

**EXPLANATORY MEMORANDUM TO**  
**THE LOCAL AUDIT (DELEGATION OF FUNCTIONS) AND STATUTORY AUDIT**  
**(DELEGATION OF FUNCTIONS) ORDER 2014**

**2014 No. 2009**

**1.** This explanatory memorandum has been prepared by the Department for Communities and Local Government and is laid before Parliament by Command of Her Majesty.

**2. Purpose of the instrument**

2.1 This instrument delegates certain functions of the Secretary of State to the Financial Reporting Council Ltd. The functions in question relate to the eligibility and regulation of local auditors within the meaning in the Local Audit and Accountability Act 2014 (“the 2014 Act”), and include: authorising professional accountancy bodies to act as recognised supervisory bodies for local audit; authorising professional accountancy bodies to offer a local audit qualification; undertaking significant public interest disciplinary cases and, where appropriate, imposing a range of sanctions on those auditors found to have committed misconduct and reporting to Parliament annually in relation to inspections. These and other delegated functions are functions under Part 42 of the Companies Act 2006 (“the 2006 Act”) as applied by Schedule 5 to the the 2014 Act.

2.2 This Order fulfils the same purpose for the local audit regime as Part 3 of the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012, S.I. 2012/1741 (“the 2012 Order”) does for the statutory audit regime applying to United Kingdom companies. This Order also amends the 2012 Order in relation to the period the Financial Reporting Council must allow for its consultations, so that the same requirement applies to both regimes.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

None.

**4. Legislative Context**

4.1 The 2014 Act puts in place new arrangements relating to the accounts of local authorities and certain other public bodies in England (and a very limited category of authorities which exercise functions partly in England and partly in Wales) – defined in the Act as “relevant authorities”, including the appointment, functions and regulation of local auditors once the Audit Commission for Local Authorities and the National Health Service in England (“the Audit Commission”) is abolished in 2015. For the bodies which are “relevant authorities” under the 2014 Act see section 2 of, and Schedule 2 to, that Act. For the meaning of “local auditor” see section 4(1)(b) of the 2014 Act.

4.2 Part 4 of the 2014 Act is concerned with the eligibility and regulation of local auditors to undertake the audit of relevant authorities under Part 3 of that Act. It applies provisions in Part 42 of the Companies Act 2006 (statutory auditors) to audits of relevant authorities. Schedule 5 to the 2014 Act contains modifications to Part 42 of the 2006 Act. Paragraphs 1 and 2 of Schedule 5 make general modifications to the 2006 Act. Paragraphs 21 and 22 of Schedule 5 make specific modifications to sections 1252 and 1253 of the 2006 Act (delegation of the Secretary of State's functions) and (delegation of functions to an existing body) under which this Order is made. The intention is for the Financial Reporting Council to start preparatory work in relation to the new regulatory regime, under certain of its delegated functions, by September of this year. Schedule 5 to the 2014 Act will be brought into force to that extent on a date to coincide with the coming into force of this Order.

## **5. Territorial Extent and Application**

This instrument applies to England and Wales (articles 1 to 9), and all of the United Kingdom (article 10).

## **6. European Convention on Human Rights**

The Minister for Local Government, Brandon Lewis, has made the following statement regarding Human Rights:

In my view the provisions of the Local Audit (Delegation of Functions) and Statutory Audit (Delegation of Functions) Order 2014 are compatible with the Convention rights.

## **7. Policy background**

7.1 In August 2010 the Government announced its intention to disband the Audit Commission, transfer the work of its in-house practice to the private sector and put in place a new audit framework – in which relevant authorities would be able to appoint their own auditors from an open and competitive market, with a robust regulatory framework to ensure that high standards of audit were upheld.

7.2 To deliver these objectives, secondary legislation is needed to:

- set out the minimum criteria that a qualification must meet in order to be recognised for the purposes of local audit;
- ensure that a public register of such local auditors is available; and
- ensure that local audit work is appropriately and robustly monitored.

7.3 During its passage through Parliament, the key concern in relation to Part 4 of, and Schedule 5 to, the 2014 Act related to the wider scope of public audit and the qualification of auditors in the new framework.

