of an EEA State, or part of an EEA State, other than the United Kingdom.
 - (3) In this paragraph, references to a person being qualified, in relation to a firm, are to the firm –
 - (a) being eligible for appointment as a local auditor, or

- (b) being eligible for a corresponding appointment as an auditor under the law of an EEA State, or part of an EEA State, other than the United Kingdom.
- (4) A firm is to be treated as controlled by qualified persons only if –
 - (a) a majority of the members of the firm are qualified persons, and
 - (b) where the firm’s affairs are managed by a board of directors, committee or other management body, a majority of the members of that body are qualified persons or, if the body consists of two persons only, at least one of them is a qualified person.
- (5) A majority of the members of a firm means –
 - (a) where under the firm’s constitution matters are decided upon by the exercise of voting rights, members holding a majority of the rights to vote on all, or substantially all, matters;
 - (b) in any other case, members having such rights under the constitution of the firm that enable them to direct its overall policy or alter its constitution.
- (6) A majority of the members of the management body of a firm means –
 - (a) where matters are decided at meetings of the management body by the exercise of voting rights, members holding a majority of the rights to vote on all, or substantially all, matters at those meetings;
 - (b) in any other case, members having such rights under the constitution of the firm as enable them to direct its overall policy or alter its constitution.
- (7) Paragraphs 5 to 11 of Schedule 7 to the Companies Act 2006 (rights to be taken into account and attribution of rights) apply for the purposes of this paragraph.
- (8) Section 25 makes provision about appropriate qualifications.

Auditors to have sufficient skill and experience

- 8 (1) The body must have rules to the effect that a person is not eligible for appointment as a local auditor unless –
 - (a) in the case of a firm, the key audit partner, or each of the key audit partners, has an appropriate level of competence to carry out local audits, and
 - (b) in the case of an individual, the individual has an appropriate level of competence to carry out local audits.
- (2) Rules under sub-paragraph (1) must comply with guidance issued by the Secretary of State.
- (3) In sub-paragraph (1) “key audit partner” means an individual identified by the firm as being primarily responsible for local audits.

Auditors to be fit and proper persons

- 9 (1) The body must have adequate rules and practices designed to ensure that the persons eligible under its rules for appointment as a local auditor are fit and proper persons to be so appointed.

- (2) The matters which the body takes into account for this purpose in relation to a person must include any matter relating to any person who is or will be employed by or associated with the person for the purposes of or in connection with local audit work.
- (3) In the case of a person who is a body corporate, the matters which the body takes into account for this purpose in relation to the body corporate must include any matter relating to—
 - (a) any director or controller of the body corporate,
 - (b) any other body corporate in the same group, or
 - (c) any director or controller of any other body corporate in the same group.
- (4) In the case of a person who is a partnership, the matters which the body takes into account for this purpose in relation to the partnership must include any matter relating to—
 - (a) any of the partners,
 - (b) any director or controller of any of the partners,
 - (c) any body corporate in the same group as any of the partners, or
 - (d) any director or controller of any body corporate in the same group as any of the partners.
- (5) Where the person is a limited liability partnership, in sub-paragraph (3) “director” is to be read as “member”.
- (6) In sub-paragraphs (3) and (4) “controller”, in relation to a body corporate, means a person who either alone or with an associate or associates is entitled to exercise or control the exercise of 15% or more of the rights to vote on all, or substantially all, matters at general meetings of the body or another body corporate of which it is a subsidiary.

Professional integrity and independence

- 10 (1) The body must have adequate rules and practices designed to ensure that—
- (a) local audit work is conducted properly and with integrity,
 - (b) persons are not appointed as local auditors in contravention of section 20 (independence requirement),
 - (c) persons are not appointed as local auditors in other circumstances in which they have an interest likely to conflict with the proper conduct of the audit,
 - (d) persons appointed as local auditors comply with sections 20 and 21 (effect of lack of independence),
 - (e) persons appointed as local auditors otherwise take steps to safeguard their independence from any significant threats to it,
 - (f) persons appointed as local auditors record any threats of that kind and the steps taken to safeguard the proper conduct of the audit from them,
 - (g) remuneration received or receivable by a local auditor in respect of local audit work is not influenced or determined by the local auditor providing other services to the relevant authority concerned, and
 - (h) remuneration received or receivable by a local auditor in respect of local audit work is not on a contingent fee basis.

- (2) The body must participate in arrangements within paragraph 23 (arrangements for setting standards), and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under those arrangements.
- (3) The body must also have adequate rules and practices designed to ensure that—
 - (a) no firm is eligible under its rules for appointment as a local auditor unless the firm has arrangements to prevent any person from being able to exert any influence over the way in which a local audit is conducted in circumstances in which that influence would be likely to affect the independence or integrity of the audit,
 - (b) any rule of law relating to the confidentiality of information received in the course of local audit work by persons appointed as local auditors is complied with, and
 - (c) a person ceasing to hold office as a local auditor makes available to the person's successor in that office all relevant information which the person holds in relation to that office.
- (4) The rules referred to in sub-paragraph (3)(b) must apply to persons who are no longer members of the body as they apply to members.
- (5) The rules referred to in sub-paragraph (3)(b) must also be binding on persons who—
 - (a) have sought appointment or acted as a local auditor, and
 - (b) have been members of the body at any time after the commencement of this Part of this Act.
- (6) Any fine imposed in the enforcement of those rules is to be recoverable by the body as a debt due to it from the person obliged to pay it.

Technical standards

- 11 (1) The body must have rules and practices as to—
 - (a) the technical standards to be applied in local audit work, and
 - (b) the manner in which those standards are to be applied in practice.
- (2) The body must participate in arrangements within paragraph 24 (arrangements for setting standards), and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under those arrangements.

Technical standards for group audit

- 12 (1) The body must have rules and practices as to technical standards ensuring that local auditors undertaking a group audit—
 - (a) review for the purposes of the audit the audit work conducted by other persons, and
 - (b) record that review.
- (2) The body must participate in arrangements within paragraph 24 (arrangements for setting standards), and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under those arrangements.

- (3) In this paragraph “group audit” means an audit that relates to the statement of accounts of a relevant authority in a case where, in accordance with proper practices, the financial transactions of an entity other than the authority must be consolidated into the statement.
- (4) In sub-paragraph (3) “entity” means any entity, whether or not a legal person.

Procedures for maintaining competence

- 13 The body must have rules and practices designed to ensure that persons eligible under its rules for appointment as a local auditor continue to maintain an appropriate level of competence in the conduct of local audits.

Monitoring and enforcement

- 14 (1) The body must—
 - (a) have adequate resources for the effective monitoring and enforcement of compliance with its rules, and
 - (b) ensure that those resources may not be influenced improperly by the persons monitored.
- (2) The body must—
 - (a) have adequate arrangements for the effective monitoring and enforcement of compliance with its rules, and
 - (b) ensure that those arrangements operate independently of the persons monitored.
- (3) The arrangements for monitoring may make provision for that function to be performed on behalf of the body (and without affecting its responsibility) by any other body or person who is able and willing to perform it.
- (4) The arrangements for enforcement must include provision for sanctions which include—
 - (a) the withdrawal of eligibility for appointment as a local auditor, and
 - (b) any other disciplinary measures necessary to ensure the effective enforcement of the body’s rules.
- (5) The arrangements for enforcement must include provision for the body making available to the public information about steps it has taken to ensure the effective enforcement of its rules.

Monitoring of audits

- 15 (1) The body must—
 - (a) have adequate arrangements for enabling the performance by its members of local audit functions, other than functions in respect of major local audits, to be monitored by means of inspections,
 - (b) in the case of members of the body who perform any local audit functions in respect of major local audits—
 - (i) participate in arrangements within paragraph 25, and
 - (ii) have rules and practices designed to ensure that a sanction determined under paragraph 25(1)(b) is to be treated as if it were a sanction which the body had determined under arrangements for enforcement within paragraph 14(2), and

- (c) have rules designed to ensure that members of the body take reasonable steps to enable their performance of any local audit functions to be monitored by means of inspections.
- (2) Any monitoring of members of the body under the arrangements within paragraph 25 is to be regarded (so far as their performance of local audit functions in respect of major local audits is concerned) as monitoring of compliance with the body's rules for the purposes of paragraph 14(1) and (2).
- (3) The arrangements referred to in sub-paragraph (1)(a) must include an inspection which is conducted in relation to each person eligible for appointment as a local auditor at least once every 6 years.
- (4) The inspection must be conducted by persons who –
 - (a) have an appropriate professional education,
 - (b) have experience of local audit work or equivalent work on the audit of accounts under the law of an EEA State, or part of an EEA State, other than the United Kingdom,
 - (c) have received adequate training in the conduct of inspections, and
 - (d) do not have any interests likely to conflict with the proper conduct of the inspection.
- (5) The inspection must review one or more local audits in which the person to whom the inspection relates has participated.
- (6) The inspection must include an assessment of –
 - (a) the person's compliance with the body's rules established for the purposes of paragraphs 10 (professional integrity and independence), 11 (technical standards) and 12 (technical standards for group audits),
 - (b) the resources allocated by the person to local audit work,
 - (c) in the case of an inspection in relation to a firm, its internal quality control system, and
 - (d) the remuneration received by the person in respect of local audit work.
- (7) An inspection conducted in relation to a firm may be treated as an inspection of all individuals responsible for local audit work on behalf of that firm, if the firm has a common quality assurance policy with which each of those individuals is required to comply.
- (8) The main conclusions of the inspection must be recorded in a report which is made available to –
 - (a) the person to whom the inspection relates, and
 - (b) the body.
- (9) The body must, at least one every calendar year, give to the Secretary of State a summary of the results of inspections conducted under this paragraph.
- (10) For the purposes of this Schedule a local audit of a relevant authority is a "major local audit" if the authority is specified in, or of a description specified in –
 - (a) regulations made for the purposes of this sub-paragraph by the Secretary of State, or

- (b) a direction (which has not been revoked) given by the Secretary of State to the body.
- (11) Regulations under sub-paragraph (10)(a) may in particular specify a description of relevant authority by reference to its income or expenditure.
- (12) A direction may be given under sub-paragraph (10)(b) only if the Secretary of State thinks that there is significant public interest in the authority, or in authorities of the description, specified in the direction.
- (13) In this Schedule “local audit function” means any function performed as a local auditor.

Membership, eligibility and discipline

- 16 (1) The rules and practices of the body relating to the matters listed in sub-paragraph (2) must be fair and reasonable and include adequate provision for appeals.
- (2) Those matters are –
 - (a) the admission and expulsion of members,
 - (b) the grant and withdrawal of eligibility for appointment as a local auditor, and
 - (c) the discipline the body exercises over its members.

Investigation of complaints

- 17 (1) The body must have effective arrangements for the investigation of complaints against –
 - (a) persons who are eligible under its rules for appointment as a local auditor, and
 - (b) the body in respect of matters arising out of its functions as a supervisory body.
- (2) The arrangements mentioned in sub-paragraph (1) may make provision for the whole or part of that function to be performed by and to be the responsibility of a body or person independent of the body itself.

Independent investigation for disciplinary purposes of public interest cases

- 18 (1) The body must –
 - (a) participate in arrangements within paragraph 26, and
 - (b) have rules and practices designed to ensure that, where the designated persons have decided that any particular disciplinary action should be taken against a member of the body following the conclusion of an investigation under those arrangements, that decision is to be treated as if it were a decision made by the body in disciplinary proceedings against the member.
- (2) In sub-paragraph (1) “the designated persons” means the persons who, under the arrangements, have the function of deciding whether (and if so, what) disciplinary action should be taken against a member of the body in the light of an investigation carried out under the arrangements.

Meeting of claims arising out of audit work

- 19 (1) The body must have adequate rules or arrangements designed to ensure that persons eligible under its rules for appointment as a local auditor take reasonable steps to secure that they are able to meet claims against them arising out of local audit work.
- (2) This may be achieved by professional indemnity insurance or other appropriate arrangements.

Register of auditors and other information to be made available

- 20 The body must have rules requiring persons eligible under its rules for appointment as a local auditor to comply with any obligations imposed on them by –
- (a) requirements under section 27 (Secretary of State’s power to call for information);
 - (b) regulations under section 37 (the register of auditors);
 - (c) regulations under section 38 (information to be made available to the public).

Taking account of costs of compliance

- 21 The body must have satisfactory arrangements for taking account, in framing its rules, of the cost to those to whom the rules would apply of complying with those rules and any other controls to which they are subject.

Promotion and maintenance of standards

- 22 The body must be able and willing –
- (a) to promote and maintain high standards of integrity in the conduct of local audit work, and
 - (b) to co-operate, by the sharing of information and otherwise, with the Secretary of State and any other authority, body or person having responsibility in the United Kingdom for the qualification, supervision or regulation of auditors.

PART 3

ARRANGEMENTS IN WHICH RECOGNISED SUPERVISORY BODIES ARE REQUIRED TO PARTICIPATE

Arrangements for setting standards concerning professional integrity and independence

- 23 The arrangements referred to in paragraph 10(2) are appropriate arrangements –
- (a) for the determining of standards for the purposes of the rules and practices mentioned in paragraph 10(1), and
 - (b) for ensuring that the determination of those standards is done independently of the body.

Arrangements for setting technical standards

- 24 The arrangements referred to in paragraphs 11(2) and 12(2) are appropriate arrangements –
- (a) for the determining of standards for the purposes of the rules and practices mentioned in paragraphs 11(1) and 12(2) respectively, and
 - (b) for ensuring that the determination of those standards is done independently of the body.

Arrangements for independent monitoring of major local audits

- 25 (1) The arrangements referred to in paragraph 15(1)(b)(i) are appropriate arrangements –
- (a) for enabling the performance by members of the body of local audit functions in respect of major local audits to be monitored by means of inspections carried out under the arrangements,
 - (b) for enabling the body performing the inspections to determine sanctions (including those mentioned in paragraph 14(4)) against members of the body where, pursuant to an inspection, it concludes that members have not complied with the body's rules in so far as they are relevant to local audit functions, and
 - (c) for ensuring that the carrying out of such inspections and the determination of such sanctions are done independently of the body.
- (2) Those arrangements must include provision for an inspection to be carried out in relation to each person eligible for appointment as a local auditor at least once every 3 years.
- (3) Sub-paragraphs (4) to (9) of paragraph 15 apply to inspections under sub-paragraph (2) as they apply to inspections under that paragraph.
- (4) The arrangements may provide for the inspecting body to decide that all or part of an inspection under sub-paragraph (2) is not needed for a member of a supervisory body who performs local audit functions in relation to 10 major local audits or fewer each year.
- (5) If, under arrangements within sub-paragraph (4), the inspecting body decides that no inspection under sub-paragraph (2) is needed for a member, the supervisory body must ensure that arrangements under paragraph 15(1)(a) apply to the member.
- (6) If, under arrangements within sub-paragraph (4), the inspecting body decides that part of an inspection under sub-paragraph (2) is not needed for a member, the supervisory body must ensure that arrangements under paragraph 15(1)(a) apply to that part of the inspection of the member.
- (7) In a case within sub-paragraph (5) or (6), an inspection under paragraph 15 must be carried out in relation to the member at least once every 3 years (and sub-paragraph (3) of that paragraph is to be read with that modification).

Arrangements for independent investigation for disciplinary purposes of public interest cases

- 26 (1) The arrangements referred to in paragraph 18(1) are appropriate arrangements –

-
- (a) for the carrying out of investigations into public interest cases arising in connection with the performance of local audit functions by members of the body,
 - (b) where it appears to be desirable following the conclusion of such investigations –
 - (i) for the holding, subject to sub-paragraph (2), of disciplinary hearings relating to members of the body,
 - (ii) unless the interests of justice otherwise require, for any such hearings to be held in public, and
 - (iii) for decisions to be made as to whether (and, if so, what) disciplinary action should be taken against the members of the body, and
 - (c) for ensuring that the carrying out of those investigations, the holding of those hearings and the making of those decisions are done independently of the body.
- (2) The arrangements may provide that decisions to take disciplinary action, and decisions as to what that action should be, may be made in respect of a member of the body without the holding of a disciplinary hearing relating to that member where the member agrees in writing that such a hearing need not be held.
- (3) In this paragraph “public interest cases” means matters which raise or appear to raise important issues affecting the public interest.

Supplementary: arrangements to operate independently of body

- 27 (1) This paragraph applies for the purposes of –
- (a) paragraph 23(b),
 - (b) paragraph 24(b),
 - (c) paragraph 25(1)(c), or
 - (d) paragraph 26(1)(c).
- (2) Arrangements are not to be regarded as appropriate for the purpose of ensuring that a thing is done independently of the body unless they are designed to ensure that the body –
- (a) will have no involvement in the appointment or selection of any of the persons who are to be responsible for doing that thing, and
 - (b) will not otherwise be involved in the doing of that thing.
- (3) Sub-paragraph (2) imposes a minimum requirement and does not preclude the possibility that additional criteria may need to be satisfied in order for the arrangements to be regarded as appropriate for the purpose in question.

Supplementary: funding of arrangements

- 28 The body must pay the costs of maintaining arrangements within paragraph 23, 24, 25 or 26 which the arrangements provide are to be paid by it.

Supplementary: scope of arrangement

- 29 Arrangements may qualify as arrangements within any of paragraphs 23, 24, 25 or 26 even though the matters for which they provide are more extensive in any respect than those mentioned in the applicable paragraph.

