



Isle of Man
Government

Reiltys Ellan Vannin



The Treasury Proposals for Local Government Audit & Financial Reporting Requirements

Consultation Response

February 2014

Introduction by Mr Alex Downie OBE MLC,

Chair of the Treasury Audit (Consultative) Committee

Under the current regulatory framework there are currently over 50 Local Government bodies within the sector that are required to prepare their financial statements, and then be subsequently audited, in accordance with the Audit Act 2006.

Whilst in the past there has been concern over the financial compliance across the Local Government sector, the sector has to be congratulated on the significant compliance improvements that have been achieved over the past few years and, per the forthcoming Local Government accounts report being submitted to Tynwald, 90% of the bodies within the sector are now fully up to date with their accounts and audit requirements.

Over the past couple of years the Committee has received several complaints from the sector about the financial regulatory burden placed upon it and in particular in relation to audit requirements. With the high level of financial compliance now being achieved across the sector the timing would now seem appropriate to consider implementing a more proportionate and cost effective approach to the accounting and assurance framework applicable to the sector and this led to this consultation on Treasury's proposals for change.

Whilst the primary route for feedback on the proposals was the consultation response forms summarised in this report, we also held two specific consultation meetings in order to allow a more dynamic forum in which to try to better understand any specific issues and to clarify some of the rationale behind our proposals. These meetings were held with:

- BDO (Isle of Man) – the existing auditors for all of the Local Government sector; and
- The Local Government Bodies themselves (and their financial advisors).

I have very much appreciated the constructive response & dialogue that we have had from all parties in progressing these proposals and as chair of the Treasury Audit (Consultative) Committee I would like to take this opportunity to thank all of those who have contributed to this consultation.

Alex Downie OBE MLC
February 2014

1. Background

1.1.1 In relation to the Local Government sector, there are 52 individual bodies that are required to be audited in accordance with the Act due to the following statutory provisions:

Type of Body	Relevant Provision in the Act	No.
Local Authorities	Section 1(1)(c)	24
Housing Committees	Section 1(1)(d)	5
Civic Amenity Related	Section 1(1)(d)	3
Swimming Pool Boards	Section 1(1)(d)	3
Burial Ground Authorities	Section 1(1)(i)	17
Total		52*

* Does not include IOM Local Government Superannuation Scheme.

1.2 Reason for these proposals

1.2.1 The Local Government sector continues to raise issues in relation to the proportionality of the requirements placed upon it by the Act and in particular whether those requirements represent value for money for ratepayers.

1.2.2 The total basic statutory audit cost to the sector is currently in the region of £214,000 per annum.

1.2.3 Following a preliminary review of the issue, Treasury is in agreement with the principle that the current financial regulatory requirements placed upon the sector are not proportionate to the level of risk across the sector.

1.2.4 Having considered the matter further, Treasury made several proposals to amend the audit and financial reporting requirements applicable to the sector and undertook a consultation exercise starting in December 2013 in order:

- To inform Local Government bodies and other interested stakeholders of the proposed introduction of new regulatory measures for the sector.
- To seek the views of all stakeholders and request feedback on the proposals.

2. Methodology

2.1.1 Whilst the consultation was fully open to the general public via the Government consultation website it was decided to specifically target the known key stakeholders:

- The Local Government Bodies directly impacted.
- The current Local Government auditors.
- Those Government Departments known to have a degree of oversight responsibility for elements of the sector.

2.1.2 The primary response method for the consultation has been the consultation response form issued along with the consultation document. The consultation questions were 'closed' i.e. yes/no questions however provision was also made for general comments in relation to each of the key proposals.

2.1.3 On a few occasions responses were received in general letter/email format. In these cases the responses have not been included within the 'yes/no' question analysis below, however the relevant comments contained within them have been considered as a part of the 'issues raised' review as if they had been comments made within the response form.

2.1.4 Whilst all comments made have been reviewed and considered it is not possible to respond to each on an individual basis. However, key themes have been identified and responded to within this report.