7.4 Part 42 of the 2006 Act (as modified by the 2014 Act) sets out functions to be exercised by the Secretary of State. Sections 1252 and 1253 give the Secretary of State

power to delegate functions to a designated body (in this case the Financial Reporting Council Ltd). This Order sets out which functions will remain exercisable by the Secretary of State, or are to be exercisable concurrently. Any functions not listed are therefore delegated to the Financial Reporting Council. These functions include the power to recognise supervisory bodies for local audit. Recognised supervisory bodies are required to put in place rules and practices to be followed by their members, before being permitted to carry out an audit and sign off an audit report. Recognised supervisory bodies are also responsible for monitoring the quality of audits undertaken by their members. The Financial Reporting Council will also undertake an additional level of oversight for the monitoring of the quality of “major local audits”, meaning local audits of specified relevant authorities – an approach that mirrors the monitoring of “major audits” in the Companies sector.

## **8. Consultation outcome**

8.1 Prior to the introduction of the 2014 Act into Parliament, the Government consulted twice: on the broad policy approach; and in more depth on the proposed new framework through publication of the draft Bill. During its passage through Parliament, Government provided draft regulations on several key provisions in the Bill to the Parliamentary Bill Committee and carried out an interactive public consultation exercise over four weeks from 25 November until 20 December (“the November consultation”), including on the proposed role of the Financial Reporting Council.

8.2 Whilst the provisions of this delegation order were not included in the consultation exercise, they have been subject to discussion by the working group, set up by DCLG and incorporating key sector practitioners, to ensure both that the regulatory proposals were fit for purpose and incorporated their views. Whilst some respondents to the consultation exercise queried the role of the Financial Reporting Council and the powers that would be delegated to it, Government and working group members remain of the view that these proposals are in line with its current oversight role in respect of statutory audit and that therefore it is best placed to undertake a similar role in relation to local audit.

## **9. Guidance**

There is no accompanying guidance from the Secretary of State to this statutory instrument.

## **10. Impact**

10.1 The impact on charities or voluntary bodies is nil; however there will be an impact on audit firms, with annualised costs per annum rising from around £1.04million to £2.18million. However this is offset by the opening up of the local public sector audit market to firms, enabling them to realise greater profits than in the baseline year and a decreased contribution to system costs. (See Annex 3 of impact assessment for the 2014 Act.)

10.2 The impact on the public sector in complying with the new audit arrangements in total is estimated to range from £2.98million per annum to £4.48million per annum, a best estimate of £3.73million per annum, which equates to roughly £4,800 per body per year in compliance costs. (See Annex 2 of impact assessment for the 2014 Act.)

10.3 An Impact Assessment was published alongside the introduction of the Local Audit and Accountability Bill to Parliament which provides an assessment of the overall cost and impact of the new regime. This can be accessed at the following address:- <http://www.parliament.uk/documents/impact-assessments/IA13-11A.pdf>.

## **11. Regulating small business**

The legislation does not apply to small business.

## **12. Monitoring & review**

12.1 As part of the Government's commitment to review the implementation of new legislation within three to five years of receiving Royal Assent, Government has set out some general principles towards developing a possible approach to such a review and assessing the impacts/outcomes associated with the Government's reforms to local audit. An overriding objective for the final approach would be to ensure that any proposed measurement is both proportionate and cost effective.

12.2 The aims and success criteria of the local audit reforms as a whole are to:

- Deliver greater localism, decentralisation and transparency;
- Maintain competitive audit fees; and
- Uphold high standards of auditing.

12.3 The post implementation review will provide Government, Parliament and the public with the opportunity to demonstrate that the local audit framework is achieving its anticipated outcomes and that the assumptions about costs and benefits identified are supported by the evidence.

## **13. Contact**

Leah Sparks at the Department for Communities and Local Government: Tel: 0303 444 1167 or email: [leah.sparks@communities.gsi.gov.uk](mailto:leah.sparks@communities.gsi.gov.uk) can answer any queries regarding the instrument.