SCHEDULE 4

Section 43

SUPPLEMENTARY PROVISIONS ABOUT DELEGATION ORDER

Operation of this Schedule

- 1 (1) This Schedule has effect in relation to a body designated by a delegation order under section 43 as follows –
 - (a) paragraphs 2 to 12 have effect in relation to the body where it is established by the order;
 - (b) paragraphs 2 and 6 to 11 have effect in relation to the body where it is an existing body;
 - (c) paragraph 13 has effect in relation to the body where it is an existing body that is an unincorporated association.
- (2) In their operation in accordance with sub-paragraph (1)(b), paragraphs 2 and 6 apply only in relation to –
 - (a) things done by or in relation to the body in or in connection with the exercise of functions transferred to it by the delegation order, and
 - (b) functions of the body which are functions so transferred.
- (3) Any power conferred by this Schedule to make provision by order is a power to make provision by a delegation order.

Status

- 2 The body is not to be regarded as acting on behalf of the Crown and its members, officers and employees are not to be regarded as Crown servants.

Name, members and chairman

- 3 (1) The body is to be known by the name specified in the delegation order.
- (2) The body is to consist of not less than 8 persons appointed by the Secretary of State after such consultation as the Secretary of State thinks appropriate.
- (3) The chairman of the body is to be a person appointed by the Secretary of State from among its members.
- (4) The Secretary of State may make provision by order as to –
 - (a) the terms on which the members of the body are to hold and vacate office;
 - (b) the terms on which a person appointed as chairman is to hold and vacate the office of chairman.

Financial provisions

- 4 (1) The body must pay to its chairman and members the remuneration that is determined by the Secretary of State.
- (2) The body must pay to its chairman and members such allowances in respect of expenses properly incurred by them in the performance of their duties as may be determined by the Secretary of State.
- (3) Sub-paragraph (4) applies if the Secretary of State determines the body should pay, or make provision for the payment of –

- (a) a pension, allowance or gratuity to or in respect of any chairman or member on their retirement or death, or
 - (b) contributions or other payment towards the provision of such a pension, allowance or gratuity.
- (4) The body must make such payments, or such provision for payments, of that kind as the Secretary of State determines.
- (5) Sub-paragraph (6) applies if –
 - (a) a person ceases to be a member of the body otherwise than on the expiry of the person's term of office, and
 - (b) it appears to the Secretary of State that there are special circumstances which make it right for that person to receive compensation.
- (6) The body must make a payment to the person by way of compensation of an amount determined by the Secretary of State.

Proceedings

- 5 (1) The delegation order may contain such provision as the Secretary of State thinks appropriate about the proceedings of the body.
- (2) The delegation order may, in particular –
 - (a) authorise the body to exercise any functions by means of committees consisting wholly or partly of members of the body;
 - (b) provide that the validity of proceedings of the body, or of any such committee, is not affected by any vacancy among the members or any defect in the appointment of any member.

Fees

- 6 (1) The body may retain fees payable to it.
- (2) The fees must be used for –
 - (a) meeting the expenses of the body in exercising its functions, and
 - (b) any purposes incidental to those functions.
- (3) Those expenses include any expenses incurred by the body on the staff, accommodation, services and other facilities that appear to it to be necessary or expedient for the proper performance of its functions.
- (4) In prescribing the amount of fees in the exercise of the functions transferred to it, the body must prescribe the fees it thinks are sufficient to meet those expenses, taking one year with another.
- (5) Any exercise by the body of the power to prescribe fees requires the approval of the Secretary of State.
- (6) The Secretary of State may, after consultation with the body, by order vary or revoke any regulations prescribing fees made by the body.

Legislative functions

- 7 (1) Regulations or an order made by the body in the exercise of the functions transferred to it must be made by instrument in writing, but not by statutory instrument.

- (2) The instrument must specify the provision of this Part of this Act under which it is made.
 - (3) The Secretary of State may by order impose the requirements that the Secretary of State thinks necessary or expedient as to the circumstances and manner in which the body must consult on any regulations or order it proposes to make.
 - (4) Nothing in this Act applies to make regulations or an order made by the body subject to any procedure in Parliament.
- 8
- (1) Immediately after an instrument under paragraph 7 is made it must be printed and made available to the public with or without payment.
 - (2) A person is not to be taken to have contravened any regulation or order if the person shows that at the time of the alleged contravention the instrument containing the regulation or order had not been made available as required by this paragraph.
- 9
- (1) The production of a printed copy of an instrument purporting to be made by the body on which is endorsed a certificate that complies with sub-paragraph (2) is evidence of the facts stated in the certificate.
 - (2) A certificate complies with this sub-paragraph if it is signed by an officer of the body authorised by it for that purpose and states –
 - (a) that the instrument was made by the body,
 - (b) that the copy is a true copy of the instrument, and
 - (c) that on a specified date the instrument was made available to the public as required by paragraph 8.
 - (3) A certificate purporting to be signed as mentioned in sub-paragraph (2) is deemed to have been duly signed unless the contrary is shown.
 - (4) Any person wishing in any legal proceedings to cite an instrument made by the body may require the body to cause a copy of it to be endorsed with a certificate of the kind mentioned in this paragraph.

Report and accounts

- 10
- (1) The body must, at least once in each calendar year for which the delegation order is in force, make a report to the Secretary of State on –
 - (a) the discharge of the functions transferred to it, and
 - (b) the other matters that the Secretary of State requires by order.
 - (2) The delegation order may modify sub-paragraph (1) as it has effect in relation to the calendar year in which the order comes into force or is revoked.
 - (3) The Secretary of State must lay before Parliament copies of each report received under this paragraph.
 - (4) The following provisions of this paragraph apply as follows –
 - (a) sub-paragraphs (5) and (6) apply only where the body is established by the order, and
 - (b) sub-paragraphs (7) and (8) apply only where the body is an existing body.

- (5) The Secretary of State may, with the consent of the Treasury, give directions to the body with respect to its accounts and the audit of its accounts.
- (6) A person may only be appointed as auditor of the body if the person is eligible for appointment as a local auditor.
- (7) Unless the body is a company to which section 394 of the Companies Act 2006 (duty to prepare individual company accounts) applies, the Secretary of State may, with the consent of the Treasury, give directions to the body with respect to its accounts and the audit of its accounts.
- (8) Whether or not the body is a company to which section 394 of the Companies Act 2006 applies, the Secretary of State may direct that any provisions of that Act specified in the directions are to apply to the body, with or without any modifications so specified.

Other supplementary provisions

- 11 (1) The transfer of a function to a body designated by a delegation order does not affect anything previously done in the exercise of the function transferred.
- (2) The resumption of a function transferred to a body designated by a delegation order does not affect anything previously done in exercise of the function resumed.
- (3) The Secretary of State may by order make the transitional or other supplementary provision that the Secretary of State thinks necessary or expedient in relation to the transfer or resumption of a function.
- (4) The provision that may be made in connection with the transfer of a function includes, in particular, provision –
 - (a) for modifying or excluding any provision of this Part of this Act in its application to the function transferred;
 - (b) for applying to the body designated by the delegation order, in connection with the function transferred, any provision applying to the Secretary of State which is contained in or made under any other enactment;
 - (c) for the transfer of any property, rights or liabilities from the Secretary of State to that body;
 - (d) for the carrying on and completion by that body of anything in the process of being done by the Secretary of State when the order takes effect;
 - (e) for the substitution of that body for the Secretary of State in any instrument, contract or legal proceedings.
- (5) The provision that may be made in connection with the resumption of a function includes, in particular, provision –
 - (a) for the transfer of any property, rights or liabilities from that body to the Secretary of State;
 - (b) for the carrying on and completion by the Secretary of State of anything in the process of being done by that body when the order takes effect;
 - (c) for the substitution of the Secretary of State for that body in any instrument, contract or legal proceedings.

- 12 Where a delegation order is revoked, the Secretary of State may by order make provision –
- (a) for the payment of compensation to persons ceasing to be employed by the body established by the delegation order;
 - (b) as to the winding up and dissolution of the body.
- 13 (1) This paragraph applies where the body is an unincorporated association.
- (2) Any relevant proceedings may be brought by or against the body in the name of any body corporate whose constitution provides for the establishment of the body.
- (3) In sub-paragraph (2) “relevant proceedings” means proceedings brought in or in connection with the exercise of any transferred function.
- (4) In relation to proceedings brought as mentioned in sub-paragraph (2), any reference in paragraph 11(4)(e) or (5)(c) to the body replacing or being replaced by the Secretary of State in any legal proceedings is to be read with the appropriate modifications.

SCHEDULE 5

Section 92

AMENDMENTS CONSEQUENTIAL ON TRANSFER OF ROLE OF INSPECTOR

- 1 The Local Government Act 1999 is amended as follows.
- 2 In section 11(7) (powers and duties: definition of “inspector”), for paragraphs (a) and (b) substitute “an inspector or assistant inspector appointed under section 10(1) or (2).”
- 3 For section 12 substitute –
- “12 Fees**
- An authority inspected under section 10 must pay the reasonable fees of the inspector for carrying out the inspection.”
- 4 Omit section 12A (fees for inspections by Auditor General for Wales).
- 5 (1) Section 13 (reports) is amended as follows.
- (2) In subsection (1) –
- (a) for “the Audit Commission” substitute “an inspector”, and
 - (b) for “it” substitute “the inspector”.
- (3) In subsection (2)(a) for “Commission” substitute “inspector”.
- (4) In subsection (3) –
- (a) for “Commission” substitute “inspector”, and
 - (b) in paragraph (a) after “to the authority concerned” insert “and to the Secretary of State”.
- (5) After subsection (3) insert –
- “(3A) The Secretary of State may publish a report and any information in respect of a report.”

- (6) In subsection (4) –
 - (a) for “Commission” substitute “inspector”, and
 - (b) omit paragraph (b) and the word “and” preceding it.
- (7) Omit subsection (4A).
- 6 Omit section 13A (reports of inspections by Auditor General for Wales).
- 7 In section 15 (Secretary of State’s powers) –
 - (a) omit subsection (10), and
 - (b) in subsections (11) and (12) omit “or (10)”.
- 8 Omit section 25(2)(a) and (aa) (coordination of inspections: Audit Commission and Auditor General for Wales).
- 9 Omit section 26(3) and (3A) (consultation with Audit Commission and Auditor General for Wales before issuing guidance).
- 10 In section 33 (grants to Audit Commission and Auditor General for Wales) –
 - (a) omit subsection (2) and (3)(a), and
 - (b) in subsection (3)(b) omit “under this Act or”.

6. EXPLANATORY NOTES

The following pages contain the Explanatory Notes for the draft Local Audit Bill.

LOCAL AUDIT BILL

EXPLANATORY NOTES

INTRODUCTION

1. These Explanatory Notes relate to the Local Audit Bill as published in draft for pre-legislative scrutiny in Autumn 2012. They have been prepared by the Department for Communities and Local Government in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the draft Bill and have not been endorsed by Parliament.
2. The notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a clause or part of a clause does not seem to require any explanation or comment, none is given.

SUMMARY AND BACKGROUND

Background

3. On 13th August 2010, the Government announced its intention to abolish the Audit Commission, privatise its in-house audit practice and put in place new decentralised arrangements for the audit of local public bodies.
4. The Government's proposals were first set out and consulted on in March 2011. The Government published its response to the consultation in January 2012 and committed to publishing draft legislation for pre-legislative scrutiny.

Summary

5. The effect of the Local Audit Bill would be to close the Audit Commission and to establish new arrangements for the audit of local public bodies in England, whereby local bodies appoint their own auditors.
6. The main provisions are as follows:
 - The repeal of legislation setting up the Audit Commission (the Audit Commission Act 1998) and provision to transfer assets, liabilities and continuing functions to other bodies.
 - A requirement for local public bodies in England to keep accounting records and prepare an annual statement of accounts, which must be audited.
 - A requirement on local public bodies to appoint an external and independent auditor on the advice of an independent auditor panel and to publish information about the appointment within 28 days of appointment.
 - A definition of local public audit that includes a value for money element (replicating the definition set out in existing legislation).

- The creation of a new regulatory framework for local public audit, corresponding to provisions for company audit in Chapter 2, Part 42 of the Companies Act 2006, whereby the Financial Reporting Council and professional accountancy bodies would regulate the provision of local public audit services.
- The transfer of responsibility for setting the high level code of audit practice to the National Audit Office and provisions for how the code should be approved by Parliament.
- The transfer of the Audit Commission's data matching powers for the purposes of preventing and assisting in the detection of fraud to the Secretary of State.
- A power for the Secretary of State to commission an inspection of a Best Value authority, mirroring current powers in existing legislation.
- Powers for the National Audit Office to undertake studies of thematic value for money issues relating to local government, and to access information held by the latter where the National Audit Office needs it to fulfil its responsibilities.

OVERVIEW OF STRUCTURE OF THE BILL

7. The Bill contains eight Parts and five Schedules. The general arrangement of the Bill is as follows:

Part 1	Abolition of Existing Audit Regime
Part 2	Basic Requirements and Concepts
Part 3	Appointment etc of Auditors
Part 4	Eligibility and Regulation of Auditors
Part 5	Conduct of Audit
Part 6	Data Matching
Part 7	Inspections, Studies and Information
Part 8	General

TERRITORIAL EXTENT AND APPLICATION

8. The Bill only applies to England.
9. No powers have been transferred to the National Assembly for Wales or the Welsh Ministers, and the Bill does not affect the functions of any of the devolved administrations.

COMMENTARY

PART 1 - ABOLITION OF EXISTING AUDIT REGIME

Clause 1 Abolition of Audit Regime and Schedule 1: Abolition of Audit Commission: supplementary provision

10. Clause 1 repeals the Audit Commission Act 1998 and abolishes the Audit Commission.
11. Schedule 1 provides for the Secretary of State to make a scheme to transfer the property, rights and liabilities of the Audit Commission to another body or

individual. This includes providing for the Secretary of State to make payments in respect of the Audit Commission Pension Scheme. It also allows for the number of Audit Commission Board members to be reduced to reflect the transitional role of the Commission pending abolition. Upon closure of the Audit Commission, the Secretary of State must prepare a final statement of accounts for the last financial year of the Commission (unless the Audit Commission has already done so) and for any subsequent period up until the abolition of the Commission and send them to the Comptroller and Auditor General to inspect and report on. The Comptroller and Auditor General must then make arrangements to lay the statement of accounts and his or her report before Parliament. The Secretary of State must also prepare a final annual report about the discharge of the Audit Commission's functions since its last annual report, which must also be laid before Parliament.

PART 2 – BASIC REQUIREMENTS AND CONCEPTS

Clause 2: General requirements for accounts

12. Clause 2 sets out the general duties of relevant authorities to keep adequate accounting records and to prepare annual statements of accounts for years ending 31 March. These duties follow the pattern of duties laid on companies and charities by the Companies Act 2006 and the Charities Act 2011. They replace the existing statutory duty on local public bodies to make up their accounts each year to 31 March, a duty which reflects the practice in earlier times of writing the year end accounting statements into the books in which the in year records were kept. The new duties draw a clear distinction between the records maintained during the year and the annual published statements. Subsection (9) flags that clause 82 gives a power to make regulations on accounting records and statements of accounts. The Accounts and Audit (England) Regulations 2011 (SI 2011/817), made under existing audit legislation, fill out the duty to keep adequate accounting records and specify the form of statements of accounts for different categories of audited body. It is expected that similar use would be made of the new power. Subsection (5) retains the power to vary the period of the financial year for relevant authorities, but in future this would be done by regulation rather than as now by direction. This power might be used, for example, if an authority was being wound up at a date other than 31 March. This subsection also allows regulations to exclude or modify the application of the clause to specified relevant authorities. Subsections (7) and (8) ensure that the section only applies to the Common Council of the City of London in its role as a local authority and police authority.

Clause 3: General requirements for audit

13. Clause 3 imposes the general requirement that the accounts of a relevant authority must be audited in accordance with the Act and by an auditor appointed by the authority. Subsection (2) defines "accounts" as including accounting records and statements of accounts. Part 5 of the Bill clarifies that some audit duties, such as the duty to give an opinion, apply only to the statement of accounts. Others, such as the duty relating to compliance with legislation, apply to both statements of accounts and accounting records. Subsection (3) allows regulations to exclude or modify the application of the clause to specified relevant authorities. This power might be used to exclude bodies whose gross income and gross expenditure falls below a certain threshold from the automatic requirement for an external audit. Subsections (4) and (5) clarify application to the Common Council in a similar way to the provisions in clause 2.

Clause 4 and Schedule 2: Relevant authorities

14. Clause 4 defines a “relevant authority” as a body listed in Schedule 2, which in turn, lists all the bodies in England to which the provisions apply. The provisions also apply to port health authorities and internal drainage boards that are partly in England and partly in Wales. The Secretary of State may amend the list of bodies in Schedule 2 and (under clause 100) make consequential amendments to any of the provisions in the Bill, or make different provision for a body added to the Schedule.

Clause 5: Application of Act to smaller authorities

15. Clause 5 gives the Secretary of State the power to disapply or vary any of the provisions in the Bill in relation to smaller authorities (bodies whose gross income and gross expenditure does not exceed £6.5m in a financial year). The regulations may provide for a body specified by the Secretary of State to appoint an auditor on behalf of a smaller authority. The regulations may also make provision about the eligibility of an auditor of a smaller authority and about the nature of the audit itself. Subsection (3) sets out how the definition of a “smaller authority” should be applied to a body. In order to avoid bodies flipping from being a smaller to a larger authority or vice versa on an annual basis, a body is only classified as a larger authority if it has exceeded the £6.5m threshold in the year of audit and in the previous two years. If the body hasn’t existed for those three years then either two years or one year is used as appropriate. Subsection (5) allows estimates to be used when determining whether a body falls above or below the £6.5m threshold, as an authority will not have outturn figures for its gross expenditure and gross income by the 31 December deadline for appointing an auditor. Subsection (6) gives the Secretary of State the power to make regulations to provide for cases where a relevant entity has been treated as a smaller entity for a financial year, but was in fact a larger entity for that year. Subsection (7) gives the Secretary of State the power to amend the definition and its application for the purposes of defining a smaller authority.

