

LOCAL AUDIT AND ACCOUNTABILITY ACT 2014

EXPLANATORY NOTES

COMMENTARY

Part 4– Eligibility and Regulation of Local Auditors

Section 18 and Schedule 5: Eligibility and regulation of local auditors

47. **Schedule 5** (which is given effect to by section 18) sets out the arrangements for the eligibility and regulation of auditors in the local audit framework. This Schedule applies Part 42 of and Schedule 10 to the Companies Act 2006, seeking largely to align the regulatory framework for local auditors with auditors of companies. Schedule 5 sets out the modifications to the Companies Act which are necessary to reflect the differences between statutory and local audit.
48. Many of the modifications to the Companies Act 2006 are to omit those provisions that are not relevant to local auditors or to change references so that the provisions of the Companies Act are appropriate for local audit. More significant modifications have been made in respect of:
 - independence, where the Act sets out specific requirements for local auditors; and
 - appropriate qualifications for local audit, where the Act provides the Secretary of State with a power both to recognise a professional qualification specifically for local audit and to enable those individuals qualified under the Audit Commission Act 1998 to continue to be appropriately qualified in the new framework.
49. Part 42 of the Companies Act 2006 sets out the arrangements for ensuring that firms and individuals undertaking local audit have the required skills, qualifications and experience to undertake that work. It also sets out specific independence requirements that auditors must comply with in order to be appointed as a local auditor.
50. Schedule 10 to the Companies Act 2006 sets out the framework governing the recognised supervisory bodies under that Act. Under the Companies Act 2006, eligibility for appointment as an auditor depends on membership of, and compliance with the rules of, a professional accountancy body which has been authorised (or “recognised”) by the Secretary of State. These bodies are referred to as “recognised supervisory bodies”, and this term is carried across to the Act in relation to local audit. In practice, the power to recognise supervisory bodies under the Companies Act 2006 is delegated to the Financial Reporting Council. Recognised supervisory bodies are required to put in place rules and practices to be followed by their members, for example, concerning ethical standards of conduct, and the experience and other criteria that individuals must meet before being permitted to carry out an audit and sign off an audit report.
51. Recognised supervisory bodies are also responsible for monitoring the quality of audits undertaken by their members. This is the case for both local and company audit.

Schedule 5 provides for an additional level of oversight for the monitoring of the quality of “major local audits”, meaning local audits of relevant authorities specified or defined in regulations or in a direction. In line with the monitoring of “major audits” in the companies sector, this role is to be delegated to the Financial Reporting Council.

52. In the local audit framework, auditors will be required to hold an “appropriate qualification” to sign an audit report and this could either be a qualification recognised under Part 42 of the Companies Act 2006, or another qualification recognised under the Act. The Secretary of State may make regulations setting out the minimum requirements that those other qualifications must meet in order to be recognised for the purposes of local audit. As well as the requirement for an auditor to hold an appropriate qualification, recognised supervisory bodies are required to have rules in place to ensure that those eligible to sign an audit report on behalf of a firm have suitable experience.

Paragraphs 1-4: Modifications to the Companies Act 2006

53. Paragraph 1(1) outlines the approach taken to applying the Companies Act 2006 and paragraph 1(2) provides definitions for the terms “local audit” and “local audit work” that are used throughout the Schedule. Paragraph 2(1) sets out the general modifications where references need to be substituted throughout. Paragraph 3 specifies a number of provisions to be omitted given that they are not relevant for local audit.

Paragraph 5: Independence requirement

54. This paragraph substitutes section 1214 of the Companies Act 2006, for the purposes of the Act, to set 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 (4) this includes where the person is an officer or employee of an entity connected to the relevant authority. Subsection (6) provides the Secretary of State with a reserve power 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.

Paragraph 6: Effect of lack of independence

55. This paragraph omits subsections (2) to (7) of section 1215 of the Companies Act 2006 which set out the criminal sanctions for auditors.

Paragraph 9: Appropriate qualifications

56. This paragraph modifies section 1219 of the Companies Act 2006 to provide when a person holds an appropriate qualification for the purposes of local audit i.e. that 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. 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 (7) sets out which existing professional qualifications will be considered appropriate for local audit under the new framework. This is to ensure that individuals qualified under the Audit Commission Act 1998 will be able to continue to undertake local audit in the new regime. Subsection (13) 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”.

Paragraph 10: Provision of documents to the Secretary of State

57. This paragraph provides the Secretary of State, a body to whom the Secretary delegates his or her functions (by order under section 1252 of the Companies Act 2006), 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.

Paragraph 11: Enforcement: general

58. This paragraph specifies modifications that reflect the arrangements for recognising appropriate qualifications for local audit. In the Companies Act 2006, Schedule 11 sets the framework and this is not applied in this Act. Instead, regulations made under the modified section 1219 of the Companies Act 2006 are to set the requirements for the recognition of appropriate qualifications.

Paragraph 14: The register of auditors

59. This paragraph concerns the register of eligible auditors and modifies section 1239 of the Companies Act 2006, mainly to recognise the differences in eligibility for auditors of companies and those of relevant authorities. It also includes a regulatory power to set requirements around the keeping of such a register.

Paragraph 16: The Secretary of State's power to require second audit

60. This paragraph modifies section 1248 of the Companies Act 2006 to specify that a copy of a direction requiring a second audit is sent to the auditor's recognised supervisory body rather than the registrar of companies. It also allows for the Secretary of State to specify when the authority must comply with the direction.

Paragraph 21: Delegation of the Secretary of State's functions

61. This paragraph modifies section 1252 of the Companies Act 2006, which provides that the Secretary of State may delegate certain functions, so that in subsection (3) such an 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.

Paragraph 28: Recognised supervisory bodies

62. This paragraph provides for general modifications to Schedule 10 to the Companies Act 2006 in relation to the responsibilities of recognised supervisory bodies, and in particular to specify the experience and training needed by those people carrying out inspections of local audits and in monitoring the quality of local audits undertaken by their member firms, including an additional level of oversight for audits of significant local bodies. Sub-paragraph (7) provides the Secretary of State with regulatory powers to set out which bodies would have their audits defined as 'major local audits', which would then be subject to this additional level of oversight by the Financial Reporting Council. Recognised supervisory bodies must also comply with guidance issued by the Secretary of State on the appropriate level of competence of auditors.