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Email



Dear Shazia

Regulation of Auditors of Local Bodies

Thank you for the opportunity to comment on the FRC's plans to expand the routes to becoming a Key Audit Partner (KAP). PSAA is strongly supportive of measures that are designed to facilitate an increase in the number of KAPs whilst preserving the need for knowledge and understanding of local audit and its unique features.

Q1. Do you agree with the overall approach at para 4.1 above that the RSB's requirements for approving KAPs need to be rigorous but avoid being overly complicated or restrictive on allowing access to the local audit market?

We agree that rigour is an important part of the process. We consider that it should not be limited to the point at which KAPs are approved, but should also apply on an ongoing basis, so that at any point the list should represent active qualified practitioners who have recent experience.

At the time of writing the Local Audit register maintained by ICAEW lists 102 KAPs. This number is worryingly low given the volume of local audits that need to be completed and the complexities involved. However, close examination reveals that a concerning number of individuals on the KAP list are in reality unavailable to carry out local audit work, for example due to moving to consultancy/internal audit in the separation process, and in further cases have not carried out external local audit roles for some considerable time. We are not suggesting that their registration should be automatically removed if they remain employed with a registered firm in a different role, but we do think that it is important to address that their presence on the list results in it painting an inaccurate and potentially misleading picture of KAP capacity. One solution would be to create a supplementary list for those that are KAP qualified but who are not currently available to practice.

We suggest that the FRC and the ICAEW carry out a thorough review of the current KAP register in liaison with the registered firms. The common aim would be to ensure that anyone not actively available to carry out local audit is identified in order to establish the actual position of how many active KAPs there are at present. An immediate and important step should be that the names of people who no longer work for the firm and so are no longer eligible should be removed altogether. This should not be confused with or contradict the need to have a smooth process in place to ensure that KAPs who move from one registered firm to another are able to maintain their KAP status without disruption wherever possible. This initial review needs to be followed by an assessment of how the KAP list should be maintained with a view to ensuring that it provides an accurate and up-to-date picture of the number of KAPs that are active or available in practice to deliver local audits.

We welcome the flexibility that a precise relevant experience requirement (to have obtained experience at a minimum of 10 engagements) can be waived in exceptional circumstances. The large variation in size and nature of local audits (even within bodies of the same type) will mean that considerably more experience can be gained from some audits compared to others.

Q2. Do you agree that an experienced RI should have had a minimum of five years' experience in the role of RI? If not, what level of experience do you think is appropriate?

Whilst five years' experience may be a helpful indicator, it is a rather blunt criterion as an absolute assessment, and one that is not necessarily to the benefit of the local audit sector. The suitability of a prospective KAP is not automatically best indicated by 'time served'. What is important is the capability of the individual to fulfil the role expected, including the '*attainment of specialised local audit training at an appropriate level*' and followed by reviews of work completed. The key is that a qualified RI has demonstrated they have met that required standard for delivering local audit. We think that this is in line with the flexibility of the approach described within question 1, which recognises that the qualitative assessment based on the type and volume of experience is more important than quantitative measurements that can be met entirely at low risk audits.

Q3. Do you support the proposal, set out at para 4.2 above, that experienced RIs should complete approved training to bridge the knowledge gap they may have from not holding a local audit qualification before they may apply for KAP status?

We agree that RIs following Route 2 to KAP status should complete approved training. We note from Annex A that there is reference to training being provided in-house or externally. We think a flexible approach is appropriate (on the assumption that any in-house training would need to be suitably accredited). However, the relatively small numbers of firms and individuals involved mean that having a viable external training option is vital. DLUHC stated in its December 2021 paper '*Measures to improve local audit delays*' that

'CIPFA is progressing development of the new local audit training Diploma in local government financial reporting and management aimed at senior auditors and other levels of auditor. It will be designed to meet the technical training needs of experienced RIs, who have not met the full existing criteria for local audit experience. It will also meet the immediate recommendations from the Redmond Review, and in particular, support firms who may bid in the next opt-in procurement for local audit contracts managed by PSAA, given the desire to attract new entrants to the market who do not currently hold local audit contracts.'

We are aware that the design of the Diploma is at an advanced stage and has been subject to detailed scrutiny and debate. PSAA strongly believes that it is vital to translate this initiative into a tangible offer in a timely manner for the reasons set out above. The same applies to the prospect of a technical advisory service that is referenced in the same document as it would provide new KAPs with an important reference framework regardless of which firm they work for.

Q4. Do you support the proposal at para 4.2 above, that there should be a specific requirement on an RSB to place an obligation on experienced RIs to have a minimum of their first two local audits hot file reviewed? Should these hot file reviews be undertaken by an independent third party or is it acceptable for the hot file reviews to be undertaken internally by their own firm? Should there be a subsequent requirement for cold file reviews?

Regardless of the KAP route and past experience/knowledge we would expect that all new KAPs would be subject to appropriate in-house review processes focusing on their first round of reviews. The processes for conducting and moderating these reviews will be subject to further regulatory oversight to ensure that they are appropriate.

In theory an additional layer of independent third party review would provide additional assurance. However, the reason for this consultation is the shortage of experienced senior local auditors, the very people who would be likely to be called upon to undertake these reviews.