PART 3 – APPOINTMENT ETC OF AUDITORS

Duty to appoint auditor

Clause 6: Appointment of auditors: general

16. Clause 6 fixes the deadline of December 31, each year, by which an auditor must be appointed. The appointment may last for more than one year but new appointments must be made at least once every five years. The Secretary of State is empowered to alter this period of time by regulations. The auditor must be eligible to audit the relevant authority’s accounts, (as set out in Part 4 of the Bill) and independent from the body he or she is auditing (see clause 20).

Clause 7: Appointment of auditors: procedure

17. Clause 7 requires that a relevant authority must consult its auditor panel and take its views into account when selecting and appointing an auditor. The relevant authority must also publish on its website, if it has one, within 28 days of making the appointment to inform people living in the area that: it has made the appointment; who the appointed auditor is; the auditor panel’s advice about the appointment; and if that advice has not been followed, the relevant authority’s reasons for not following it. The relevant authority may omit information that would prejudice commercial confidentiality. These provisions are subject to modification by regulations.

Clause 8: Appointment of auditors: certain local authorities

18. Clause 8 sets out arrangements for the appointment of auditors by certain types of local authorities. Subsection (1) stipulates that in local authorities operating executive arrangements (i.e. Leader and Cabinet or Mayor and Cabinet) the full council, not the executive, must appoint the auditor. Subsection (2) states that local authorities, as defined by section 101 of the Local Government Act 1972 must not delegate the function of appointing an auditor to a committee or subcommittee. Subsection (3) states that the Mayor of London and London Assembly must jointly appoint the auditor for the Greater London Authority.

Clause 9: Appointment of auditors: chief officers of police

19. Clause 9 sets out the arrangements for the appointment of auditors by chief officers of police. Subsections (2) to (4) require that the police and crime commissioner, and not the chief constable, will appoint a single auditor to audit the accounts of both the police and crime commissioner and chief constable for an area. When selecting and appointing the auditor the police and crime commissioner must consult and take into account the views of the commissioner's auditor panel. Subsections (6) to (8) set out the arrangements for appointing an auditor to audit the accounts of the Commissioner of Police of the Metropolis. The Mayor's Office for Policing and Crime, and not the Commissioner of Police of the Metropolis, will appoint a single auditor to audit the accounts of both the Office and Commissioner of Police of the Metropolis. In selection and appointment of that auditor the Office must consult and take account of the views of the Office's auditor panel.

Clause 10: Appointment of auditors: other authorities

20. This clause enables regulations to be made that provide for the appointment of an auditor to audit accounts of a body, to be specified in those regulations, that is not an authority already covered by clause 8 or 9.

Auditor panels

Clause 11: Requirement to have auditor panel

21. Clause 11 requires each relevant authority to have an auditor panel to exercise the functions of an auditor panel under the Bill. Subsections (2) to (5) set out that a relevant authority's auditor panel must either be appointed by the relevant authority for the purpose of being an auditor panel; or appointed jointly by more than one relevant authority; or may be an existing committee (or sub-committee) of a relevant authority that meets the requirements in clause 12; or may be an auditor panel for more than one relevant authority. The Mayor of London and London Assembly must appoint or determine the auditor panel for the Greater London Authority. Subsection (7) excludes Chief Constables and the Commissioner of Police of the Metropolis from the requirement to have an auditor panel. This is because they will be audited by the auditor appointed to audit the relevant Police and Crime Commissioner's accounts (or the Mayor's Office for Policing and Crime's accounts in the case of London).

Clause 12: Constitution of auditor panel

22. The auditor panel must consist of at least a majority of independent members, and must be chaired by an independent member. Subsection (2) provides a definition of independence for these purposes. A panel member must not have been a member or officer of the relevant authority in question within the last five years, nor be a

relative or close friend of a member or officer of the relevant authority. If the relevant authority is an individual (i.e. a corporation sole, such as a police and crime commissioner), that individual is not considered independent. Subsection (4) defines what is meant by “a relative” in subsection (2) – it also includes spouses, civil partners and cohabitants. Subsection (5) gives the Secretary of State power to amend the provisions in subsections (2) to (4). Subsection (6) gives a regulation-making power to make further provision about the constitution of an auditor panel, including the number of members on a panel, how members may be appointed and removed, the terms of reference of the panel and remuneration of panel members. Subsection (9) provides that reasonable expenses incurred by the auditor panel must be met by the relevant authority.

Clause 13: Functions of auditor panel

23. Clause 13 sets out the main functions of an auditor panel and gives a power to the Secretary of State in subsection (6) to make regulations that may set out further details about these functions, give additional functions to an auditor panel or allow a relevant authority to give additional functions to an auditor panel. The auditor panel must advise the relevant authority on maintaining an independent relationship with its auditor and on selection and appointment of its auditor, either when asked by the relevant authority or if the panel thinks it is appropriate to do so. Subsections (4) and (5) set out that an auditor panel must, if asked, also advise the relevant authority’s auditor on any proposal to make a public interest report (clause 63), or enter into a liability limitation agreement (clause 16) relating to the relevant authority. Subsection (7) states that the relevant authority must publish advice from the auditor panel, to bring it to the attention of local people. Subsections (8) and (9) provide that the auditor panel must take account of any guidance the Secretary of State issues in relation to the exercise of its functions, as must the relevant authority in exercising its functions in relation to its auditor panel.

Clause 14: Relationship with relevant authority

24. The auditor panel is entitled, on its request, to any information held by a relevant authority that is of relevance to its work. The auditor panel may require a member or officer of a relevant authority to attend a meeting of the panel to answer questions; they must attend if asked. However members and officers have the same entitlement to refuse to answer questions as exists for the purposes of court proceedings in England and Wales.

Failure to appoint auditor

Clause 15: Failure to appoint auditor

25. Clause 15 makes provision for cases where a relevant authority fails to appoint an auditor. Subsection (1) provides that the Secretary of State may either direct the relevant authority to appoint a named auditor, or appoint an auditor on their behalf. Such an appointment would be essentially the same as one made by the relevant authority, on the terms specified by the Secretary of State. To exercise these powers the Secretary of State must inform the relevant authority of his or her intent to do so not less than 28 days beforehand, and must also consider any representations made by the relevant authority. However there is provision for the Secretary of State to move more quickly, and without considering representations, if a function would need to be exercised by an auditor within 60 days of appointment made or direction to appoint given.

Limitation of auditor's liability

Clause 16: Limitation of auditor's liability

26. This clause makes it possible for auditors to limit their liability by agreement with a relevant authority. The clause defines a “liability limitation agreement” as an agreement that seeks to limit the liability of an auditor to a relevant authority he or she audits. The agreement can cover liability for negligence, default, breach of duty or breach of trust by the auditor. Further provisions on the scope and nature of such agreements may be set out by the Secretary of State in regulations. These provisions may include the duration of the agreement and the amount to which the auditor's liability may be limited, and requirements for the agreement to contain certain provisions specified in regulations. The power to make such regulations may be exercised with a view to preventing adverse effects on competition. The relevant authority must seek and consider its auditor panel's views on the agreement before entering into a liability limitation agreement. This clause also provides that a liability limitation agreement that complies with relevant regulations is not subject to section 2(2) or 3(2)(a) of the Unfair Contract Terms Act 1977.

Resignation and removal of auditor

Clause 17: Resignation and removal of auditor

27. Clause 17 provides the Secretary of State with the power to make regulations about resignation or removal of a local auditor from office. These regulations may specify what is required from an auditor, and in turn from the relevant authority, in the process of the auditor's resignation, and when that resignation can take effect. They may also specify what actions are required, and by whom (such as the local auditor, relevant authority, and auditor panel) to remove a local auditor from office, and following that removal from office.

PART 4 – ELIGIBILITY AND REGULATION OF AUDITORS

Eligibility for appointment as local auditor

Clause 18: Eligibility for appointment as local auditor

28. This clause provides that for a person (or firm as defined in clause 52) to be eligible for appointment as a local auditor, the person must be a member of a recognised supervisory body and be eligible for appointment under the rules of that body. Clause 23(2) clarifies that references to such members include references to persons who are not members but who are subject to the body's rules. Clause 23 and Schedule 3 address the recognition of supervisory bodies, and lay down the requirements they must meet to be recognised.

Clause 19: Effect of ineligibility

29. This clause provides that no person may act as a local auditor if he or she is ineligible. It specifies that, on becoming ineligible, the auditor must resign his or her office and give notice in writing to the relevant authority. Failure to comply with this requirement is an offence, conviction of which can result in a fine (subsections (3) and (4)). If the auditor continues to act as a local auditor after conviction (subsection (5)(b)), or continues to fail to give notice that he or she is ineligible for appointment as a statutory auditor (subsection (6)(b)), he or she commits a further offence for which a daily fine may be imposed after conviction (subsection (7)). Subsection (8) provides a defence if the person did not know nor had any reason to believe that he or she was, or had become, ineligible.

Independence requirement

Clause 20: Independence requirement

30. This clause sets out the circumstances where a person may not act as a local auditor on grounds of lack of independence. Under subsection (2) this includes persons who are officers or elected members of the relevant authority, individuals exercising executive authority as corporations sole (for example, Police and Crime Commissioners), or the partner or employee of such persons. Under subsection (3), this includes where the person is an officer or employee of an entity connected to the relevant authority. Subsection (7) defines a connected entity as one whose financial transactions, under proper accounting practices, consolidate into the group accounts of the relevant authority. The Secretary of State may amend the definitions in subsection (7) by regulations (subsection (9)). Subsection (4) allows the Secretary of State to make regulations regarding other connections between the relevant authority and the local auditor by virtue of which a person will be regarded as lacking independence.

Clause 21: Effect of lack of independence

31. This clause requires a local auditor to resign that office and give notice in writing to the relevant authority of the resignation and reasons for it if, at any time, he or she becomes prohibited from acting as a local auditor as he or she falls within one of the descriptions set out in clause 20(2) to (4).

Effect of appointment of partnership

Clause 22: Effect of appointment of a partnership

32. The effect of this clause is to ensure that when a partnership constituted in England and Wales, Northern Ireland, or any other country or territory in which a partnership is not a legal person, is appointed as a local auditor, the appointment may continue even if a partner leaves the partnership. For a partnership or other person to be considered as appropriate for the appointment to continue, they must be eligible for appointment as a local auditor and not be prohibited (as indicated in clause 19(1)). Without this provision, the auditor appointment would cease every time the membership of the partnership changed.

Supervisory bodies

Clause 23: Supervisory bodies

33. This clause defines a supervisory body as a body established in the UK which maintains and enforces rules regarding the eligibility of persons appointed as local auditors and the conduct of local audit work. Subsection (5) introduces Schedule 3, which specifies the requirements supervisory bodies must meet in order to be recognised, and the process for doing so.

Schedule 3: Recognised supervisory bodies

Part 1: Grant and revocation of recognition

34. Paragraph 1 of Schedule 3 identifies the steps a body is required to take to become recognised by the Secretary of State. Paragraph 2 provides that the Secretary of State must make or refuse to make a recognition order and provides that the Secretary of State may refuse to make a recognition order on the grounds that there are one or more other bodies which have already been recognised. Paragraph 4 specifies the steps that the Secretary of State is required to take if the recognition of the body is revoked. Paragraph 5 provides that recognition (and revocation) orders are not statutory instruments.

Part 2: Requirements for recognition

35. Paragraphs 6 and 7 require a recognised supervisory body to ensure that persons eligible for appointment as a local auditor hold appropriate qualifications (as defined in clause 25). They require a firm that is a statutory auditor to be controlled by qualified persons. Paragraphs 8 to 13 require a recognised supervisory body to have rules and practices to ensure that those primarily responsible for a local audit have sufficient skill and competence to carry out local audits; that they are fit and proper persons; that professional integrity and independence is maintained; that technical standards for audits are assured; and that there are procedures for maintaining appropriate levels of competence. Paragraphs 14 to 22 specify the requirements for monitoring, enforcement, discipline, investigation of complaints, the cost of compliance, and promotion and maintenance of standards. In particular paragraph 15(1)(b) provides that a recognised supervisory body must have adequate arrangements for ensuring that members of the body who undertake major audits (see paragraph 15(10)) participate in independent monitoring of those audits.

Part 3: Arrangements in which recognised supervisory bodies are required to participate

36. Paragraphs 23 to 29 specify the arrangements with independent bodies that recognised supervisory bodies must enter into in order to meet the requirements of this Schedule described above.

Clause 24: Exemption from liability for damages

37. This clause sets out those bodies and individuals that are exempt from liability for damages arising from the discharge or claimed discharge of supervisory functions as specified in this Part of the Bill (these include the effects of rules, practices, powers and arrangements of the body). It applies to recognised supervisory bodies (see clause 23 and Schedule 3) and their officers, employees and members of their governing bodies. The exemption does not apply if they have acted in bad faith, or if it would prevent an award of damages because the act was unlawful under the Human Rights Act 1998.

Appropriate qualifications

Clause 25: Appropriate qualifications

38. This clause provides that a person holds an appropriate qualification for the purposes of local audit if he or she holds either a qualification recognised in accordance with regulations made by the Secretary of State, or a professional qualification obtained in the UK which is recognised in accordance with Chapter 2 of Part 42 of the Companies Act 2006. Subsections (2) to (6) set out the matters about which the Secretary of State may make regulations to provide for a qualification to be recognised as an appropriate qualification, including how such a qualification is to be recognised, and the requirements such a qualification would need to meet. Subsection (10) provides that a qualifying body which offers a qualification that has been recognised in accordance with regulations made by the Secretary of State is to be known as a “recognised qualifying body”.

Information

Clause 26: Matters to be notified to the Secretary of State

39. This clause corresponds with section 1223 of the Companies Act 2006 and allows the Secretary of State to identify events that must be notified to him or her if they occur. It requires that recognised supervisory and qualifying bodies must provide

information, either in writing or some other specified manner that is reasonably required for the Secretary of State to carry out his or her functions.

Clause 27: Secretary of State's power to call for information

40. This clause corresponds with section 1224 of the Companies Act 2006. It provides the Secretary of State with the power to require information from a recognised supervisory body, a recognised qualifying body or an individual local auditor. For example, as a result of a report provided under clause 26, the Secretary of State may request further information on a specific point to clarify if a recognised supervisory body is complying with the requirements in Schedule 3.

Clause 28: Provision of documents to the Secretary of State

41. This clause provides the Secretary of State, a body to whom the Secretary delegates his or her functions (by order under clause 43), or a recognised supervisory body, with the power to require a relevant authority to make available to them their accounts or other such documents that might reasonably be required.

Enforcement

Clause 29: Enforcement: general

42. This clause corresponds with section 1225 of the Companies Act 2006. If a recognised supervisory or qualifying body fails to meet the requirements in Schedule 3, or it fails to comply with another requirement contained in this Part of the Act, then the Secretary of State may apply to the court for an order to make the body comply. The ultimate sanction for non-compliance by a body would be revocation of its status as a recognised body under Schedule 3 or regulations under clause 25.

Clause 30: Directions: general

43. This clause provides the Secretary of State with a power to issue a direction to a body that he or she considers is not fulfilling the requirements made of it in this Part. Subsection (1) provides that a direction can direct the body concerned to either satisfy the requirement that should have been complied with, or mitigate the effect (or prevent non-recurrence) of non-compliance. Subsection (2) provides that a direction can only require a body to take steps which it has the power to take and may require that the body refrain from a particular course of action. Subsection (4) enables the Secretary of State to take what steps he or she considers to be appropriate to monitor the extent to which any direction has been complied with.

Clause 31: Directions: supplementary

44. This clause makes supplementary provision about directions made under clause 30. Before issuing a direction the Secretary of State is required to give the body notice of the proposed direction. Subsection (2) sets out what such notice must comprise; subsection (3) provides that the period during which the body concerned can make written representations in respect of the proposed direction should be no less than 14 days. Subsection (5) requires the Secretary of State to consider such representations before deciding whether or not to give the body the proposed direction. The Secretary of State is required to publish the direction in such a manner as he or she considers appropriate to bring it to the attention of those likely to be affected (subsection (8)), and has power to revoke any direction he or she has made (subsection (9)).

Clause 32: Compliance orders

45. This clause allows the High Court, in response to an application, to order a body to take such steps as it considers appropriate to satisfy the requirement that should have been complied with under this Part. Where such an application is made in relation to a direction made under clause 30, the court may not make an order unless it first decides that the requirement or obligation in the direction is not satisfied (subsection (2)).

Clause 33: Financial penalties: general

46. This clause replicates similar provisions in the Companies Act 2006 and provides the Secretary of State with a power to impose a financial penalty on a body that he considers is not fulfilling the requirements made of it in this Part. The Secretary of State may decide what amount of financial penalty is appropriate to impose but in doing so must have regard to the nature of the requirement which has not been satisfied and must not take into account the Secretary of State's own costs in discharging functions under this Part (subsection (2)).