2.1.5 Whilst the primary route for feedback on the proposals was the consultation response forms summarised in this report, we also held two specific consultation meetings in order to allow a more dynamic forum in which to try to better understand any specific issues and to clarify some of the rationale behind our proposals. These meetings were held with:

- BDO (Isle of Man) – the existing auditors for all of the Local Government sector; and
- The Local Government Bodies themselves (and their financial advisors).

The key issues raised within these meetings were also reflected within the written consultation responses however the discussions around these issues has helped inform Treasury's response to the issues raised.

3. Overview

3.1.1 Overall 40 written responses were received to the consultation.

3.1.2 Approximately 65% of the Local Government bodies invited to respond to the consultation submitted a written response.

3.1.3 In addition, other written responses included:

- The current public auditors;
- Accountancy firms who provide professional accounts preparation services to various bodies within the sector;
- Government Departments having oversight responsibility for specific parts of the sector.

3.1.4 Overall the response to the proposal has been very positive with only one question receiving an overall negative response (this was Question 2(vi) in relation to whether additional risk factors should be considered to trigger assurance levels). In reality this was also effectively a positive response as the proposal as it stands does not include additional risk factors and the question was seeking feedback on whether this was the correct approach to adopt.

4. Analysis of Consultation Responses

4.1 Question 1: Burial Ground Authorities

4.1.1 Summary of Proposal

Treasury is of the opinion that Burial Ground Authorities should be subject to the same Treasury powers to make subordinate legislation in relation to audit exemption.

4.1.2 Consultation Question

Question 1: Burial Ground Authorities

Do you agree that Burial Ground Authorities should be subject to the same Treasury powers in relation to audit as other Local Government bodies?

4.1.3 Response Form Analysis

Yes	No	Don't Know
86%	6%	8%

4.1.4 Treasury Response to Key Issues Raised

Summary of Issue	Treasury Response
There were two negative responses to this question, both from Burial Ground Authorities. The relating comments both make a preference for a proportionate approach based upon size of the organisation to ensure best value.	There may have been a misunderstanding in the question as a similarly proportionate approach to that proposed for other Local Government bodies cannot be adopted without an amendment to Treasury powers. Treasury intends to progress as originally proposed.

4.2 Proposed Regulatory Framework: Audit

4.2.1 Summary of Proposal

The Treasury, having noted the high level of financial compliance now being achieved across the sector, now considers that the existing 'one size fits all' approach is no longer appropriate and so is proposing a revised and more proportionate 3 tier framework to audit/inspection, based upon turnover:

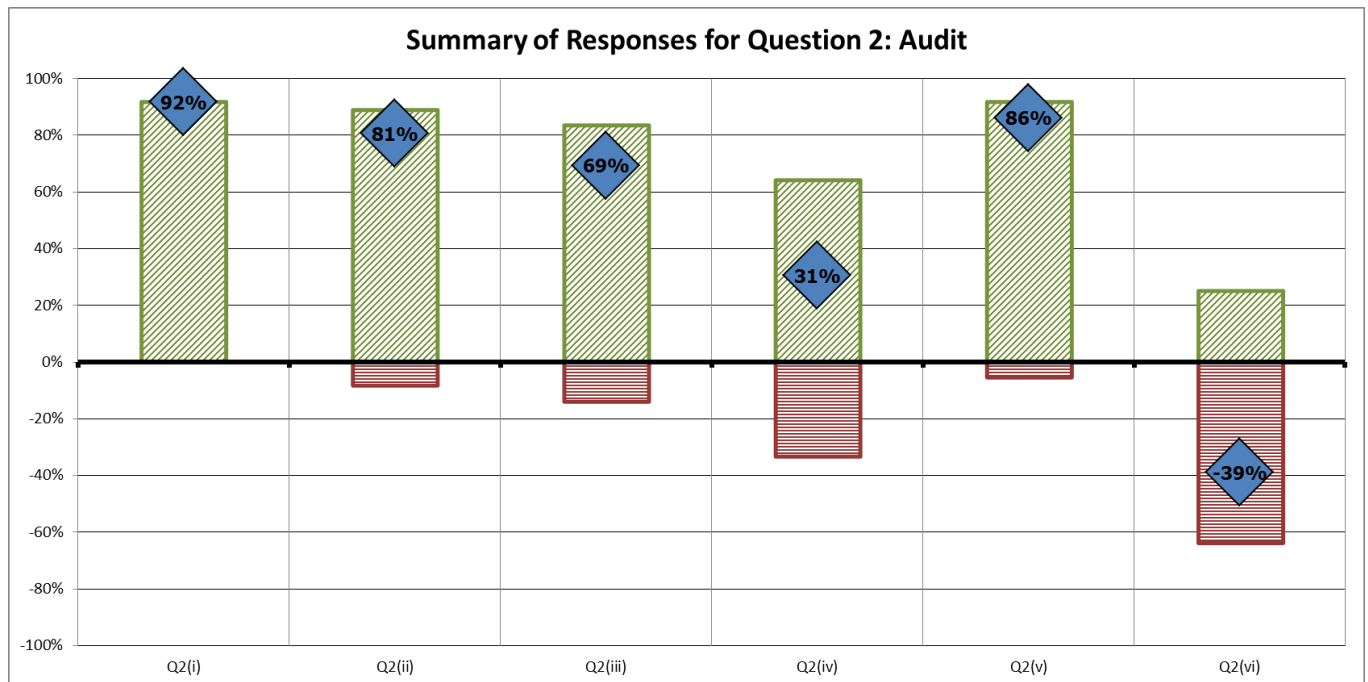
Turnover Threshold	Independent Audit/Examination Requirement
Up to £100k	Qualified Independent Examination.
Between £100k to £1m	Assurance Review by a regulated auditor.
Over £1m	Full Statutory Audit.