We consider that it would be reasonable to have a requirement that the firm arranges for a hot review a new KAP's first two local audits, followed by cold file reviews proportionate to risk as determined by the firm. It should be made clear that the hot review sample size of two is a minimum and the sample size should be proportionate to risk. We note that the Registration Committee may impose further conditions such as requiring '*regular engagement quality control reviews*' on individuals which is covered in Q5.

We also consider that it is important that there is a clear publicly stated expectation from the regulator that the required reviews would be followed up with structured support to assist new KAPs to overcome any identified shortcomings. This would help to emphasise to prospective KAPs that the system as a whole is taking a constructive and encouraging approach to developing capacity in this important area.

Q5. Do you support the proposal at para 4.2 above, that there should be a specific requirement on an RSB to place an obligation on experienced RIs to be subject to regular engagement quality control reviews undertaken as part of the firm's engagement management procedures for the duration of the period of the hot and cold file reviews?

We agree that the RSB should consider imposing (rather than an automatic imposition) a requirement for engagement quality control reviews for a new KAP for a set period or for particular types of body if they form part of that KAP's portfolio. As a general rule our observation would be that the new KAP's audits are subject to hot and cold file reviews because of the KAP's status, whereas an engagement quality review would normally occur because of the nature of the engagements that they oversee. In a second and subsequent years an engagement quality review may be required as part of an individual improvement plan, but again that would be on a case-by-case basis.

Q6. Do you support the proposal at para 4.3 above, that there should be a new tier of KAP which is restricted in the type of work for which responsibility may be taken?

We agree that the statutory distinction between the auditor qualification requirements for NHS Foundation Trusts and other NHS Trusts is difficult to reconcile when considering the respective organisations' and auditors' responsibilities side-by-side. The update of the Local Audit and Accountability Act necessary to provide ARGAs with its statutory local audit role offers an opportunity to address this anomaly, whilst also considering the reasons for policy decisions that were designed to provide Foundation Trusts with greater freedom from central control.

We are aware that there are significant challenges in the NHS audit market and consider that introducing the Route 3 does have some merit, as for example it would enable RIs with evidence of experience of Foundation Trusts to carry out the audits of other NHS entities under the LAAA 2014. We note that *'It is not intended as a replacement for other routes to KAP status, but a method for allowing those with the necessary skills and competence to undertake work which reduces the burden on existing KAPs'*.

However, as part of a wider solution to the current crisis within local audit we feel that benefits of opening this route need to be assessed against the risk that it may signal further fragmentation between the local government and health sectors which would be unhelpful and contrary to the expected direction of travel. If local audit is to be an attractive proposition for firms, then the two sectors need to be joined up as much as possible.

Footnote 8 says that the training will *'concentrate solely on those elements of audit work which are required for the audit of NHS entities under the Local Audit and Accountability Act 2014 but are not a requirement for corporate audit. The training will be a subset of the approved training required for Route 2'*. These elements will presumably include:

- the public sector environment and how that impacts NHS audits

- format of the accounts and the financial reporting framework across the NHS;
- the NAO Code of Audit Practice and the application of auditing standards via Practice Note 10;
- reporting value for money arrangements;
- exercise of statutory powers (eg recommendations to the audited body under s24 and sch7 of the LAAA 2014); and
- the NHS legal, regulatory (including of audit) framework.

Footnote 8 also recognises that the training would be a subset of the forthcoming Diploma or in-house material. However, we think that last sentence of the footnote could be clearer in relation to the situation where a route 3 KAP seeks to obtain unrestricted KAP status. In that case it is essential that the additional elements of the route 2 training are required to be completed (ie those that are local government specific).

Q7. Is the type of work which is currently accepted as providing relevant local audit experience too narrow in scope? If so, are there other types of work which challenge a potential KAP and provide the same level of experience of risk and complexity which are not currently accepted as providing relevant local audit experience?

Our understanding is that at present audit experience in not for profit sectors that are outside of the local audit environment such as Higher and Further Education or housing is not counted as relevant. The opening up of new routes will be helpful for experienced RIs who specialise in these areas, as it would ensure that they receive appropriate training to build on their existing knowledge. Route 1 would remain for those who have built up sufficient directly applicable experience, and this seems to be a sensible balance.

An important additional aspect to consider for route 2 would be those who have qualified abroad and who have considerable public sector experience. At present they may face having to complete private sector work in the UK in order to enable them to become an RI, and only then are they able to pursue becoming a KAP. This is a very significant disincentive that may mean an individual with all of the experience needed may decide not to become a KAP. Opening up route 2 to those that have suitable experience in non-UK environments should be worked through in conjunction with registered firms, subject to consideration on a case-by-case basis.

Q8. Do you have any additional suggestions of how the level of competence and experience required for the approval of KAPs might be addressed.

We have no further comments on the proposals, but we stress the importance of finalising the new routes as soon as possible and in good time for our procurement. In line with DLUHC's measures paper referenced in question 3, firms need to know what is happening as soon as possible in order that they can build their bids. The deadline for them to submit their bids is 11 July, which is driven by the statutory requirement on us to make audit appointments by 31

December following consultation with all winning firms and the 470 bodies that have opted in to our scheme.

Yours sincerely

A solid black rectangular box used to redact the signature of Tony Crawley.

Tony Crawley
Chief Executive