Clause 34: Financial penalties: supplementary

47. This clause makes supplementary provision about financial penalties imposed under clause 33. Before imposing a penalty the Secretary of State is required to give the body concerned notice of the proposed penalty. Subsection (1) sets out what such notice must comprise; subsection (2) provides that the period during which the body can make written representations in respect of the proposed penalty should be no less than 21 days. Subsection (4) requires the Secretary of State to consider such representations before deciding whether or not to impose the proposed penalty. Where he or she decides to impose a penalty the Secretary of State must set out (in the notice imposing the penalty) why he or she considers the requirement has not been complied with or, if the requirement has now been satisfied, why he considered it had not been complied with at the time of issuing the notice of the proposed penalty (subsection (6)). The Secretary of State is required to publish the penalty notice in such a manner as he or she considers appropriate to bring it to the attention of those likely to be affected (subsection (8)), and has power to rescind a penalty notice he or she has made (subsection (9)).

Clause 35: Appeals against financial penalties

48. This clause sets out the process by which a body can appeal against a financial penalty that has been imposed by the Secretary of State under clause 33. Subsection (2) sets out the grounds on which an appeal can be made. The appeal is by way of application to the High Court and must be made within three months of notification of the decision to impose a financial penalty (subsection (3)). The High Court can quash the penalty, substitute a different amount, vary the time by which the penalty must be paid (subsection (4)), and require the payment of interest (subsections (5) to (8)).

Clause 36: Recovery of financial penalties

49. This clause provides that if all or part of a financial penalty imposed by the Secretary of State under clause 33 is not paid by the time specified, the unpaid balance carries interest (subsection (1)). Where an appeal is made by a body against a financial penalty, the penalty does not have to be paid until the appeal has been determined or withdrawn (subsection (2)). The Secretary of State may recover any of the penalty and any of the interest which has not been paid.

Registration of auditors etc

Clause 37: The register of auditors

50. This clause requires the Secretary of State to make regulations that require the keeping of a register of those persons eligible to be a local auditor. Subsection (2) sets out the information that must be included on the register and includes the person's name and address and the name of the relevant supervisory body for the person. Information relating to both individuals and firms eligible to be local auditors must be entered separately on the register and cross-referenced. In subsection (3) additional information, namely the name and address of directors, members or partners, is required from bodies corporate (including limited liability partnerships), corporations sole and partnerships. The clause allows for certain parts of the register to be kept by different persons. Subsection (6) provides that the register may be kept with the register required under section 1239(1)(a) of the Companies Act 2006 i.e. the register of statutory auditors. Subsection (8) confers a power to provide that information in the register, or a certified copy of it, is made available to the public upon request.

Clause 38: Information to be made available to public

51. This clause gives the Secretary of State the power to make regulations placing an obligation on local auditors to make information regarding their ownership, governance, internal controls with respect to quality and independence of audit work, turnover and names of persons for whom the person has acted as local auditor, available to the public. Any such obligations are additional to those referred to in clause 37.

Power to require second audit

Clause 39: Secretary of State's power to require second audit

52. This clause provides for the Secretary of State to require a second audit of a relevant authority in circumstances where the person appointed as local auditor was not an appropriate person i.e. not eligible for appointment or was not independent of the entity audited. Subsection (2) permits the Secretary of State to direct either that a second audit is performed or that a review of the first audit is carried out (which will inform whether a second audit is required). Subsection (7) allows the audited entity to recover the costs of the second audit from the first auditor, if the first auditor knew when he or she acted that he or she was not eligible or not independent.

Misleading, false and deceptive statements

Clause 40: Misleading, false and deceptive statements

53. This clause replicates similar provisions in the Companies Act 2006 and sets out offences in respect of persons who provide information that they know to be misleading, false or deceptive. Subsection (3) makes it an offence for a person to hold himself or herself out as a registered local auditor where he or she is not registered as such in accordance with clause 36. Subsection (4) makes it an offence for either a supervisory or qualifying body to hold itself out as recognised when it is not so recognised. Subsection (10) provides a defence if the person took all reasonable precautions and exercised all due diligence to avoid committing the offence.

Fees

Clause 41: Fees

54. This clause empowers the Secretary of State to make regulations to prescribe periodical fees which must be paid by recognised supervisory bodies and recognised qualifying bodies. It also provides that an applicant for a recognition order which can be granted by the Secretary of State in accordance with Schedule 3 must pay the fee prescribed by the Secretary of State in regulations.

Duty of Secretary of State to report on inspections

Clause 42: Duty of Secretary of State to report on inspections

55. This clause requires the Secretary of State (or his or her delegate) to publish, annually, a summary of the inspections that are undertaken by a recognised supervisory body in accordance with paragraph 15(9) of Schedule 3.

Delegation of Secretary of State's functions

Clause 43: Delegation of Secretary of State's functions and Schedule 4: Supplementary provisions about delegation order

56. This clause empowers the Secretary of State to establish a body, or appoint an existing body, to exercise his or her functions under the Part relating to local auditors and the recognition of bodies that supervise auditors. To do so, the Secretary of State must make a delegation order that is in accordance with Schedule 4. However, subsection (5) provides that some delegated functions must remain exercisable concurrently by the Secretary of State: namely the power to call for information (clause 27) and the power to issue directions to comply with international obligations (clause 45). Subsection (6) provides that a delegation order may have the effect of making the body to whom functions are delegated subject to the obligations of the Freedom of Information Act 2000, but only in respect of information held by the body that relates to the exercise of the functions which have been delegated to it (subsection (7)).

Schedule 4: Supplementary provisions about delegation order

57. This Schedule sets out further supplementary provisions about a delegation order that could be made in accordance with clause 43. This includes provision about the status of a body to whom functions are delegated under clause 43 and provides that such a body is not be regarded as a crown body (paragraph 2). It also makes provision about the funding of that body, the powers of that body to make regulations by a non-statutory instrument, and a requirement for such a body to produce an annual report (which must be presented to Parliament by the Secretary of State) about how it has discharged the functions delegated to it.

Clause 44: Delegation of functions to an existing body

58. This clause specifies the conditions for delegating functions to an existing body. It ensures that an existing body is not precluded from exercising any delegated function on the basis of its involvement with the monitoring, investigation or disciplinary arrangements that are set out in Schedule 3.

International obligations

Clause 45: Directions to comply with international arrangements

59. This clause empowers the Secretary of State to direct recognised supervisory or qualifying bodies, or any body delegated under clause 43, to comply with Community or other international obligations. If the body fails to comply with a

direction, the Secretary of State can apply to the court for his direction to be enforced.

Provisions about offences

Clause 46: Offences by bodies corporate, partnerships and unincorporated associations

60. This clause replicates similar provisions in the Companies Act 2006 and deals with offences committed by bodies corporate, partnerships and other unincorporated associations. Where an offence committed by such a body is committed with the consent or connivance of, or is attributable to the neglect of, an officer (in the case of a body corporate), a partner (in the case of a partnership) or an officer or member (in the case of an unincorporated association), that officer, partner or member is also guilty of the offence.

Clause 47: Time limits for prosecution of offence

61. This clause sets a twelve-month time limit for the prosecution of offences. Subsections (1) to (4) identify that the date on which knowledge of sufficient evidence of the offence to justify prosecuting becomes known to either the Secretary of State or Director of Public Prosecutions is taken as the date from which the twelve month time limit commences. In any event, the prosecution may not be commenced if three years have passed since the date on which the offence was committed.

Clause 48: Jurisdiction and procedure in respect of offences

62. This clause deals with the jurisdiction and procedure in respect of offences. It specifies that the jurisdiction is that in which a body corporate or unincorporated association has its place of business or, in the case of an individual, where he or she is located. It also provides for an unincorporated association to be treated in the same way as a body corporate.

Notices etc

Clause 49: Service of notices

63. This clause states how notices and other documents may be served under this Part of the Bill on any person other than the Secretary of State.

Clause 50: Documents in electronic form

64. This clause allows delivery of notices, directions or other documents in electronic form. It allows the use of e-communications where existing provisions in this Part impose requirements on the giving or sending of notices, directions or other documents, provided the recipient indicates he or she is prepared to accept this form of delivery.

Interpretation

Clause 51: Meaning of associate

65. This clause defines the meaning of “associate”. This definition is particularly relevant for the independence requirement for statutory auditors set out in clause 20.

Clause 52: Interpretation of Part 4

66. This clause defines words and terms used in the Part.

Powers to amend

Clause 53: Power to make provision in consequence of changes affecting accountancy bodies

67. This clause corresponds with section 1263 of the Companies Act 2006 and empowers the Secretary of State to amend by regulation legislation (including this Act) that refers to accountancy bodies in the event of a name change, merger or transfer of engagements affecting the bodies.

Clause 54: Power to amend Part following changes to companies regime

68. This clause gives the Secretary of State powers to amend this Part by regulations to ensure that the provisions stay broadly in step with those set out in Part 42 of the Companies Act 2006.

PART 5 – CONDUCT OF AUDIT

General provisions about audit

Clause 55: Codes of audit practice

69. This clause requires the Comptroller and Auditor General of the National Audit Office to prepare one or more code of audit practice which sets out how auditors carry out their role under this Bill. The Comptroller and Auditor General may prepare a single code with different provisions for different types of relevant authorities or more than one code. The Comptroller and Auditor General is required to ensure that the code(s) embodies the best professional practice with respect to standards, procedures and techniques to be adopted by the auditors appointed to undertake local public audits. It requires the Comptroller and Auditor General to consult relevant persons before preparing the code(s). The relevant persons are: associations or representatives of local public bodies whose accounts are audited under the code(s), relevant accountancy and auditing bodies, registered auditors, Government departments, bodies that the Government has delegated functions to and any other bodies that he or she considers appropriate.

Clause 56: Procedure for codes of practice

70. This clause sets out how the code(s) of audit practice will be published and approved by Parliament. Following publication by the Comptroller and Auditor General, the code(s) will be laid before both Houses of Parliament by a Government Minister to be approved by negative resolution which means that if either House of Parliament resolves not to approve the code within 40 days of the code being laid before Parliament, then it is not approved. If the code(s) is not approved, the Comptroller and Auditor General may not issue it and must prepare another code of audit practice unless one or more is already in place. If Parliament does approve the code(s), the Comptroller and Auditor must issue it.

Clause 57: Re-publication of codes

71. This clause requires the Comptroller and Auditor General to update the code(s) at least every five years unless it has been replaced subsequently; and requires the same publication and approval procedures to apply (see clause 56). If the code(s) is not approved by Parliament the Comptroller and Auditor General is required to prepare another code of audit practice unless one or more is already in place. In this situation, the previous code(s) will continue to apply until a new one is approved.

Clause 58: Alteration and replacement of codes of audit practice

72. This clause requires the Comptroller and Auditor General to keep under review the code(s) of audit practice and enables him to produce an alteration or replacement to the code. When issuing an altered or replacement code(s), the Comptroller and Auditor General is required to consult the bodies set out in clause 55. The same process applies as set out in clause 56 for publishing and obtaining Parliamentary approval. An altered or replacement code of audit practice formally takes effect when Parliament has approved it.

Clause 59: Supplementary provisions about codes

73. This clause requires the Comptroller and Auditor General to publish each code of audit practice. Where he is altering the code(s), the Comptroller and Auditor General is required to publish the alteration, or the altered code. Subsection (3) provides the Comptroller and Auditor General with a right to access information held by relevant authorities that he reasonably requires for his role in preparation and publication of the code(s) of audit practice.

Clause 60: General duties of local auditors

74. This clause sets out the general duties with which an appointed auditor must comply when auditing the statements of accounts of a relevant authority subject to audit under this Bill. It requires the auditor to be satisfied that the relevant authority's statement of accounts have been prepared in accordance with the relevant legislative requirements; that proper practices have been observed in the compilation of the statement of accounts; and that the relevant authority has made proper arrangements for securing economy, efficiency and effectiveness in the use of its resources. It also requires the auditor to comply with the relevant code(s) of audit practice.

Clauses 61 and 62: Local auditors' right to document and information and offences relating to section 61

75. This clause gives the auditor a right of access at all reasonable times to every document that relates to the relevant authority and any entities connected to the relevant authority which the auditor considers necessary to undertake his or her functions under this Bill. Subsection (2) enables the auditor to inspect, copy or take the document away and subsections (4), (5) and (6) provide that if the document is electronic, the auditor can require that this is produced in a form which is legible and can be taken away; inspect any computer or associated apparatus which the auditor thinks has been used in connection with that document; and require the person responsible for the computer or apparatus to assist with that inspection. Subsections (3), (7) and (8) give the auditor the right to require relevant people to provide further information or explanation or to meet the auditor (the relevant people are the person holding or accountable for the document, a member or officer of the audited body, a member or officer of the entity connected to the relevant authority, and the auditor of the connected entity). Subsection (9) requires the relevant authority or connected entity to provide the auditor with all of the facilities and information that the auditor reasonably requires.
76. Clause 62 makes it an offence for an individual at a relevant authority or at a connected entity, or the auditor of a connected entity to obstruct the auditor's right to access information or to fail to comply with the auditor's requests for

information. The offence is punishable by a fine including daily fines if the offence continues after conviction and may be tried by summary trial only.

Reports and recommendations

Clause 63: Public interest reports

77. This clause requires an auditor of a relevant authority to consider whether he or she should make a report in the public interest on any matter coming to his or her attention in the course of the audit, so that the matter may be considered by the relevant authority or brought to the attention of the public. This duty refers to both the authority being audited and any entities connected to that authority. Subsection (3) requires the auditor to decide whether the public interest report should be published immediately or at the end of the audit. Subsection (4) requires the auditor to consult the authority's auditor panel before he or she makes a public interest report and subsection (5) provides that the auditor can recover the reasonable costs of preparing the public interest report from the relevant authority or entity concerned.

Clause 64: General reports and recommendations

78. This clause sets out the outputs that the auditor is required to produce when he or she has concluded his or her audit of the accounts of a relevant authority. The auditor must include within the statement of accounts (a) a certificate to confirm that the auditor has completed the audit in accordance with the Bill and (b) the auditor's opinion on the statement of accounts. Subsections (3) and (4) enable an auditor of a relevant authority (except charter trustees, port health authorities and internal drainage boards) to also make a written recommendation to the relevant authority for it to consider in the same way that it considers public interest reports – see clauses 67 and 68 (for Greater London Authority bodies). Subsection (5) requires all recommendations to be sent to the Secretary of State. It also requires that if an auditor makes a written recommendation to a connected entity, the recommendation must also be sent to its parent body (the relevant authority that it is connected to). A written recommendation to a functional body of the Greater London Authority or the London Pension Funds Authority must also be sent to the Mayor of London at the same time. A recommendation in relation to the Commissioner of Police of the Metropolis must also be sent to the Greater London Authority at the same time.

Clause 65: Supply of public interest reports

79. This clause specifies to whom an auditor must send a public interest report. Subsections (1) and (3) require the auditor to send reports to the relevant authority and the Secretary of State. Reports relating to a connected entity must be sent both to the connected entity itself and to its parent body. Reports relating to the Commissioner of Police of the Metropolis must be sent to the Greater London Authority. A public interest report for a parish meeting must be sent to the chairman of the parish council (subsection (2)). Subsection (4) requires immediate reports to be sent as soon as reasonably practicable and non-immediate reports to be sent within 15 days of the conclusion of the audit. Subsections (5) to (8) refer to the arrangements that different bodies must follow in considering public interest reports. Subsection (7) means that charter trustees, port health authorities, internal drainage boards and connected entities must consider a public interest report as soon as practicable after receiving it. Arrangements for the Greater London Authority and other bodies are set out in clause 68 and 67 respectively.

Clause 66: Publicity for public interest reports

80. This clause sets out the publicity requirements for a public interest report relating to a relevant authority or an entity connected with that authority. Subsection (2) applies these provisions to the Greater London Authority where a public interest report is made on an entity connected to Transport for London. Subsection (3) applies these provisions to the Mayor's Office for Policing and Crime where a report is made on the Commissioner of Police of the Metropolis. The relevant authority is required to publish the public interest report as soon as practicable. Subsection (5) places a duty on the relevant authority to ensure that the public are able to inspect the report at all reasonable times and copy it without charge. Alternatively they can require the relevant authority to copy it for a reasonable payment. Subsection (4)(b) requires the relevant authority to publish a notice that informs the public of this. This notice should be published on the website if there is one, otherwise in a way that brings the notice to the attention of local residents (subsection (7)). Subsection (5) requires the relevant authority to send a copy of the public interest report to each of its members (if it has members) and members of its auditor panel. Subsection (7) allows the auditor to notify and send copies of the public interest report to any person that the auditor considers fit.

Clause 67: Consideration of report or recommendation at meeting

81. This clause specifies how relevant authorities should consider public interest reports and auditors' written recommendations made under clause 64(3) that relate to the relevant authority or a connected entity. This clause does not apply to the Greater London Authority, charter trustees, port health authorities and internal drainage boards: provision for these bodies is set out in clauses 68 (the Greater London Authority) and 65 (other bodies listed). Subsection (2) applies these provisions to the Mayor's Office for Policing and Crime where a report is made on the Commissioner of Police of the Metropolis. Subsection (4) sets out that a relevant authority must consider any public interest reports and auditors' recommendations at a meeting within one month of the report or recommendation being sent to the body (or for parish councils, the chairman). Subsection (7) enables the auditor to extend this period if he or she considers that it is reasonable to give the relevant authority more time to consider the report or recommendation. Subsection (5) requires the relevant authority to decide whether to take action or accept the auditor's recommendation and what action, if any is required in response. Subsection (9) enables the Secretary of State to amend these provisions through regulations.

