

EXPLANATORY MEMORANDUM TO
THE ACCOUNTS AND AUDIT REGULATIONS 2015

2015 No. 234

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**

This instrument revokes and replaces the Accounts and Audit (England) Regulations 2011 (S.I. 2011/817) (“the 2011 Regulations”). It contains provisions on internal control and annual accounts and audit procedures applying to relevant authorities (apart from health bodies) as defined in Schedule 2 to the Local Audit and Accountability Act 2014 (“the 2014 Act”). The Regulations contain detailed rules about the preparation, approval and publication of the annual statement of accounts, and about the arrangements for local electors and other interested persons to exercise their rights of inspection, objection and to question the local auditor.

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

None.

4. **Legislative Context**

4.1 The 2014 Act makes new provision for the audit of local public bodies (“relevant authorities” as defined in section 2 of and Schedule 2 to that Act) and will repeal the Audit Commission Act 1998 from 1 April 2015. The 2014 Act imposes a requirement on relevant authorities to appoint an external and independent auditor on the advice of an independent auditor panel. It also creates a regulatory framework for local audit which applies, with modifications, Part 42 of the Companies Act 2006, whereby the Financial Reporting Council and professional accountancy bodies regulate the provision of local audit services.

4.2 Section 32 of the 2014 Act gives the Secretary of State the power to make provision through regulations about the financial management, internal control, and annual accounts and audit procedures applying to relevant authorities and broadly mirrors section 27 of the Audit Commission Act 1998 (which the 2014 Act repeals and replaces). These Regulations replace the 2011 Regulations to reflect the requirements relating to annual published accounts and audit procedures applying to relevant authorities (apart from health service bodies as defined in section 3(9) of the 2014 Act) detailed in the 2014

Act. In particular some requirements included in the 2011 Regulations are now set out in that Act – for example the requirement to keep adequate accounting records and to prepare an annual statement of accounts.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 These Regulations are required in order to implement the new local audit arrangements set out in the 2014 Act and replace the 2011 Regulations which relate to the framework for the audit of relevant authorities (excluding health service bodies) under the Audit Commission Act 1998 which the 2014 Act replaces.

7.2. The Regulations have been drafted to reflect new requirements and to remove provisions that are no longer needed. They have been restructured to follow a more logical progression through the accounts process and be easier to follow and understand than the 2011 Regulations they replace.

7.3 Part 1 of the Regulations defines the terms used throughout, and in particular defines relevant authorities that are either required to be, or choose to be, subject to a full audit as Category 1 authorities. This includes a smaller authority that has chosen to prepare its accounts for the purpose of a full audit in accordance with regulation 8 of the Local Audit (Smaller Authorities) Regulations 2015. The meaning of the term ‘smaller authority’ is set out in section 6 of the 2014 Act. In summary, a relevant authority qualifies as a smaller authority if, in the relevant financial year under consideration, the authority’s gross income and expenditure in that year does not exceed £6.5 million.

7.4 All other authorities are classed as Category 2 authorities. A Category 2 authority with exempt status is a Category 2 authority that has certified itself as exempt in accordance with regulation 9(1) of the Local Audit (Smaller Authorities) Regulations 2015. This requires, among other things, that the higher of the authority’s gross income and expenditure, or gross receipts and payments for the year does not exceed £25,000.

7.5 Regulations 3 to 6 in Part 2 set out the general requirements on all relevant authorities in relation to accounting records, internal audit and internal control and review. These have been updated to remove elements that are now set out in section 3 of

the 2014 Act. The general duties on internal control in regulation 3 have been recast to bring them closer to corporate governance requirements in the private sector and elsewhere in the public sector. Regulation 5 restates the role of internal auditor to follow modern standards and the requirement for an annual review of internal audit has been removed, as such a review will be part of the review of internal control required by regulation 6.

7.6 Part 3 and Schedule 1 set out the specific requirements for a Category 1 authority in relation to the preparation, approval and publication of the statement of accounts and annual governance statement. It brings forward in the financial year the timetable for the preparation and publication of the statement of accounts for Category 1 authorities. It also includes a new requirement for such authorities to prepare and publish (including on the authority's website) a narrative statement commenting on their financial performance and economy, efficiency and effectiveness in their use of resources over the year. This is intended to help readers understand the financial position reflected in the accounts.

7.7 Part 4 sets out the requirements for a Category 2 authority in relation to the publication of accounts and annual governance statement, including publication on the authority's website or, in the case of a Category 2 authority without its own website in accordance with regulation 2(5) on any website provided that the information so published is accessible to any member of the public without registration or payment, or in the case of a Category 2 authority that is a parish meeting, displayed in a conspicuous place.

7.8 Part 5 contains some of the main changes from the 2011 Regulations. It reforms the rules on the exercise of the public's rights to inspect the accounts and to put objections and questions to the auditor. The periods for the exercise of these rights will be set by the authority instead of, as under the 2011 Regulations, the auditor. There is a new requirement that the single 30 working day period for the exercise of these rights (during which persons interested will have the right to inspect the accounts of any authority in their area) must now include a common ten day period, during which the accounts of every authority will be available for inspection (although the rights to put objections and questions to the auditor remain limited to local electors).

