EXPLANATORY MEMORANDUM TO

THE LOCAL AUDIT (LIABILITY LIMITATION AGREEMENTS) REGULATIONS 2014

2014 No. 1628

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

To set out requirements and restrictions in relation to agreements (liability limitation agreements) to limit the liability of a local auditor appointed under Part 3 of the Local Audit and Accountability Act 2014 ('the Act') in respect of any negligence, default, breach of duty or trust in relation to the authority who appointed them.

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 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.

4.2 Part 3 of the Act is concerned with the appointment, resignation, removal and replacement of local auditors. Section 7 provides that a local auditor must be appointed by a relevant authority to audit its accounts for a financial year.

5. Territorial Extent and Application

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 The Act places a duty on relevant authorities to appoint their own auditor, to replace previous arrangements whereby auditors were appointed for them by the Audit Commission.

7.2 In appointing their auditor, authorities could decide to enter into a Liability Limitation Agreement (LLAs) with the auditor, which would limit the extent to which the auditor could be held liable for any negligence, default, breach of duty or breach of trust occurring in the course of the audit.

7.3 LLAs were not part of the previous audit regime for local authorities, and are very rare in the companies sector. This instrument is unlikely to impact on the majority of relevant authorities, as we do not expect LLAs to be widely used. However, they provide an important safeguard should an authority agree to put one in place.

7.4 The Government consider that it is important that any such agreement is transparent and fair, and does not unreasonably exclude the auditor from costs they should be liable for. The Act therefore requires LLAs to comply with relevant regulations made by the Secretary of State. This instrument sets out the conditions which an LLA must meet, modelled on equivalent provisions in the companies sector.

7.5 The instrument achieves these policy aims by requiring that any LLA:

- Can only cover the period, or part of the period, of the auditor's appointment
- Can only limit the auditor's liability to an amount that is 'fair and reasonable', having regard to the auditor's responsibilities and contractual obligations, and the professional standards expected of them., without regard to matters arising after the loss or damage has been incurred, or to the possibility of recovering compensation from elsewhere.

8. Consultation outcome

As this is a minor and technical provision that is unlikely to impact on the majority of local bodies, no specific consultation on a draft instrument was carried out. During the passage of the Act, the Government published a statement of intent that confirmed our intention to make regulations that would reflect arrangements in the companies sector (including the disclosure and 'fair and reasonable' requirements). The enabling power was consulted on when the draft local audit bill was published.

9. Guidance

The Government intends to develop guidance with respect to the wider duties of relevant authorities around the appointment of auditors, and the role of local

auditor panels in advising on this process. We will consider whether it would be helpful for this to include further guidance on the use of LLAs.

10. Impact

10.1 There is unlikely to be any impact on charities or voluntary bodies, as they are not covered by the Act or this instrument. Any impact on business is likely to be very small. As above, the use of LLAs in relation to audit in the companies sector is very rare, and we expect this to be the case for the audit of relevant authorities. For most audit firms providing audit services to local public bodies, no LLA will be put in place and these regulations will have no additional impact.

10.2 The impact on the public sector is also likely to be limited. As above, we expect use of LLAs to be rare.

10.3 An Impact Assessment has not been prepared for this instrument as we expect the impact on business or voluntary sector to be minimal. Where LLAs already exist in the companies sector, businesses will already be required to comply with relevant requirements under the Companies Act 2006, which this instrument replicates.

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 Act which is available from the following weblink http://www.parliament.uk/documents/impact-assessments/IA13-11A.pdf. 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

The aim of the instrument is to ensure that the use of LLAs is fair, reasonable and transparent. Government does not intend to monitor local use of LLAs.

13. Contact

Luke Scofield at the Department of Communities and Local Government Tel: 0303 444 2562 or email: luke.scofield@communities.gsi.gov.uk can answer any queries regarding the instrument.