Clause 68: Consideration of report or recommendation at meeting: Greater London Authority

82. This clause specifies how the Greater London Authority should consider public interest reports and auditors' written recommendations in relation to the Greater London Authority, any connected entity of the Greater London Authority, and any connected entity of Transport for London. Subsections (2) and (3) set out that the London Assembly must consider any reports and recommendations at a meeting which the Mayor must attend. The Assembly must decide at the meeting what recommendations to make to the Mayor (subsection (4)) and the Mayor must consider the report or auditor's recommendation and the Assembly's recommendation before deciding whether to take action or accept the auditor's recommendation and what action, if any, is required (subsection (5)). These

actions must take place within one month of receiving the report, unless the auditor allows more time.

Clause 69: Bar on delegation of functions relating to meetings

83. This clause prevents relevant authorities from delegating the consideration of public interest reports or auditors' recommendations. Subsection (1) prevents a local authority which operates executive arrangements from delegating the consideration of a public interest report or auditor's recommendation to an executive of that authority. Subsection (2) refers to section 101 of the Local Government Act 1972 which gives wide powers whereby local authorities may arrange for the discharge of functions by a committee, sub-committee or officer, or by another local authority – and excludes the consideration of public interest reports and auditors' recommendations from that provision. Subsections (3) and (4) preclude the Mayor of London and the London Assembly from delegating the consideration of public interest reports and auditors' recommendations.

Clause 70: Publicity for meetings

84. This clause sets out the arrangements that a relevant authority must follow regarding publicity for meetings to consider public interest reports and auditors' recommendations. The relevant authority must publish a notice at least 7 days before the meeting which sets out the time and place of the meeting; that the meeting is to discuss a public interest report or auditor recommendation; and the subject matter of the report or recommendation. If the relevant authority has a website, the notice must be published on the website, otherwise the authority should publish in a manner that the authority considers will be brought to the attention of residents of the area. When the authority's members are sent the agenda for the meeting, this must be accompanied by a copy of the public interest report.

Clause 71: Access to meetings and documents

85. This clause sets out that the public interest report is not considered as excluded or exempt information with regards to provisions made in the Public Bodies (Admission to Meetings) Act 1960 and the Local Government Act 1972. The public interest report is not to be excluded from documents that are open to inspection or information supplied under Local Government Act 1972 Part VA (subsections (5) to (7)). Subsection (1) provides that public interest reports should not be considered as material that should be excluded should it be requested by a newspaper under the Public Bodies (Admission to Meetings) Act 1960.

Clause 72: Publicity for decisions following meetings

86. This clause sets out the requirements that a relevant authority must follow after deciding how to respond to a public interest report or auditor recommendation. Subsection (1) requires the relevant authority to notify the auditor of its decisions and publish a notice summarising the decision. Subsection (2) requires the notice to be published on its website if the authority has one, or if not, in such a way to bring it to the attention of the residents of the area. Subsection (3) allows for the notice to exclude any decisions that were made in the meeting while the public were excluded for protection of public interest (under section 1(2) of the Public Bodies (Admission to Meetings) Act 1960), confidential matters (under section 100A(2) of the Local Government Act 1972 or exempt information (under Section 100A(4) of the Local Government Act 1972). The notice must also specify if there are any documents that are available for inspection.

Public inspection etc and action by the auditor

Clause 73: Inspection of statements of accounts and auditors' reports

87. This clause requires relevant authorities to enable local government electors of the area to inspect and make copies of the statement of accounts prepared by the relevant authority and any report made by the auditor (other than an immediate report). Subsection (1)(c) places a duty on the audited body to provide a copy of the statement of accounts or auditor report to an elector that has requested these, upon payment of a reasonable sum. The documents should also be made available for inspection by a local government elector at all reasonable times without payment.

Clause 74: Inspection of documents

88. This clause provides that any interested person may inspect the accounting records and supporting documents for the audit year and make copies of those documents. The clause also provides for the local elector or his or her representative an opportunity to question the auditor about the accounting records. This precludes the local government elector from inspecting any document containing personal information that could identify a person or to require any personal information to be disclosed in way of response, but information is not to be considered personal information if it relates to the business carried out by an individual as a sole trader.

Clause 75: Right to make objections at audit

89. This clause provides for a local government elector (in the area which the accounts relate) to make an objection to the auditor if they consider that there is a matter in respect of which the auditor could make a public interest report or apply for a declaration of unlawful expenditure. Subsection (2) requires that the objection must be made in writing with a copy sent to the relevant authority. Subsection (3) requires the auditor to decide whether to consider the objection, and if so under what grounds - whether via a public interest report or declaration of unlawful expenditure. The auditor may decide not to consider the objection if he or she considers that it is frivolous, vexatious or repeats a previously considered objection (subsection (4)). Where the auditor decides not to take action regarding the objection he or she may recommend that the relevant authority instead take action itself in way of response.

Clause 76: Declaration that item of account is unlawful

90. This clause provides for the auditor to apply to the courts to declare that an item in the accounts is unlawful. The court will then decide whether to make that declaration and where it does, may order changes to be made to the statement of accounts. If an auditor decides not to investigate an objection made under clause 75 relating to unlawful expenditure, the person raising the objection may require the auditor to provide written reasons for that decision and appeal against the decision to the courts. This must be undertaken within 6 weeks beginning on the date when the person was notified that it was not being investigated. In situations where a local elector appeals to the court, the court has the same powers as it does if the auditor had applied for a declaration. Subsection (5) enables the court to make an order for the relevant authority to make a payment of expenses incurred by the authority or local government elector as a result of this action. The High Court and county courts have jurisdiction for this purpose.

Prevention of unlawful expenditure etc

Clause 77: Advisory notice

91. This clause enables an auditor to issue an advisory notice to a relevant authority if the auditor thinks that the authority or an officer has, or is about to, undertake unlawful action. Subsection (1) sets out that these unlawful actions are: a decision which incurs unlawful expenditure, unlawful action or entering an unlawful item on the statement of accounts. Subsection (2) prescribes that the content of the advisory notice must: be addressed to the relevant authority or officer; specify the decision incurring unlawful expenditure, unlawful course of action or unlawful item of account; and specify the notice period within which the authority or officer must inform the auditor of their intentions. This notice period must not exceed 21 days (subsection (3)). Subsection (5) sets out how the advisory notice should be served. Subsections (6) and (7) require the auditor to serve a statement of the auditor's reasons for issuing the advisory notice within 7 days of issuing the notice. Documents being served on an officer must be addressed to the officer and delivered, sent by post or left at the office where the officer is employed (subsection (8)). Subsections (9) and (10) provide for the withdrawal of an advisory notice.

Clause 78: Effect of an advisory notice

92. This clause sets out the implications of a relevant authority or officer of a relevant authority being served with an advisory notice. Subsection (1) sets out that while the advisory notice has effect it is unlawful for the authority or officer to continue to take or implement the action that the advisory notice refers to (i.e. the decision regarding expenditure, the course of action or the item of account). Subsection (2) sets out that if the authority/officer has considered the auditor's notice and the consequence of taking the action, informed the auditor of their intention to take the action and the notice period has expired, then it is not unlawful for the authority/officer to continue to take that action. Subsection (3) explains that the advisory notice takes effect from the day on which the notice is served and ceases to take effect after seven days if the auditor does not serve a statement of reasons for the advisory notice, when it is withdrawn. Subsection (4) enables the auditor to recover from the relevant authority any expenses reasonably incurred.

Clause 79: Further provisions about advisory notices

93. This clause provides for the situation where a relevant authority has either entered into a contract to dispose of or acquire an interest in land before the advisory notice is served, or before the disposal or acquisition is completed, an advisory notice takes effect which would mean it would be unlawful to complete the disposal/acquisition. The existence of the advisory notice does not affect the damages that could be available and no action lies against the auditor in respect of any loss or damages as a result of an advisory notice issued in good faith.

Clause 80: Power of auditor to apply for judicial review

94. This clause gives the auditor power to apply to the courts for a judicial review if the auditor considers that a decision by a relevant authority or a failure by the relevant authority to act would have an effect on the authority's accounts. Subsection (4) enables the court to order the relevant authority to pay the auditor's legal expenses.

Miscellaneous

Clause 81: Audit of accounts of officers

95. This clause provides that where an officer of a relevant authority receives money or property on behalf of a relevant authority, the local auditor must audit the accounts of that officer. Subsection (2) sets out other sections of the Bill that apply, with modifications, to the audit of these accounts. These are the sections relating to the general duties of the local auditor, public interest reports, and unlawful expenditure.

Clause 82: Accounts and audit regulations

96. Clause 82 provides a power to make regulations on matters connected with the accounts, audit and corporate governance of relevant authorities. It is based on the power in existing legislation to make accounts and audit regulations. The power has been amended to take account of the new statutory distinction between accounting records and statements of accounts (see clause 2). Existing accounts and audit regulations contain important provisions connected with the accounting records that concern financial management and internal control, and the new power includes a specific mention of these areas. A power has been added to make regulations on the preservation of accounting records and statements of accounts. In line with the existing regulation making power the clause specifies persons who must be consulted before regulations are made.

Clause 83: Requirement to observe proper practices

97. Section 21 of the Local Government Act 2003 provides a definition of proper practices in relation to accounts which applies to the use of that term in the 2003 Act and in other legislation, including legislation relating to audit. It also gives a power to define accounting practices by regulation. These powers have been used to give statutory backing to the application of professional accounting codes to principal local authorities and to establish accounting practices that avoid unwarranted increases in council tax (see the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, SI 2003/3146, as amended). Section 22 of the 2003 Act provides a related definition of "revenue account". Both these sections apply only to bodies that are "local authorities" as defined by or under section 23 of the Act plus three types of body (parish councils, community councils and charter trustees) added by sections 21(6) and 22(3). The effect of this clause would be to extend the list of bodies to which sections 21 and 22 apply to include all bodies that are relevant authorities under clause 4. This will ensure that, for all these bodies, there will be a clear definition of proper practices for the purposes of clause 60 and a specific power to make regulations on accounting practices.

PART 6 – DATA MATCHING

Clause 84: Power to conduct data matching exercises

98. This clause provides for the Secretary of State to carry out data matching exercises or to arrange for them to be done on his behalf. Subsection (2) defines what a data matching exercise is. It involves the comparison of sets of data. For example, taking two local authority payroll databases and matching them. Matches should not occur but if they do, fraudulent activity may be highlighted. Subsection (3) defines the purposes for which the data matching powers can be exercised. These purposes are assisting in the prevention and detection of fraud. Subsection (4) provides that data matching may not be used to identify patterns and trends in an

individual's characteristics or behaviour which suggest nothing more than his or her potential to commit fraud in future.

Clause 85: Mandatory provision of data

99. This clause enables the Secretary of State (or another person acting on his or her behalf) to require the provision of data to conduct a data matching exercise. Subsection (2) sets out persons who may be required to provide data under this clause. They are (a) relevant authorities (i.e. those authorities subject to audit), or (b) English best value authorities (not subject to audit, for example a waste disposal authority).

Clause 86: Voluntary provision of data

100. This clause provides that where the Secretary of State thinks it appropriate, he or she may conduct a data matching exercise using data held by or on behalf of persons not required to provide data under clause 85. It also provides that such a person may disclose data to the Secretary of State for those purposes. Subsection (2) provides that nothing relating to voluntary provision of data authorises any disclosure which (a) contravenes the Data Protection Act 1998 or (b) is prohibited by Part 1 of the Regulation of Investigatory Powers Act 2000. Subsection (3) provides that the disclosure of information does not breach (a) any obligation of confidence owed by a person making the disclosure or (b) any other restriction on the disclosure of information however imposed. Subsection (5) provides that data matching exercises may include data provided by a body or person outside England and Wales.

Clause 87: Disclosure of results of data matching etc

101. This clause sets out the circumstances in which information (obtained for a data matching exercise and the result of any such exercise) may be disclosed by or on behalf of the Secretary of State – see subsection (2). These circumstances are different to those under which disclosures can be made in relation to the rest of the Act (see subsection (8) and clause 95). Subsection (6) places restrictions on the further disclosure of information disclosed under subsection (3). Subsection (7) creates an offence of disclosing information (except as authorised by subsections (2) and (6)) and sets out the penalty.

Clause 88: Publication

102. This clause enables the Secretary of State to publish a report on data matching exercises, notwithstanding the limits on disclosure under clause 87. Subsection (2) provides that a report that is published may not include information relating to a particular body or person if (a) the body or person is the subject of any data included in the data matching exercise; and (b) the body or person can be identified from the information; and (c) the information is not otherwise in the public domain. Subsection (3) provides that a report may be published in such a manner as the Secretary of State considers appropriate for bringing it to the attention of those members of the public who may be interested.

Clause 89: Fees for data matching

103. This clause requires the Secretary of State to prescribe a scale (or scales) of fees in respect of the data matching exercises he or she conducts. Subsection (2) provides that a person required to provide data in accordance with clause 85 must pay the Secretary of State according to the fee scales provided for in subsection (1).

Subsection (3) provides for circumstances where the work involved in a data matching exercise is substantially more or less than originally envisaged. The Secretary of State can charge the body a fee which can be larger or smaller than that referred to in subsection (2). Subsection (4) requires the Secretary of State to consult those persons required to provide data in accordance with clause 85 or other persons as he thinks appropriate before he prescribes a scale of fees. Subsections (5) and (6) provide that the Secretary of State may charge a fee to other bodies providing information or receiving results for data matching and the terms under which such a fee is payable.

Clause 90: Code of data matching practice

104. This clause requires the Secretary of State to prepare and keep under review a code of data matching practice. Subsection (2) provides that all those bodies and other persons involved in data matching must have regard to the code of data matching practice. Subsection (3) requires the Secretary of State to consult those persons required to provide data in accordance with clause 85, such representatives of those persons (for example, the Local Government Association with regard to local authorities), the Information Commissioner, and such other bodies as he thinks appropriate before preparing or altering the code of data matching practice. Subsection (4) places a duty on the Secretary of State to: (a) lay the code before Parliament; and (b) publish the code from time to time.

Clause 91: Powers to amend this Part

105. Subsection (1) provides for the Secretary of State to extend by order the purposes of data matching exercises and to modify the application of this Part accordingly. Subsection (3) provides for the Secretary of State to add or remove by order public bodies to those required to provide data in accordance with clause 85 (2)(a) and (b), and to modify the application of this Part to those bodies. Subsections (2) and (4) require the Secretary of State to consult certain persons before making an order under subsections (1) and (3) respectively.

PART 7 – INSPECTIONS, STUDIES AND INFORMATION

Miscellaneous

Clause 92: Inspections: transfer of role of inspector and Schedule 5: Amendments consequential on transfer of role of inspector

106. Clause 92 contains amendments to Section 10 of the Local Government Act 1999. Under that Act, the Secretary of State can require the Audit Commission to carry out an inspection of a specified authority's compliance with its best value duties. This new clause gives the Secretary of State a similar power to appoint an inspector to carry out such an inspection, following the abolition of the Audit Commission. Schedule 5 contains amendments to sections of the Local Government Act 1999, arising as a consequence of the transfer of the role of inspector from the Audit Commission to a person appointed by the Secretary of State on abolition of the Commission.

Clause 93: Transitional provision relating to social security references and reports

107. This clause enables an auditor who has discovered social security issues when undertaking an audit under this Bill to bring these to the attention of the relevant Secretary of State if the issues are relevant to the Secretary of State's functions.

This is intended to be a transitional measure, only having effect until the Welfare Reform Act 2012 repeals section 139D of the Social Security Administration Act 1992, after which the auditor will still be required to send copies of any public interest reports related to social security to the relevant Secretary of State. These provisions are necessary to ensure that powers are provided to auditors to refer any matters coming up through an audit once the Audit Commission is closed, and before Housing Benefit completes the transition to Universal Credit. Equally, amendments to the Social Security Act 1992 ensure that the references to the Audit Commission Act are replaced with the relevant sections in this Bill.

Clause 94: Studies by the Comptroller and Auditor General

108. This clause amends the National Audit Act 1983 by inserting a new section 7ZA to provide a new power to the Comptroller and Auditor General to undertake studies regarding the economy, efficiency and effectiveness with which the English local government sector has used resources in undertaking its functions. The National Audit Act 1983 provides powers to the Comptroller and Auditor General to carry out examinations into the economy, efficiency and effectiveness with which any department it audits has used its resources in discharging its functions; and similar studies relating to bodies that receive more than half their income from public funds and which are appointed (or whose members are required to be appointed), by or on behalf of the Crown. These powers do not extend to local authorities and many other local public bodies. Clause 94 provides for the Comptroller and Auditor General to undertake thematic examinations relating to the local authority sector or across a number of local authorities. It is intended that these studies should have two interlinked purposes, to (a) complement the NAO's role in holding Government to account to Parliament regarding the resources it provided to local government and (b) support the local government sector learn from any thematic or systemic issues identified. These powers do not enable examinations of individual authorities and are not designed to enable assessment of the performance of individual councils or comparative analyses. This clause enables the Comptroller and Auditor General to access information required for these studies. It allows the Comptroller and Auditor General to combine examinations under this new power with examinations undertaken within existing powers (i.e. of government departments and other bodies as set out above). It precludes the Comptroller and Auditor General from questioning the merits of the policy objectives. Finally, in designing the examinations, the Comptroller and Auditor General must take into account other examinations being undertaken. Finally, the clause enables the Comptroller and Auditor General to publish the results of these examinations.