7.9. Part 5, when taken together with the transitory provision in regulation 21, makes further provision for the public inspection of the accounts for Category 1 authorities. It gives these authorities time to prepare for the new timetable by delaying its introduction until the accounting year 2017/18. From that year they will be required to have closed their accounts by 31 July rather than 30 September, following the accounting year end, and to commence the period for the exercise of public rights on a day that ensures that the period covers the first 10 working days of June.

7.10 Regulations in Part 6 include provisions in relation to the Greater London Authority, joint boards, combined authorities and National Park Authorities and in relation to the publication of an annual audit letter as well as the transitory provision mentioned in paragraph 7.9 above. The 2014 Act provides that joint committees will no

longer be subject to a separate audit but will be included in the accounts of their constituent bodies; references to joint committees have therefore been removed from these provisions.

7.11 The following regulations in the 2011 Regulations have been omitted:

- 17 (passenger transport executives) and 18 (internal drainage boards) as the 2014 Act (Schedule 12, paragraph 50) brings both types of body under the definition of “proper practices in relation to accounts” set out in section 21 of the Local Government Act 2003,
- 21, as public rights will no longer depend on a date specified by the auditor,
- 23, as it is considered incompatible with the role of an auditor to approve a change in accounting records, and
- 28, as there is no provision in the 2014 Act for extraordinary audits.

7.12 Regulation 22 and Schedule 2 provides for the revocation of the 2011 Regulations on 1 April 2015 although they will continue to have effect in relation to accounts prepared for any financial year ending on or before 31 March 2015.

8. Consultation outcome

8.1 Prior to the introduction of the 2014 Act into Parliament, the Government consulted twice, both 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 set out its policy intent for these Regulations in an interactive public consultation exercise over 4 weeks from 25 November until 20 December 2013¹ The consultation response to that exercise was published on 10 March 2014². A further interactive consultation containing a draft of the Regulations was carried out between 19 June and 18 July 2014³. Of the 123 responses, 89% commented on the draft Accounts and Audit Regulations.

8.2 The Government published its response to that consultation on 5 December 2014⁴. However, the main issues raised during consultation on these draft Regulations were as follows. 71 respondents supported electronic publication of the accounts and broadly two thirds of responses were in favour of the common period for the public right to inspect the accounts and for the 30 day inspection and objection period, although some concerns were expressed that this may prevent ‘early’ authorities in laying their final accounts and that for ‘late’ authorities, the public would be inspecting incomplete records. Very few comments were received about the proposals for ‘exempt’ Category 2 authorities although

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260929/Future_of_Local_Audit_-_Consultation_on_secondary_legislation_2_.pdf

² <https://www.gov.uk/government/consultations/future-of-local-audit-consultation-on-secondary-legislation>.

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324239/Local_Audit_Consultation3.pdf

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383694/Future_of_Local_Audit_Consultation_Summary_and_Response.pdf.

sector bodies suggested that the role played by auditors currently in helping smaller councils comply with audit requirements should not be underestimated.

8.3 The main concern expressed by respondents was in relation to the compression of the audit timetable, with the majority querying how this measure would increase local accountability and expressing views that it would be likely to lead to quality issues as accounts would make greater use of estimates. In response to these concerns, Government's view is that timely publication of the Statement of Accounts aligns with the Government's wish to improve local government transparency and accountability. It is the Government's view that a more timely closedown process would increase public interest in local authority accounts, especially when coupled with proposed moves to simplify accounting statements and a common public inspection period. In addition, earlier closure will encourage more rigorous in year monitoring of finances, and reduce uncertainty about the financial position of an authority in the following year. By giving 3 years' notice of these changes the Government is providing authorities and auditors with a reasonable timescale to adjust.

9. Guidance

The Department for Communities and Local Government will publish a guide on the local accountability arrangements, including audit arrangements and accounting requirements, for smaller authorities'.

10. Impact

10.1 There is no impact on charities or voluntary bodies, although 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 a wider range of firms, allowing them to realise greater profits at a reduced cost over the longer term due to the simplification of the audit regime. Further details are set out in Annex 3 of the Impact Assessment for the 2014 Act (footnoted link in 10.3 below).

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 A revised Impact Assessment was published in September 2014⁵ following Royal Assent of the 2014 Act which provides an updated assessment of the overall cost and impact of the new regime.

⁵https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/349418/2014_FINAL_Local_Audit_IA.pdf.

11. Regulating small business

Whilst the legislation does not apply to small business, in a wider sense there will be an impact on audit firms. The detailed costs and benefits are set out in Annex 3 of the impact assessment for the 2014 Act. However, whilst the new arrangements will result in an increased cost to audit firms, this is offset by the opening up of the local public sector audit market to a wider range of firms, enabling them to realise greater profits over the longer term, with a decreasing contribution to system costs over the current regime.

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 are to:

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

The post implementation review will provide Government, Parliament and the public with the evidence 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

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