4.2.2 Consultation Question

Question 2 Audit:

- (i) Do you agree that the existing audit framework (i.e. 'one size fits all') is disproportionate and an alternative framework should be implemented?
- (ii) Do you agree that a 3 tier approach to audit/examination is appropriate?
- (iii) Do you agree with the level of audit/examination proposed for each level?
- (iv) Do you agree with the proposed thresholds for each level?
- (v) Do you agree that 'turnover' is the most appropriate financial risk factor to be used to determine the level of independent scrutiny of the financial statements?
- (vi) Do you think that other risk factors should also be used (in addition to turnover) to determine the level of independent scrutiny of the financial statements?

4.2.3 Response Form Analysis



4.2.4 Treasury Response to Key Issues Raised

Summary of Issue	Treasury Response
<p><u>Audit Exemption</u> A similar audit exemption approach as that implemented for local Charities should be adopted i.e. for those bodies with turnover <£25,000.</p>	<p>We consider that there is a key difference in principle between the charity sector and the Local Government sector in that, unlike charitable funding, the payment of rates is not voluntary. Treasury intends to progress as originally proposed.</p>
<p><u>Thresholds</u> Various alternative thresholds were suggested (both higher and lower).</p>	<p>In formulating the proposal Treasury developed a basic assurance risk model to assist in assessing the impact of various potential thresholds. The £100k threshold is still considered to best balance the overall financial risk, the no. of entities at risk and the estimated assurance costs. Treasury intends to progress as originally proposed. However the impact of financial thresholds will be regularly monitored for appropriateness.</p>

Summary of Issue	Treasury Response
<p><u>Additional Assurance Segments</u> It was suggested that by some respondents that the proposed middle band is too large and should be segmented further to more proportionately manage the risks.</p>	<p>Whilst we understand this issue we also think it is important to keep the assurance framework as simple as possible. In particular it is difficult to create and regulate additional assurance 'products'. It may be appropriate to consider alternative risk triggers for the proposed assurance levels to ensure a better fit (however see issue below in relation to other risk factors). In addition, and in agreement to other issues raised (see below) Treasury considers that Internal Audit forms a part of the overall assurance framework for the sector and effectively provides a mechanism for an additional assurance tier.</p> <p>Treasury intends to progress as originally proposed.</p>
<p><u>Internal Audit</u> Whilst not a specific question within the consultation several respondents suggested that the threshold for the requirement for Internal Audit should also be considered within the overall assurance framework.</p>	<p>We agree that the assurances gained and consequent costs from Internal Audit should be considered as an integral part of the overall assurance framework applicable to the sector. However it was interesting to note that some responses considered that relaxing the level external assurance placed more reliance on internal audit, whilst others considered the opposite.</p> <p>Treasury proposes to review the Internal Audit threshold applicable to Local Authorities.</p>
<p><u>Additional Risk Factors to be considered</u> Q2(vi) overall negative response.</p>	<p>As commented earlier, the overall negative response is effectively support for the framework as proposed.</p> <p>Treasury intends to progress as originally proposed.</p>