Clause 95: Restriction on disclosure of information

109. This clause imposes an obligation of confidentiality in relation to a local auditor or a body exercising functions under the Act. It provides that no information obtained in the exercise of functions under the Act which relates to a particular body or person can be disclosed except insofar as such a disclosure is made in accordance with the exceptions set out in subsection (4). Subsections (5) and (6) permit a disclosure where this is by a public authority (within the meaning of the Freedom of Information Act 2000), or by a local auditor, unless such a disclosure would prejudice the functions of the authority or auditor. Subsection (7) allows a disclosure by another person with the consent of a local auditor. Subsection (10) provides that a person who discloses information in contravention of this clause is guilty of an offence, conviction of which can result in a fine.

Clause 96: Consent under section 96

110. This clause makes further provision about the process by which a person must obtain the consent of a local auditor before making a disclosure in accordance with clause 95(7). It sets out how a request for consent must be made (subsection (2)), and provides that consent must be given except where doing so would prejudice the effective performance of functions conferred on a local auditor by or under an enactment. A request for consent must be dealt with within 20 working days (subsection (6)).

Clause 97: Provision of information to Auditor General for Wales

111. This clause requires auditors and the organisation to which the National Fraud Initiative is transferred to provide information to the Auditor General for Wales that he reasonably requests in undertaking studies under sections 41 and 42 of the Public Audit Wales Act 2004 (studies relating to the economy, efficiency and effectiveness of local government bodies in Wales).

PART 8 – GENERAL PROVISIONS

Clause 98: Orders and regulations

112. This clause provides how regulations and orders made under the Act are to be made.

Clause 99: Interpretation of Act

113. This clause defines words and terms used in the Act.

Clause 100: Power to make consequential provision

114. This clause enables the Secretary of State to make any consequential amendments by regulations to the Act itself, any other legislation passed before or in the same Session as this Act.

Clause 101: Extent

115. This clause states that the provisions extend to England and Wales but that any amendments to other legislation made by this Act only has the same territorial extent as the relevant piece of legislation being amended.

Clause 102: Commencement

116. This clause states that sections of the Act will come into force on a day specified by the Secretary of State, with the exception of specified provisions.

Clause 103: Short title

117. This clause sets out the short title of the Act.

ANNEX A: CONSULTATION QUESTIONS AND HOW TO RESPOND

A.1. The following table lists the consultation questions posed in this document.

Draft Local Audit Bill:

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

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

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

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

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

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

Q7. Do you have any comments on the proposals set out above (paragraphs 26-34) on removal and resignation?

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

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

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

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

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

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

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

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

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

Impact Assessment:

Q18. Does the impact assessment identify the main drivers on fees? Are there any other drivers on fees?

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

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

Proposals for smaller bodies:

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

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

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

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

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

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

How to respond

A.2. This paper is available on the Department for Communities and Local Government website at www.communities.gov.uk.

A.3. Responses are requested by 31 August 2012. For further details please email fola@communities.gsi.gov.uk. Please ensure that responses are sent in before the closing date. A response form is available from the Department for Communities and Local Government website.

A.4. Responses can be sent by email to: fola@communities.gsi.gov.uk. Alternatively, they can be posted to:

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

A.5. When responding, please state whether you are doing so as an individual or on behalf of an organisation.

Confidentiality

A.6. Information provided in response to this consultation, including personal information, may be published, or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

A.7. If you want any information you provide to be treated as confidential you should be aware that under the Freedom of Information Act, there is a statutory code of practice with which public authorities must comply, and which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential.

A.8. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give any assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

A.9. The department will process your personal data in accordance with the Data Protection Act and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

ANNEX B: GLOSSARY

Accounting and Audit Regulations

These regulations are currently made under the Audit Commission Act 1998, but will in future be made using the powers set out in the draft Local Audit Bill. They set out the requirements on local bodies regarding their methods of financial management and internal control, publication of accounts and audit opinions, the procedure for audit, and any variances for particular authorities. The latest version can be found at: <http://www.legislation.gov.uk/ukxi/2011/817/contents/made>

Best Value Authority

The Local Government Act 1999 sets out a list of best value authorities.
<http://www.legislation.gov.uk/ukpga/1999/27/part/I/crossheading/best-value-authorities>

CIPFA

Chartered Institute of Public Finance and Accountancy is the professional body for people in public finance.
www.cipfa.org.uk

Companies Act 2006

The Companies Act 2006 forms the primary source of UK company law.
<http://www.companieshouse.gov.uk/companiesAct/companiesAct.shtml>

Comptroller and Auditor General

Created by the Exchequer and Audit Departments Act 1866 to authorise funding to Government departments and examine departmental accounts, reporting the results to Parliament.

Ethical Standards

The Financial Reporting Council issues Ethical Standards for auditors containing basic principles and essential procedures together with related guidance in the form of explanatory and other material. These cover the objectivity, integrity and independence requirements for auditors. The recognised supervisory bodies are required to ensure that their members comply with the Ethical Standards in carrying out their work. A copy of the Ethical Standards can be found at:
<http://www.frc.org.uk/apb/publications/ethical.cfm>

Financial Reporting Council

The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. They also oversee the regulatory activities of the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.
<http://frc.org.uk/>

ICAEW

The Institute of Chartered Accountants England and Wales is the professional membership organisation for chartered accountants.
<http://www.icaew.com/en>

Joint Practitioners' Advisory Group

This is an independent group formed to set standards for accountability and governance at small public bodies in local government.

National Audit Act 1983

This established the National Audit Office and the Public Accounts Commission to oversee its work.

<http://www.legislation.gov.uk/ukpga/1983/44>

National Audit Office

The National Audit Office scrutinises public spending on behalf of Parliament.

<http://www.nao.org.uk/default.aspx>

National Fraud Initiative

Since 1996 the Audit Commission has run the National Fraud Initiative (NFI), an exercise that matches electronic data within and between audited bodies to prevent and detect fraud.

www.audit-commission.gov.uk/nfi

Public Audit Forum

The public audit agencies, the National Audit Office, the Northern Ireland Audit Office, the Audit Commission for Local Authorities and the National Health Service in England, the Wales Audit Office and Audit Scotland have established the Public Audit Forum to provide a focus for developmental thinking in relation to public audit.

<http://www.public-audit-forum.gov.uk>

Public interest reports

Under section 8 of the Audit Commission Act 1998, the appointed auditor is required to consider whether to issue a report in the public interest on any significant matter coming to his or her notice in the course of an audit, and to bring it to the attention of the audited body and the public.

Recognised qualifying body

A recognised qualifying body is a professional body that has been granted powers by the government to award appropriate qualifications for carrying out audit work.

A list of recognised qualifying bodies can be found at:

<http://www.frc.org.uk/documents/paganager/pob/List%20of%20RQBs%20and%20RSBs%20100611.pdf>

Recognised supervisory body

A recognised supervisory body is a professional body that has been granted powers by the government to supervise audit work. A list of recognised supervisory bodies can be found at:

<http://www.frc.org.uk/documents/paganager/pob/List%20of%20RQBs%20and%20RSBs%20100611.pdf>

ANNEX C: IMPACT ASSESSMENT

The following pages contain the Government's consultation stage impact assessment for the proposals contained in the draft Bill.

Title: Draft Audit Bill: Draft Impact Assessment IA No: Lead department or agency: Department for Communities and Local Government Other departments or agencies:	Impact Assessment (IA) Date: July 2012 Stage: Consultation Source of intervention: Domestic Type of measure: (Draft) Primary legislation Contact for enquiries: foia@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 One-Out?
£1,151.32m	£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; maintain 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 Audit Commission's inspection and assessment functions will cease, freeing 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

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

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: _____

23/05/12

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Yr 2010/11	PV Base Yr 2010/11	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -	High: -	Best Estimate: 1,151.32

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-	10	-	-
High	-		-	-
Best Estimate	73.93		107.77	970.85

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 £4.43m 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 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 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	-		246.54	2,122.16

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 (£50m pa savings from 2011/12 levels). The Exchequer is already seeing savings of £28m pa from the ending of functions that Government funded directly. 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.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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(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 draft impact assessment is in several main parts:
 - A) Background: What is the Audit Commission?
 - B) The current Audit Commission regime (as in 2009/10 the baseline position)
 - C) The problem under consideration and the rationale for Government intervention
 - D) The new regime: Description of the new framework
 - E) Approach to the analysis, underpinning assumptions and the counterfactual
 - F) The costs and benefits of the reforms (monetised and non-monetised)
 - G) Annex 1: Factors affecting future audit fee levels
 - H) Annex 2: Comparison of local bodies' compliance costs under the current and the new local audit frameworks
 - I) Annex 3: Costs and benefits to businesses

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 the 11,000 local bodies 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 (CAA) 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 874 principal bodies: 353 local authorities; 268 NHS bodies (in addition to Special Health Authorities audited by the National Audit Office, and Foundation Trusts); 38 police authorities¹; and 215 other bodies, including fire and rescue authorities; national park authorities; conservation boards; larger internal drainage boards; joint committees; and probation trusts². 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 Police authorities are to be replaced by directly elected Police and Crime Commissioners and Police Constables, under the Police Reform and Social Responsibility Act 2011

² It is intended that the audit of Probation Trusts will 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 CURRENT AUDIT COMMISSION REGIME (AS IN 2009/10: THE BASELINE POSITION)

4. 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 prevent and detect fraud, including the running of the National Fraud Initiative.
5. The Commission has three main statutory functions in relation to local public audit:
 - a) Acting as the overall regulator, 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;
 - (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 commissioner, 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 provider 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. 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.
6. For the purposes of this draft 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 the Audit Commission and implement a new local audit regime. This is fully explained at paragraph 54.

C) THE PROBLEM UNDER CONSIDERATION AND RATIONALE FOR INTERVENTION

7. There are five key reasons for Government intervening and reforming 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.
8. This draft impact assessment estimates the total financial benefit of the reforms as £1.15bn over ten years. Of this, around £650m will be realised in the next five years.

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

9. 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.
10. 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.
11. In its evidence to the Communities and Local Government Select Committee inquiry 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 arrangements³.
12. 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 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).

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>

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

13. 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.
14. 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. The fact the Commission has a number of functions and also covers its costs through a top slice over which local bodies have no control, combined with the limited transparency, has meant the Commission has less incentive to minimise costs than local bodies would (its own corporate costs, the cost base of its in-house practice, and the costs of its private sector audit suppliers).
15. The new framework will be more transparent: the audit fee that a local body pays will relate only to its audit service and be the result of a transparent procurement process (in accordance with OJEU⁴ 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

16. 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 stakeholders and government. The Government considers that, particularly in these straightened 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.
17. 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 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.

(d) Duplication across regulatory regimes

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

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

19. 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.
20. 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.
21. The House of Lords Economic Affairs Select Committee⁵ 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".
22. 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

23. 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. 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 – remaining 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.
24. 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 its existing powers. As a direct result of this work being done by the private sector, the Commission will be able to reduce costs by £30m per annum⁶. 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

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/ldconaf/119/119.pdf>

⁶ Audit Commission press notice <http://www.audit-commission.gov.uk/pressoffice/pressreleases/Pages/reduce-audit-fees-by-40-percent.aspx>

from Autumn 2012⁷, generating further savings of £19m pa. 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.

25. 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.

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 £9m from 2013/14 (Audit Commission forecasts).

D) THE NEW REGIME: DESCRIPTION OF THE NEW FRAMEWORK

26. 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;
- b) The ceasing of certain functions.

27. 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	<u>To be transferred</u> to Financial Reporting Council, professional accountancy bodies and National Audit Office	Following primary legislation – plan 2015/16
Commissioning local audit	<u>To be transferred</u> to local public bodies	Following the end of the outsourcing contracts (last financial year 2016/17)
Providing local audit	<u>To be transferred</u> to private sector audit firms	Already transferred under outsourcing (from Autumn 2012)
Comprehensive Area Assessment	<u>To cease</u>	June 2010, as assessment was a discretionary power
Routine inspection and annual assessment of local government	<u>To cease</u> (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	<u>To be reformed</u> : 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 2012-13
National Fraud Initiative	<u>To be transferred</u>	Following primary legislation – working assumption 2015/16
Co-ordination of grant certification work	<u>To cease</u> : 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

28. 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.
29. 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 annum⁸) 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.
30. Similarly, as the auditor of some 460⁹ 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.
31. In the Audit Commission framework, all its oversight and overhead costs are covered by the audit fees charged to local government. Where private sector firms are doing the audit work (from autumn 2012 it will be wholly done in the private sector) they agree to surrender a 'top slice' of the audit fees they collect to the Audit Commission. This top slice thereby acts as a 'charge' to firms that they must pay in order to take part in the local audit market. 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.
32. 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. The Government is still exploring with the Financial Reporting Council the fairest and most efficient way of funding these additional responsibilities. The recognised supervisory bodies are funded through levies paid by firms who are registered with them, so any new costs they incur, when they take over from the Audit Commission, will either need to be absorbed by those bodies or be passed on to firms working on local public audits, in the form of specific fees or levies. However, it is difficult to anticipate the changes to fees and levies to any degree, as the regulatory framework will mirror as far as possible that for the private sector audit regime there should be economies of scale.
33. 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

⁸ *Key facts and trends in the accountancy profession*, June 2011, Financial Reporting Council Professional Oversight Board, <http://www.frc.org.uk/images/uploaded/documents/Final%20KFAT%20Report%20June%202011.pdf>

⁹ *National Audit Office Strategy 2012-13 to 2014-15*

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.

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. They will also have the flexibility to jointly procure an auditor with other bodies, which could enable savings to be realised through economies of scale.
35. All principal local public bodies 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;
 - b) advise the local body on the maintenance of an independent relationship with its auditor, to ensure independence is maintained; and
 - c) advise on proposals for a public interest report.
36. 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.
37. 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 contractors¹⁰. The Government considers there should be no barriers in terms of expertise that would prevent local bodies procuring their external auditors, subject to the appropriate safeguards to protect auditor independence.
38. 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, 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 (CIPFA) and National Audit Office relating to the procurement of audit services and the work of auditors. 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.

Re-procuring auditors

39. In the new framework, the audited body will be required to undertake a competitive procurement process 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

¹⁰ 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>

firm may be re-appointed following competition, the existing ethical standards¹¹ will continue to apply, including Ethical Standard 3: long association with audit engagement.

Auditor indemnity

40. 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. In practice, calls on the indemnity are infrequent. The Audit Commission informed the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities¹² that, in the five years to 2010, it had been called upon only once. Over the same five-year period, auditors from the Commission's in-house audit practice have faced litigation three times, in which in all cases the in-house auditor won. The costs of cases against in-house auditors not recovered from the other side are met by the Commission, and are also passed on to audited bodies in audit fees, so in effect the indemnity is extended to the Commission's own auditors.
41. There will be no central body to offer indemnity to the auditor in the new framework. Instead, audit firms will need to have appropriate professional indemnity insurance in place. Since such insurance is already in place for most firms in relation to the work they do in the private sector audit market, and given that auditors have only faced legal action four times out of the approximately 4,370 audits of principal local bodies undertaken in the five years to 2010 (a rate of less than 0.01%), it is expected that the additional costs 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

42. 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.
43. 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.
44. 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 reduced value for money audit, 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.

¹¹ The ethical standards are available on the Financial Reporting Council's website at: <http://www.frc.org.uk/apb/publications/ethical.cfm>

¹² Further supplementary evidence submitted by the Audit Commission to the CLG Select Committee, see <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/763/763we17.htm>

Public interest reporting and unlawful spending

45. 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 on 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

46. 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.

Smaller bodies (limited assurance regime)

47. The 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 is being 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. Following responses to the Future of Local Audit consultation in summer 2011¹³, the Government is considering the details of how smaller bodies should be treated in the new audit framework. Our intention is that the arrangements should remain proportionate, both in terms of the audit requirements and the way in which external auditors are appointed, and will be seeking further views from the sector on how best to achieve this. The draft Bill therefore includes a power for the Secretary of State to vary the arrangements in relation to smaller bodies by means of secondary legislation. A separate impact assessment will be produced to accompany the secondary legislation.

Research and value for money studies

49. 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 enable a greater focus on issues the sectors consider will be able to add greatest value.

National Fraud Initiative

50. The Government is committed to retaining the National Fraud Initiative as part of its commitment to tackling fraud in the public sector. Government is considering where the National Fraud Initiative would be best located in order to align with wider counter-fraud efforts and maximise its impact. The appropriate data matching powers will be transferred, in their entirety, to the Secretary of State, who will in practice delegate them to an existing

¹³ A Summary of Responses and the Government Response were published on 4 January 2012, see <http://www.communities.gov.uk/publications/localgovernment/localauditgovresponse>

public sector body. 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 the same, and so it is treated as cost-neutral for the purposes of this draft impact assessment.

Routine inspection and assessment of local government

51. 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.

E) APPROACH TO THE ANALYSIS, UNDERPINNING ASSUMPTIONS AND THE COUNTERFACTUAL

Overall approach

52. The cost-benefit approach taken in this draft impact assessment is, of necessity, high-level in that it compares the underlying costs associated with the current 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.
53. 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.

Baseline – the counterfactual

54. For the purposes of this draft 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

55. The reforms covered by this draft 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.
56. 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.
57. Following consideration of the draft Local Audit Bill to which this draft impact assessment relates, the Government intends to introduce the necessary primary legislation as soon as Parliamentary time allows. Subject to the timing of a legislative slot and Parliamentary approval, we are working on the basis that elements of the new audit framework will be introduced from 2015/16 (but this could change subject to Parliamentary timing), 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	<ul style="list-style-type: none">• Ending of assessment and inspection, including Comprehensive Area Assessment• Announcement of disbandment of the Audit Commission
2012/13	<ul style="list-style-type: none">• Outsourcing contracts take effect; Audit Commission staff transfer to private sector.
2014/15	<ul style="list-style-type: none">• Final year of Audit Commission framework• Residual Audit Commission closes (before April 2015, subject to the Parliamentary timetable)
2015/16	<ul style="list-style-type: none">• New regulatory regime is introduced• Outsourcing contracts are transferred to another body to run their remaining two years.
2017/18	<ul style="list-style-type: none">• Local bodies appoint their own auditors from the start of the financial year

Key assumptions

58. As far as possible, figures quoted in this draft 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, although data relating to future years is largely derived from Audit Commission forecasts that are not in the public domain. The Audit Commission has reviewed the figures used in this draft impact assessment. Assumptions made by DCLG are clearly explained where relevant.
59. One of the key assumptions underpinning this draft 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, saving the public purse a total of £50m per annum¹⁴ (on 2011/12 fee levels).
60. 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.

¹⁴ The Audit Commission has 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/pressoffice/pressreleases/Pages/reduce-audit-fees-by-40-percent.aspx>

61. Nonetheless, once the market is opened up, analysis¹⁵ 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.
62. 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.
63. 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 Including from independent advice commissioned by DCLG. Include details of FTI report. Published alongside this impact assessment.

F) COSTS AND BENEFITS OF THE REFORMS (MONETISED AND NON-MONETISED)

Costs of current Audit Commission framework

64. Table 3 below summarises the costs which this draft 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	
<i>Underlying costs</i>	<i>Underlying costs</i>	<i>Transitional & other costs</i>
Providing external audit	Providing external audit	Redundancy costs
Regulating local audit including Audit Commission corporate costs	Regulating local audit	Pension liabilities
Non-audit functions	<i>Continuing</i> 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

65. 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 benefit of £1.15bn over the ten-year period, of which around £650m will be realised in the next five years. Once the new framework has been fully implemented there will be an estimated annually reoccurring benefit in the region of **£164 million**, 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.

66. 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 **£140 million**, with that to central government calculated at around **£24 million**.

Table 4 – Summary of costs and benefits over the 10-year period

	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	Across 10-year period		
												Total	Average	NPV total
Annual Costs														
AC framework														
Income														
Audit fees paid by local bodies	175.53	167.00	148.60	116.20	83.50	81.30	0.00	0.00	0.00	0.00	0.00	596.60	59.66	565.21
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	2.36	2.22	2.00	2.00	2.00	2.00	0.00	0.00	0.00	0.00	0.00	10.22	1.02	9.57
Contribution from reserves	7.94	26.06	2.39	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	28.45	2.85	28.37
Sub-total: AC income	221.04	209.52	152.99	118.20	85.50	83.30	0.00	0.00	0.00	0.00	0.00	649.51	64.95	617.39
Expenditure														
Paid to firms for outsourced audit work	40.15	40.68	35.80	51.70	76.30	73.80	0.00	0.00	0.00	0.00	0.00	278.28	27.83	256.66
Paid to researchers, contractors and consultants	14.31	4.46	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	4.46	0.45	4.46
Costs of in-house auditors (minus overhead)	97.27	93.07	72.50	40.30	0.00	0.00	0.00	0.00	0.00	0.00	0.00	205.87	20.59	200.74
Cost of assessment/inspection (minus overhead)	21.31	33.33	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	33.33	3.33	33.33
AC statutory responsibilities, support and overhead costs	48.00	38.00	23.00	12.30	9.00	9.00	0.00	0.00	0.00	0.00	0.00	91.30	9.13	87.66
Transitional liabilities	0.00	0.00	0.00	7.80	5.40	1.20	0.00	0.00	0.00	0.00	0.00	14.40	1.44	13.20
Surplus: contribution to reserves	0.00	-0.01	21.69	6.10	-5.20	-0.70	0.00	0.00	0.00	0.00	0.00	21.88	2.19	21.34
Sub-total: AC expenditure	221.04	209.52	152.99	118.20	85.50	83.30	0.00	0.00	0.00	0.00	0.00	649.51	64.95	617.39
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	246.54	209.52	152.99	118.20	85.50	83.30	0.00	0.00	0.00	0.00	0.00	649.51	64.95	617.39
Transition framework annual costs														
Audit fees	0.00	0.00	0.00	0.00	0.00	0.00	79.80	79.80	51.20	0.00	0.00	210.80	21.08	172.35
Paid to firms for outsourced audit work	0.00	0.00	0.00	0.00	0.00	0.00	72.60	72.50	46.50	0.00	0.00	191.60	19.16	156.65
Contract management	0.00	0.00	0.00	0.00	0.00	0.00	3.00	3.00	2.00	0.00	0.00	8.00	0.80	6.54
FRC and prof bodies regulatory costs	0.00	0.00	0.00	0.00	0.00	0.00	2.00	2.00	0.00	0.00	0.00	4.00	0.40	3.31
Surplus	0.00	0.00	0.00	0.00	0.00	0.00	2.20	2.30	2.70	0.00	0.00	7.20	0.72	5.85
Total transition framework annual costs	0.00	0.00	0.00	0.00	0.00	0.00	79.80	79.80	51.20	0.00	0.00	210.80	21.08	172.35

	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	Across 10-year period	
												Total	Average
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	28.10	74.50	74.50	177.10	17.71
NAO regulatory costs	0.00	0.00	0.00	0.00	0.00	0.00	2.00	2.00	2.00	2.00	2.00	10.00	1.00
NAO VFM studies	0.00	0.00	0.00	0.60	1.20	1.80	1.80	1.80	1.80	1.80	1.80	12.60	1.26
Local bodies compliance costs (ie. procurement and independent panel members)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	4.43	4.43	4.43	4.43	17.72	1.77
Total new framework annual costs	0.00	0.00	0.00	0.60	1.20	1.80	3.80	8.23	36.33	82.73	82.73	217.42	21.74
Total annual costs of the regime	246.54	209.52	152.99	118.80	86.70	85.10	83.60	88.03	87.53	82.73	82.73	1,077.73	107.77
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
NAO transition costs (excl. VFM studies)	0.00	0.00	0.00	1.70	1.60	1.60	0.00	0.00	0.00	0.00	0.00	4.90	0.49
Total additional transition costs	0.00	0.00	11.90	1.70	1.60	1.60	0.00	0.00	0.00	0.00	0.00	16.80	1.68
Transition costs already accounted for in AC budgets above													
Audit Commission transition costs	5.32	25.83	0.00	7.80	5.40	1.20	16.90	0.00	0.00	0.00	0.00	57.13	5.71
Total transitional costs	5.32	25.83	11.90	9.50	7.00	2.80	16.90	0.00	0.00	0.00	0.00	73.93	7.39
Total transition and annual costs	246.54	209.52	164.89	120.50	88.30	86.70	83.60	88.03	87.53	82.73	82.73	1,094.53	109.45
Baseline costs	246.54	246.54	246.54	246.54	246.54	246.54	246.54	246.54	246.54	246.54	246.54	2,465.43	246.54
Avoided costs (net benefit)	0.00	37.02	81.65	126.04	158.24	159.84	162.94	158.51	159.01	163.81	163.81	1,370.90	137.09
Net Present value of avoided costs	0.00	37.02	78.89	117.66	142.73	139.29	137.19	128.95	124.98	124.40	120.19		115.13
													1,151.32

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. The figures for 2011/12 to 2014/15 are Audit Commission estimates (March 2012). The Audit Commission estimate for 2015/16 is £79.8m and so that figure is used from 2015/16 for the remainder of the outsourced contracts to 2016/17. 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 and 2010/11 are taken from the Audit Commission's annual report and accounts 2010/11 p42 and are then assumed to represent a steady state so are carried forward for the remainder of the residual Audit Commission's existence ending 2014/15.
4. Figures for contribution from reserves for 2009/10 and 2010/11 are taken from the annual report and accounts 2010/11 p42 (operating surplus). The figure for 2011/12 is an Audit Commission estimate. Without detailed forecasts, no contribution from reserves for subsequent years is assumed.
5. 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. The figures for 2011/12 to 2014/15 are Audit Commission estimates. Following the outsourcing, all work will be undertaken by private sector suppliers, and therefore all costs are shown as being paid to firms. The Audit Commission estimates have been adjusted to reflect the actual prices bid in the outsourcing process, as announced in their press notice of the outsourcing contracts (<http://www.audit-commission.gov.uk/pressoffice/pressreleases/Pages/reduce-audit-fees-by-40-percent.aspx>) that the prices bid by firms will reduce costs by £30m, resulting in estimated costs of £76.3m per year. 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).
6. Amounts paid to researchers, contractors and consultants for 2009/10 and 2011/12 are taken from the Audit Commission annual report and accounts 2010/11 p60. In the absence of more detailed data, no spend is assumed in subsequent years.
7. The costs of in-house auditors are derived as follows. For 2009/10 and 2011/12, 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 10 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. Therefore, the calculation for 2009/10 is $£103.39m - £40m = £63.39m$. The figures of £72.5m for 2011/12 and £40.3m 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.
8. Figures for the costs of assessment/inspection (which includes Comprehensive Area Assessment) are calculated by taking the estimated overhead allocated to these functions 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 10 below). For 2010/11, the calculation is $£39.34m$ less £6m of the £38m overhead costs. The £39.34m figure is relatively high as it includes redundancy costs of £15.1m incurred as a result of the ending of Comprehensive Area Assessment from summer 2010 at Government's request. There are therefore no costs from 2011/12 onwards.
9. 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. Figures for 2012/13 to 2014/15 are Audit Commission upper-bound estimates.
10. 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.
11. 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.
12. 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.

13. 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.
14. 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 £79.8m, with the costs paid to auditors being £72.6m. 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.
15. The costs of contract management are DCLG estimates calculated as follows: the Audit Commission's upper-bound estimate for its running costs in 2013/14 and 2014/15 is a maximum of £9m. For 2015/16 and 2016/17, therefore, DCLG estimates that the costs of managing the contracts will amount to a maximum of £3m pa, as it is assumed that around a third of the Audit Commission's costs relate to managing the contracts. The costs of managing the contracts in 2017/18 are estimated as £2m as this role will only last for part of the year.
16. It is assumed that, while the outsourced contracts are running, the costs of regulation will continue to be met from within audit fees paid by local bodies, as is the case under the Audit Commission regime. However, as the National Audit Office will receive funding directly for producing the code of audit practice, only those regulatory costs relating to the Financial Reporting Council and the professional bodies will need to be covered by fees (see note 20 below which explains how the £2m is calculated).
17. 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 23).
18. 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 whichever 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 (i.e. not those relating to the National Audit Office's role, which it is envisaged, subject to parliamentary approval, will be funded separately) will be included in the fees. Therefore the sum of £2m has been added on (see note 20). 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.
19. Figures for the National Audit Office's regulatory costs in the new framework are shown from 2015/16 as this is the year that it is expected, subject to Parliament's approval of the necessary legislation, that elements of the new framework can be introduced. In evidence to the Communities and Local Government select committee, the Audit Commission estimated that of its £48m running costs in 2009/10, £3m related to its regulatory functions. Government considers that the bodies undertaking regulation in the new framework will be able to perform those functions just as efficiently as the Audit Commission owing to their existing infrastructures, expertise and the potential synergies. An estimate of £3m regulatory functions plus an allocation of £1m support costs is therefore used for 2015/16 onwards. In the new framework, the regulatory role will be split between the National Audit Office, and the Financial Reporting Council and the professional bodies. The £4m has therefore been split equally between the National Audit Office and the Financial Reporting Council/professional bodies. 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.
20. The figures for National Audit Office local value for money studies are based on a National Audit Office estimate of a budget of £300k per study, beginning with two studies in 2012/13, building up to four in 2013/14 and six per year in 2014/15 onwards.

21. 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.
22. 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 DCLG and 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 funding of £11.9m provided by DCLG in 2011/12). The National Audit Office costs are taken from their Strategy 2012/13 – 2014/15, p24 figure 3 (available at: http://www.nao.org.uk/publications/1012/nao_strategy_2012-13_2014-15.aspx) reduced by the costs of undertaking value for money studies (as per note 21 above), to avoid double-counting. The Audit Commission's annual report and accounts 2010/11 (p62) show that it incurred £5.32m in redundancy costs in 2009/10 that are unrelated to disbandment, though these are shown for completeness. Similarly, 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. On the basis of figures provided by the Audit Commission, redundancy liabilities of £7.8m are forecast in 2012/13 as a result of the outsourcing of the work of the in-house practice, and liabilities of £5m on closure in 2015/16. In addition, the Audit Commission is forecasting stranded costs of £5.4m in 2013/14, £1.2m in 2014/15, and £0.9m in 2015/16. On closure, it may also face lease liabilities of £1.1m. 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. The transitional costs that are forecast to be incurred in 2015/16 (£16.9m) are therefore not accounted for in the Audit Commission's budgets shown above but rather it is likely these will be passed to DCLG to be off-set against the income from fees.
23. For clarity, the Commission's Payment by Results exercise for the NHS and the National Fraud Initiative are not included, since the former will cease shortly and the National Fraud Initiative will be transferred to another body – both should therefore be largely be cost-neutral and therefore for simplicity are not factored into this table which in essence seeks to present a before/after comparison of the new framework.

Table 6 – Indirect costs and benefits to business

	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)	7.99	8.10	7.12	10.29	15.18	14.69	14.45	14.43	14.85	14.83	14.83	128.75	12.87	108.78
Benefit compared with baseline	0.00	0.11	-0.87	2.30	7.19	6.70	6.46	6.44	6.86	6.84	6.84	48.85	4.88	40.01
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	12.51	9.42	8.78	12.34	7.20	7.50	2.00	2.00	2.00	2.00	2.00	55.24	5.52	50.32
Total cost to business	13.59	10.50	9.86	13.36	8.22	8.52	3.02	3.02	4.18	4.18	4.18	69.03	6.90	61.86
Baseline cost to business	13.59	13.59	13.59	13.59	13.59	13.59	13.59	13.59	13.59	13.59	13.59	135.89	13.59	116.97
Avoided costs	0.00	3.09	3.73	0.23	5.37	5.07	10.57	10.57	9.41	9.41	9.41	66.86	6.69	55.11

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 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.

67. 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.
68. Additionally, businesses choosing to take part in the local audit market incur costs in tendering for the audit work that is not done in-house by the Commission, and in contributing to the Commission's costs through passing back the 'top slice' on audit fees. This is outlined at (d) below.
- a) (i) Audit fees paid by local public bodies: The cost of providing external audit*
69. 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.
70. 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).
71. Historically, around 70%-75% of the audit fee has related directly to the audit services, and the remaining 25%-30% top slice¹⁸ has funded the Commission's regulatory functions, certain other functions, and its corporate costs. In 2009/10, the Audit Commission estimates its support and overhead costs amounted to £48m, out of income of around £221m, a top slice of 23%.
72. 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 corporate costs from £48m in 2009/10 down to £23m in 2011/12¹⁹ and forecast

¹⁸ 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 topslice 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 £221m (see table 4), which equates a topslice of 22%. From 2013/14, the Commission forecasts its corporate costs will be £9m pa out of total audit fees of £83.5m, an 11% topslice.

¹⁹ 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>

these to drop to a maximum of £9m from 2013/14, or even lower²⁰. 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.

73. The direct cost of providing audit services in 2009/10 was £137.42m. 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 £97.27m 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

74. 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, rather than the firm receiving the full fee for the work carried out. This 'top slice' thereby acts as a charge to firms that is used to cover the Commission's costs, including those assignable to its regulatory functions.

75. 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.²¹

76. The Audit Commission estimates that, in 2013/14 and 2014/15, the costs of undertaking its statutory duties will fall within an upper bound of £9m per year (although, in practice, this figure is likely to come down). It is estimated that a maximum of £3m of this relates to managing the outsourced audit contracts. 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 £3m has therefore been used for 2015/16 and 2016/17, and an estimate of £2m 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

77. 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 £5m²² (there will have been some additional overhead/support costs).

²⁰ Audit Commission forecast from their Medium Term Financial Plan, not currently in the public domain.

²¹ Audit Commission Supplementary written evidence to the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities, 2011.

²² 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

78. Certain other of the Commission's non-audit functions are funded directly by central government, such as Comprehensive Area Assessment (£21m in 2009/10²³) and other inspections (for example, of registered providers of social housing), grants for which totalled £7m in 2009/10²⁴, a cost to central government of £28m.
79. 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 2009/10²⁵. The total income derived from fees and grants from assessment and intervention in 2009/10 was therefore **£35.2m**²⁶.

c) Compliance costs to local bodies

80. 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 draft impact assessment.
81. 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.
82. 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 draft impact assessment, the cost to local bodies of compliance with Comprehensive Area Assessment is estimated in the region of **£11.8–£39.2 million per year**, and we use a midpoint figure of £25.5m²⁷.
83. Table 7 below summarises the costs associated with the existing framework under each of the eight key headings:

²³ Audit Commission annual report and accounts 2010/11, note 5 p63.

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 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	£73.80m
Paid to researchers, contractors and consultants	£14.31m	0
Costs of in-house auditors (minus overhead)	£97.27m	0
Cost of assessment/inspection (minus overhead)	£21.31m	0
Audit Commission statutory responsibilities, support and overhead costs	£48.00m	£9m
Transitional liabilities	-	£1.20m
Surplus: contribution to reserves	-	-£0.70m
Cost to local bodies of compliance	£25.50m	0
Total costs	£246.54m	£83.30m

Note: these are estimates and forecasts, and their limitations as estimates must be acknowledged.