4.3 Clarification of Treasury Powers in relation to Audits

4.3.1 Summary of Proposal

Treasury is of the opinion that its subordinate powers under the Act should be clarified to enable the adoption of alternative assurance regimes to audit to be more simply & explicitly implemented.

Treasury is also of the opinion that it is essential that a power should exist to enable it to direct any 'relevant bodies' to be audited by professional auditors if the need arises.

4.3.2 Consultation Question

Question 3: Treasury Powers

Do you agree that Treasury's subordinate powers be amended as proposed?

4.3.3 Response Form Analysis

Yes	No	Don't Know
100%	0%	0%

4.3.4 Treasury Response to Key Issues Raised

Treasury intends to progress as originally proposed.

4.4 Proposed Regulatory Framework: Financial Reporting

4.4.1 Summary of Proposal

Having considered various alternative approaches Treasury proposes to implement a 3 tier framework to financial reporting requirements linked to the proposed audit examination thresholds:

Turnover Threshold	Financial Reporting Requirement
Up to £100k	Receipts & Payments Accounts (cash accounting) based upon a fixed template. (Income & Expenditure accounting as an option.)
Between £100k to £1m	Basic Income & Expenditure accruals accounting based upon a fixed template (with the option for full FRSSE based Income & Expenditure accounting).
Over £1m	Full Income & Expenditure accruals accounting based upon the FRC Financial Reporting Standard for Smaller Entities (FRSSE).

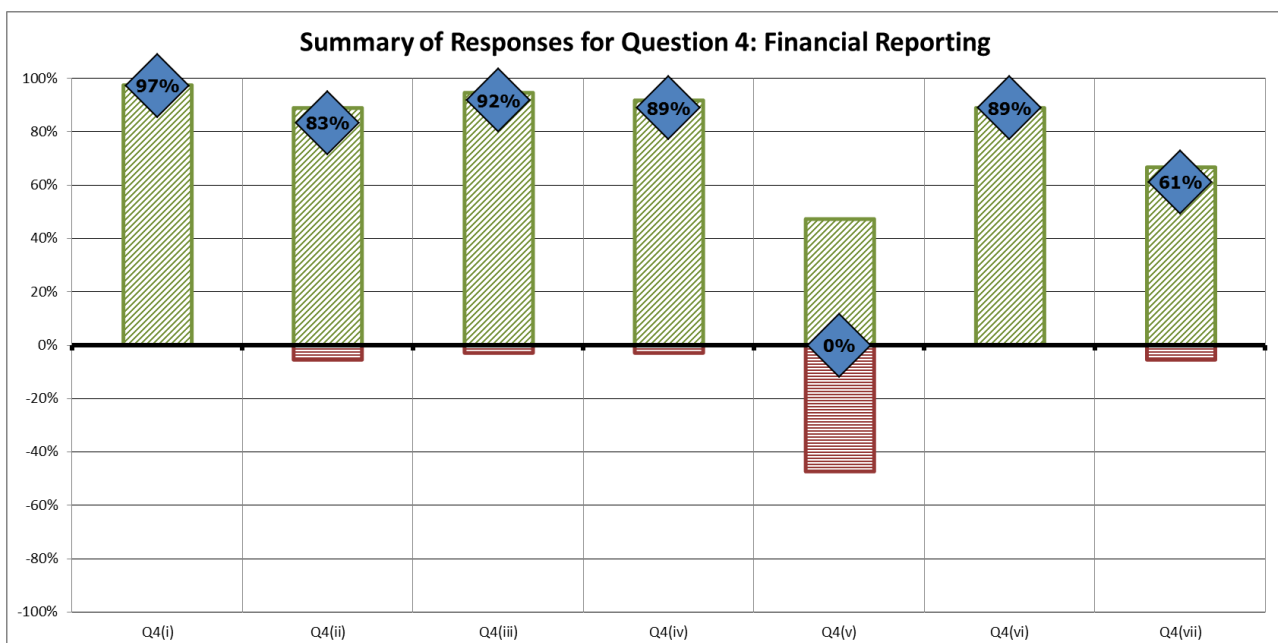
4.4.2 Consultation Question

Question 4 – Financial Reporting

Do you agree that:

- (i) The existing 2 tier financial reporting audit framework is disproportionate and an alternative framework should be implemented?
- (ii) It would be more appropriate to adopt a 3 tier approach to financial reporting?
- (iii) The financial reporting levels should be linked to those proposed for audit/examination?
- (iv) Introducing fixed templates for smaller entities will assist transparency and comparability for users?
- (v) Cash accounting should be introduced for the smallest bodies?
- (vi) The current 2007 IOM SORP needs review and updating?
- (vii) The FRC FRSSE would be a more appropriate standard than the CIPFA SORP on which to base any revised IOM Treasury issued 'proper practices'?

4.4.3 Response Form Analysis



4.4.4 Treasury Response to Key Issues Raised

Summary of Issue	Treasury Response
<p><u>Cash Accounting</u> Cash accounting – as can be seen there was a divided view on the issue of introducing cash accounting, in particular it being seen a retrograde step in financial transparency now that the majority of bodies were producing accruals accounts. However it was also noted that there were some issues from accruals accounting for Burial Ground Authorities arising from the difference in their year-end date.</p>	<p>Treasury does not now intend to introduce cash accounting as proposed. However consideration will be given to the issuing of appropriate guidelines for the treatment of certain items to ensure clarity and consistency of approach in the adoption of accruals based accounting.</p>
<p><u>Financial Templates</u> Whilst the use of alternative risk factors was not generally supported for the assurance framework, it is apparent from comments received that consideration should be given to additional factors other than 'turnover' to appropriately accommodate the different complications for financial reporting. e.g. different requirements for Burial Ground Authorities; Housing , Pension and rates reporting requirements.</p>	<p>Whilst Treasury still intends to progress a two template approach for small & medium sized bodies it now considers it more appropriate to progress:</p> <ul style="list-style-type: none"> • A Burial Ground Authorities accruals template. • A small – medium Local Government accruals template, with supplementary reporting requirements for housing, pensions etc. when required.
<p><u>The SORP</u> Whilst there was majority agreement that the current SORP is over burdensome it was apparent that respondents would like further information in order to give appropriate consideration to its replacement.</p>	<p>Accepted. We have already commissioned a detailed impact analysis for a move from Isle of Man SORP to a FRSE based approach. We would propose circulating this to the potentially affected local government bodies.</p> <p>Treasury intends to consult further with impacted Local Government bodies prior to progressing a replacement for the existing IOM SORP.</p>

4.5 Auditor Appointment

4.5.1 Summary of Proposal

Having considered various alternative approaches Treasury proposes that the auditor/examiner contracts be fulfilled as follows:

Audit/ Examination Type	Estimate of Number of Bodies Affected	Fulfilled By
Qualified Independent Examination	23	Individual bodies to be able to appoint their own examiners subject to their having certain qualifications and meeting key independence criteria. Examination Fee payable to be on a scale fixed by the Treasury. Examiners to be subject to oversight by the Treasury appointed auditors.
Assurance Review	22	To be undertaken by the Treasury appointed auditors.
Statutory Audit	7	To be appointed by the Treasury (as per existing provision).

It is proposed therefore that the aim of the forthcoming Local Government Audit Contract tender shall be to appoint a single auditor for undertaking both Statutory Audits and Assurance Reviews across the sector.