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

84. 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.
85. 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.
86. 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 TUPE²⁸) 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

²⁸ The Transfer of Undertakings (Protection of Employment) Regulations 2006

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.

87. 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*²⁹, 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.
88. This draft 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 **£7.99m per year**. Annex 3 explains the origin of these figures in greater detail.
89. 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*,³⁰ and making a series of assumptions about the costs involved, this draft impact assessment estimates the costs to firms around **£1.08m per year in 2009/10**.
90. 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 is thereby a 'top slice' payable to the Commission, and effectively acts as a contribution to system costs by the firms actually carrying out audit work. Taking the difference between the percentage of fees assignable to firms (30%) and the amount the Commission paid to firms, this draft impact assessment estimates the firms' contribution to system costs in the baseline year (2009/10) as **£12.51m**.
91. 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

²⁹ Last published in June 2011 and available at: <http://www.frc.org.uk/pob/publications/pub2592.html>

³⁰ http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

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 **£7.99m per year**.

Costs associated with new local audit framework

92. 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.

93. 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 2015/16;
- (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.

94. 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

95. 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 financial year 2017/18, which is the year after the outsourcing contracts expire. 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.

96. 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 £9m per annum 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 2017/18 as being £74.5m per year.

97. 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 travel³¹. 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, and the removal of the Commission as the “middle man” in the existing relationship between local bodies and their auditors, 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.
98. 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)”³². Annex 1 considers the range of factors which is likely to exert pressure, both upwards and downwards, on future fee levels in more detail.
99. Ultimately, recognising the absence of complete and certain information about the future level of audit fees, this draft impact assessment takes the figure for the direct cost of audit in 2016/17 as the final year of the outsourcing contracts (£72.5m) as the starting point for the cost of fees in the new regime, adds on the £2m 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 **£67.05m - £81.95m 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 +/- £3.73m.**

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
10 % decrease on current levels	£67.05 million
Equal to current levels	£74.50 million
10 % increase on current levels	£81.95 million

100. Given the uncertainties, our best estimate for the incremental benefit/cost of future audit fees for local bodies is zero.

³¹ Future of Local Public Audit report by FTI Consulting Ltd for DCLG, May 2011, being published alongside this draft impact assessment.

³² The report from our financial advisers is being published on the DCLG website alongside the draft Local Audit Bill, see www.communities.gov.uk

(b) Regulatory costs

101. 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.
102. 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, the Audit Commission estimated that, of their £48m costs, £3m related to their regulatory responsibilities. It is estimated that in the final years of the residual Audit Commission around £1m of the Commission's governance/support costs will relate to the regulatory function. This puts the total regulatory cost at £4m per annum in the final years of the residual Audit Commission.
103. 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 £4m 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 £4 million to reflect the uncertainty around this figure, putting the estimated range for the purposes of this draft impact assessment at **£3.2 – £4.8 million per year, with a best estimate of £4m.**
104. In practice, some of this will be a cost on 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 draft 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 £4m, it is assumed that roughly half will relate to the National Audit Office's role, and around half 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

105. 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 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 £300k 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 £5 million (an average of £312.5k per study). In the new framework, the annual cost of local value for money studies would total **£1.8m**, compared to a current cost of £5m a year, an annual **saving of £3.2m per year**.
106. 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. 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. Compared to the baseline cost to central government, of £28m, this resulted in a saving to central government of £15.1m in 2010/11. 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 £28m. The total benefit to central government over the 10-year period totals £267.12m.
107. Local bodies incurred additional fees as a result of discretionary inspections of £7.2m in 2009/10. From 2010/11, when discretionary inspections were reduced, local bodies incurred fees of £1.4m, which resulted in a saving of £5.8m in 2010/11 when compared to the £7.2m baseline. From 2011/12, discretionary inspections have ceased, which results in annual savings to local bodies of £7.2m 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.

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

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Across 10-year period	
	Baseline	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Total	NPV
Savings to central government	0	£15.12	£28.00	£28.00	£28.00	£28.00	£28.00	£28.00	£28.00	£28.00	£28.00	£267.12	£228.13
Savings to local bodies	0	£5.84	£7.20	£7.20	£7.20	£7.20	£7.20	£7.20	£7.20	£7.20	£7.20	£70.64	£60.61
Total savings	0	£20.96	£35.20	£35.20	£35.20	£35.20	£35.20	£35.20	£35.20	£35.20	£35.20	£337.76	£288.75

(d) Compliance costs to local bodies

108. 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.

109. 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 draft impact assessment. Based on this approach, total local body procurement and recruitment costs are expected to range from **£3.54m - £5.32m per year** for local bodies, a **best estimate of £4.43m per year** from 2015/16. As this will be a new requirement, this will be an additional cost to local bodies totalling £14.16m - £21.28m over the four relevant years³³ of the 10-year period of this draft impact assessment, a best estimate of £17.72m.

110. 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.

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

111. 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 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 of the reforms.

³³ 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.

112. 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 £76.3m 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).
113. The potential profit margin (benefit) open to private sector audit firms is therefore **£15.18m 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.
114. 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*,³⁴ and making a series of assumptions about the costs involved, this draft 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**.
115. The figures relating both to potential profit and procurement costs are estimates and subject to a significant degree of uncertainty. The Government intends to work with firms to provide more robust estimates alongside the final Bill.

Transitional and other costs

116. 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 regulators for the new framework.

³⁴ http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

(a) *Redundancy costs*

117. 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 £41m, incurred between 2010/11 and 2015/16 when the Commission is disbanded³⁵.

(b) *Pensions*

118. 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.

119. The Government is negotiating with the trustees with the intention of putting in place 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.

120. The most recent estimates from the ongoing triennial valuation of the scheme have shown that funding levels are 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 is seeking 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 with trustees to minimise liabilities and/or manage them in line with the department's wider financial planning and priorities.

121. 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 draft 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 draft impact assessment, however, it is assumed that the department will not do so.

³⁵ £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, p54) with an additional £10.72m from efficiencies, £7.8m estimated redundancy costs as a result of the outsourcing of the in-house practice in 2012/13 (Audit Commission Project Board paper PPB 12-12, 14 March 2012), and a remaining £5m on final closure (Audit Commission estimate, January 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.

(c) Early termination costs for leases, etc

122. 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 additional cost is estimated to be £11m³⁶ in 2015/16. There may also be some other, smaller, stranded costs to the residual Audit Commission between 2013/14 – 2015/16 of £7.5m in total³⁷, allocated £5.4m in 2013/14, £1.2m in 2014/15 and £0.9m in 2015/16 (likely to be covered by transitional framework surplus to audit fees).

(d) Preparatory work by regulators for the new framework

123. 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.

124. 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 an increase in net resource requirements of £2.3m in 2012/13, £2.8m in 2013/14, and £3.4m in 2014/15³⁸. These include, however, the National Audit Office beginning to undertake value for money studies into the local sectors. As set out above, these are estimated to cost £300k per study. The National Audit Office intends to undertake two in 2012/13, four in 2013/14 and six in 2014/15, and then six per year subsequently. These figures are reflected in Table 4. Figures from other regulatory bodies are not yet available, but will be included in the full impact assessment to accompany the final legislation.

Non-monetised costs and benefits

125. 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 and the sectors themselves in data collection and improvement activity, where they feel this would be of value.

126. 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

³⁶ Audit Commission Medium Term Financial Plan, October 2011

³⁷ Audit Commission Medium Term Financial Plan, October 2011

³⁸ 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.

new framework will provide increased pressure on all the organisations that have a role to keep costs under review and prevent “mission creep”.

127. 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.
128. 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).
129. 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.

Post-implementation review

130. The data and evidence presented in this draft impact assessment are, of necessity, strategic. Data limitations have meant that assumptions, about both impacts of the proposed changes and the costs of implementing those changes, have been estimated. They have been, as far as possible, derived from robust published data but we acknowledge that there is scope to expand and refine the analysis further, and to update the impact assessment with the latest available data. The final impact assessment will be subject to further scrutiny of the data available and the assumptions made.
131. It is anticipated that, once enacted, the policy will be subject to review - both in terms of the process of how the new audit framework is operating, and the impact in terms of costs and benefits to the public sector. Details of the methodology for the review will be developed as part of the full impact assessment.

G) ANNEX 1: FACTORS AFFECTING FUTURE AUDIT FEE LEVELS

132. 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.

133. 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 levels³⁹. 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. EU Commission proposals and UK Competition Authorities consideration
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. Market forces
3. Removal of Audit Commission auditor indemnity	6. Reduced costs through merging private and public sector audit compliance regimes	14. Possible reduced utilisation for firms: larger number of discrete contracts could reduce their ability to plan staff utilisation beyond 5-year contract period
	7. Changes to approach of audit – more risk-based and greater reliance on work of others (e.g. inspectorates)	
	8. Giving auditors greater discretion in relation to objections to accounts	
	9. End to existing grant certification arrangements	
	10. Opening up the market to competition means significantly greater value of work is available to firms	
	11. Joint procurement by local bodies, increasing bargaining power and economies of scale	

³⁹ See Future of Local Public Audit report by FTI Consulting for DCLG, May 2011, being published alongside this impact assessment.

Upward Pressures

(1) Increase in tendering requirement on audit firms

134. 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

135. 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 £40.15 million⁴⁰. 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

136. 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.

137. In practice, however, this indemnity is rarely used (as explained in paragraphs 40 and 41): only 4 cases in the 4,370 principal audits undertaken in the 5 year period to 2010. Since firms already have liability insurance in place for their work in the private sector audit market, an extension to the sub-market of local public audit should not result in significant additional costs.

138. In addition, 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

⁴⁰ 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.

the audited body, which may negate the impact on fees of the loss of the Audit Commission's fee-setting role.

Downward Pressures

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

139. 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

140. 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

141. 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).

142. 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) Changes to approach of audit – more risk-based and auditors will be encouraged to look to work from inspectorates, other sources

143. In the new regime, the National Audit Office will have scope to change the approach that auditors take to meet their legislative responsibilities in relation to the scope of public audit.

144. In the new regime, auditors will continue to have to satisfy themselves about the arrangements bodies have in place to secure value for money. Currently, the Audit

Commission's code of audit practice requires auditors to produce a conclusion on value for money. The National Audit Office, who will take responsibility for the code of audit practice, will look at making the audit more risk-based and proportionate which would affect the audit fee differently for different bodies. They will also look to encourage auditors to take account of the work of inspectorates and other bodies when taking on audit work. This could result in a reduction of the amount of work auditors are required to undertake to meet their legal obligations and therefore could result in a downward pressure on fees.

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

145. 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.

146. 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.

(9) End to existing Grant Certification arrangements

147. 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.

148. 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.

149. However, the new approach, where the onus is 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.

(10) Opening up this market to competition means significantly greater share of the market is available to firms

150. By opening up the market so that all 100% of local public audit work can be bid for by firms (as opposed to the 30% of the market that has traditionally been outsourced by the Audit Commission), the value of the market will increase from

£40.15m in the baseline year of 2009/10, to £76.3m in 2013/14⁴¹. Although the market share available to the private sector will increase by over 200% (from 30% to 100%) in this period, the value of this market share will increase by 82%, taking into account declining audit fee levels since 2009/10. 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.

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

151. 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.
152. 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.
153. 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).

Unknown pressures

(12) EU Commission proposals and UK Competition Authorities consideration (for a transitional period)

154. The EU Commission have put forward a range of proposals relating to audit and the audit market, to which the UK Government has responded. Within the UK, the Competition Authorities are investigating the concentration in the audit market. The recommendations that may emerge from these processes may create a degree of uncertainty for firms bidding to local bodies for audit work, but this would equally be the case if the Audit Commission were still in existence.

(13) Market forces

155. 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

⁴¹ See Table 4 and explanatory note 6 on p.170 for explanation of data relating to "fees paid to firms for outsourced audit work".

the wider audit market). In contrast, under the current system the Audit Commission sets price levels through its 'scale fees' system.⁴²

156. 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.⁴³

157. 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, and so this may lead to a differential impact on fees as determined by the market. While this draft 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.

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

158. 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.

159. 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.

160. 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.

161. In the new framework, local bodies will be required to undertake a competitive procurement process to appoint their 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 instance 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.

⁴² For an explanation of the current 'scale fee' system: <http://www.audit-commission.gov.uk/audit-regime/audit-fees/Pages/default.aspx>

⁴³ See Future of Local Public Audit report by FTI Consulting for DCLG, May 2011, being published alongside this impact assessment.

162. 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.
163. 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.

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

The current framework

164. Two sources were drawn on to estimate the compliance costs under the current framework:
- An Office for Public Management study commissioned by the Audit Commission entitled 'Establishing the Costs of Comprehensive Area Assessment', 2010⁴⁴; and,
 - A Deloitte study commissioned by Leicestershire County Council entitled 'Measuring the Workload: Public Sector Performance Reporting and Inspection Regimes in Leicestershire', 2009⁴⁵.
165. 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).
166. 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.
167. 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.
168. **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 draft 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.
169. 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.

⁴⁴<http://www.audit-commission.gov.uk/SiteCollectionDocuments/Downloads/20100316establishingthecostsofcaa.pdf>

⁴⁵ http://www.leicestershiretogether.org/oct09_deloitte_inspection_rpt.pdf

The new framework

170. 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*

171. 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 Association⁴⁶ 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 Office⁴⁷ which estimates the average cost of 'managing service contracts' (a wider measure of costs which includes procurement amongst other things).

172. 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.

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

⁴⁶ Available on the Local Government Association A website at: <http://new.lga.gov.uk/lga/aio/17119084>

⁴⁷ 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.	£1.7 million ⁴⁸	£1.2 million ⁴⁹
Two per cent (informed by National Audit Office report) of the estimated total annual worth of local public bodies' audit contracts.	£1.46 million ⁵⁰	£1.02 million ⁵¹
Total	£3.16m	£2.22m

174. 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

⁴⁸ The Local Government Association report (<http://new.lga.gov.uk/lga/aio/17119084>) 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 (874) divided by the period of years over which this cost will be borne (5) is equal to £1.7 million. 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 £1.7 million may be in the high side if audit contracts for the smaller of the principal bodies are below the financial threshold of approx £100k.

⁴⁹ 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). £1.2 million is simply the individual approach estimate (£1.7 million) reduced by 30 per cent.

⁵⁰ The National Audit Office report (http://www.nao.org.uk/publications/0809/central_governments_management.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 £73 million, this puts the estimated cost of managing a service contract in the region of £1.46 million per year.

⁵¹ Calculated by reducing the estimated cost of managing a contract by 30 per cent assuming a more collaborative approach.

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 **£2.22 million per year** for the purposes of this draft impact assessment.

(2) *Remuneration of independent panel members*

175. 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 (which may reduce the overall number of auditor panels).
176. Given these uncertainties, this draft impact assessment provides a best estimate of the potential cost.
177. 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):

Table 12 – Independent member allowances

Local authority type	Indicative independent member allowances (£)	
	Chairman ⁵²	Member ⁵³
London borough	1,974	398
Metropolitan district	3,593	424
County	3,782	782
Shire district	1,597	313
Unitary	3,456	702

178. 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.

⁵² 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.

⁵³ 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	521	3,928	£2,046,488
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TOTAL (874 bodies):	£3,160,167
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179. 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 £3.16m 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.

180. 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 draft impact assessment in the region of **£2.21m per year**.

Total compliance costs

181. 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 **£3.54m - £5.32m per year, a best estimate of £4.43m per year**.

I) ANNEX 3 – CALCULATION OF COSTS AND BENEFITS TO BUSINESSES

Benefits to firms (profit)

182. 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%.⁵⁴

Table 14: Average profit of firms

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

183. 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%) (£ million)

	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	35.80	51.70	76.30	73.80	72.60	72.50	74.60	74.50	74.50
Potential Profit	7.99	8.10	7.12	10.29	15.18	14.69	14.45	14.43	14.85	14.83	14.83

184. 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 6 to Table 4. From 2013/14, the market available to the private sector increases to £76.3m per year, giving a potential profit margin of £15.18m. This then fluctuates slightly over the following years reflecting possible changes in the number of bodies, and the inclusion of regulatory costs under the new framework in the fees charged by firms to bodies.

⁵⁴ <http://www.kpmg.com/UK/en/WhoWeAre/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

185. Under the Audit Commission framework, firms surrender part of the fee income they collect 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 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). 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	£44.58m	£64.04m	£83.50m	£81.30m
Amount paid to firms	£40.15m	£40.68m	£35.80m	£51.70m	£76.30m	£73.80m
Top slice returned to Audit Commission	£12.51m	£9.42m	£8.78m	£12.34m	£7.20m	£7.50m

186. 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).

Cost of tendering

187. 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%).

188. 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*.⁵⁵ 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.

⁵⁵ http://www.nao.org.uk/publications/0910/collaborative_procurement.aspx

189. 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.
190. In order to calculate the initial costs, we have identified twelve broad groups of local public bodies.⁵⁶ 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.
191. For years 2009/10 to 2011/2012, 30% of the audit work was outsourced to the private sector. When this work went out to tender⁵⁷, 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.
192. 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**.
193. 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 new regime, however this is difficult to quantify therefore we have continued to use seven for consistency. Table 17 below sets out the calculations.

⁵⁶ 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.

⁵⁷ In two procurement exercises, in 2006 (20% of the market) and 2007 (a further 10%).

194. 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).

195. 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) $\text{£}5000 \times 7 \times \text{number of lots}$	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

196. 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 decreased contribution to system costs.

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ISBN 978-0-10-183932-7



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