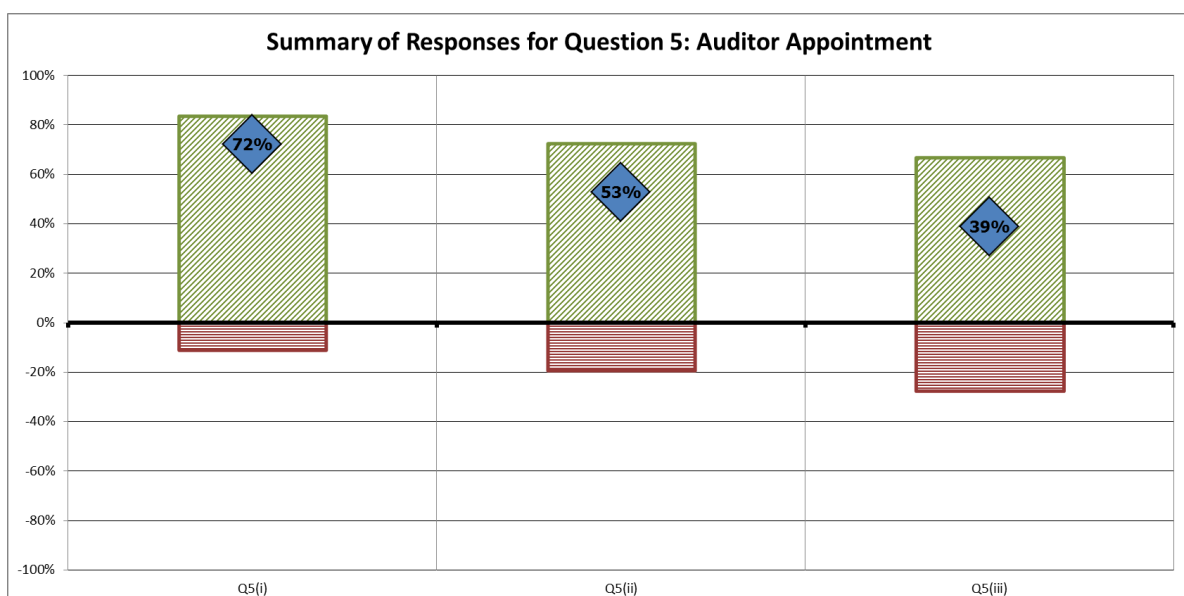
4.5.2 Consultation Question

Question 5 – Auditor/Examiner Appointment

Do you agree that:

- (i) The smallest bodies should be permitted to appoint their own Independent Examiners?
- (ii) Independent Examination fees should be fixed by the Treasury?
- (iii) A single point of contact should be maintained for medium & large Local Government bodies? i.e. a single Treasury appointed auditor should undertake all Assurance Reviews and Audits.

4.5.3 Response Form Analysis



4.5.4 Treasury Response to Key Issues Raised

Summary of Issue	Treasury Response
<p><u>Independent Examiner Appointment</u> There was majority support for the smallest bodies to be able to appoint their own independent examiners however there was also a common feeling that this should be from a central list of approved examiners maintained by the Treasury.</p>	<p>Agreed. Treasury will consider the most appropriate mechanism by which to implement.</p>
<p><u>Independent Examiner's Fees</u> Concern was raised that introducing a mandatory fee would prevent the appointment of Honorary examiners as this is a key restriction imposed by the relevant professional accountancy bodies. Conversely some responses were concerned that if the fee were set too low then it would become difficult for bodies to find suitable persons to accept the appointment.</p>	<p>Agreed. Whilst it was our initial view that a fee would raise both the professionalism and credibility of the examination Treasury will consider the most appropriate mechanism by which to set a viable <i>maximum</i> fee only.</p>
<p><u>Auditor/Assurance Reviewer Appointment</u> Whilst there was overall support for the central appointment of a single auditor for the conduct of statutory audits and assurance reviews, some respondents felt that more flexibility would be beneficial for the bodies affected.</p>	<p>Whilst we have noted some bodies' preference to appoint their own auditors we still think that it is important to maintain a single point of contact for both consistency of approach and to cost-effectively monitor compliance across the sector. In addition we consider that there is an important governance principle in maintaining a separation between those appointing the auditors and those being audited.</p> <p>Treasury intends to progress as originally proposed. However we will ensure that there is appropriate Local Government representation on the appointment panel for Local Government auditors.</p>



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