

May 2015

Feedback Statement

Regulation of Auditors of Local Bodies

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1 Introduction

1.1 In July 2014 the Financial Reporting Council (FRC) issued a consultation paper <https://www.frc.org.uk/Our-Work/Publications/Professional-Oversight/Consultation-Document-Regulation-of-Auditors-of-Lo.pdf> seeking views on the way in which it should give effect to three specific responsibilities delegated to it under the Local Audit and Accountability Act 2014. These are to

- make regulations on the reports, known as transparency reports, which the 2014 Act requires auditors of major local bodies to publish each year;
- make regulations about the keeping of the Register of Local auditors;
- give statutory guidance to the body or bodies recognised to supervise auditors of local bodies on the level of competence and experience required for the approval of those individuals within an audit firm that take responsibility for a local audit and sign an audit opinion on behalf of the firm.

1.2 There is more information on the background to each topic and to the FRC's approach in the consultation paper.

2 Responses to the consultation

2.1 The consultation period closed on 17 October 2014. Eighteen responses were received from:

- Audit firms – 7
- Professional/representative bodies – 6
- Public Sector bodies – 4
- Others – 1

2.2 A list of respondents is given in the Appendix. Copies of the responses are available on the FRC's website other than where the respondent asked it to remain confidential.

2.3 Overall consultees were supportive of the proposals, though we will make some detailed changes in the light of a number of the comments and suggestions made.

2.4 A summary of the main points made on each question, and the FRC's response is given below.

2.5 In our consultation, we used the terms "local public auditor", "local public audit" and "engagement lead" which we believed to be more readily understood than "local auditor", "local audit" and "key audit partner" which are the terms used in the 2014 Act. However, respondents have told us that they have found this to be confusing and we will therefore use the same terminology as in the Act.

2.6 We also note that the EU Audit Regulation, which applies to auditors of private sector public interest entities, from June 2016, makes a number of changes to the detailed requirements for transparency reports by those auditors. The FRC will need to consult during 2015 on changes needed to ensure that the existing regulations on transparency reporting reflect the amended requirements. We would expect to consult at the same time on the extent to which the regulations for local audit transparency reporting should reflect changes made in respect of private sector audits.

FRC Regulations: Transparency Reports by Auditors of Major Local Bodies

Q1 Do you agree that the requirement to publish transparency reports should be restricted to auditors of “major local audits”

2.7 Most consultees supported this approach. However:

- One suggested that the requirement should apply to “principal authorities” (as currently used by the Audit Commission), “as “major local audit” would exclude audits of some district councils, fire authorities, police and health authorities.
- On the other hand, one expressed a concern that the (statutory) definition of “major local audit” included some local bodies that did not have a high public profile or national significance, such as many of the NHS Clinical Commissioning Groups, and that their inclusion could dilute the relevance of some transparency reports.

FRC Response

2.8 We do not propose to change from setting the requirement in relation to auditors of “major local audits”. This aligns the obligation to prepare a transparency report with the scope of inspections by the FRC. “Principal authority” is the term used by the Audit Commission to cover certain types of local bodies, including for example all District Councils and all Clinical Commissioning Groups, and is not a term defined in legislation. It includes significantly more local bodies than “major local audit”, which is defined in legislation and includes a size threshold, though we consider it unlikely that the use of either term will affect significantly the number of audit firms who have to prepare a local audit transparency report.

Q2 Do you agree that a firm that audits both major local bodies and private sector public interest entities should be able to publish a single transparency report (4.4.2)?

2.9 This was strongly supported.

FRC Response

2.10 We shall proceed as proposed.

Q3 Do you agree that (i) the information requirements and (ii) the requirements for publication should follow as closely as possible the existing requirements for auditors of private sector public interest entities (paragraph 4.4.3)?

2.11 There was strong support for this proposal. However, several respondents highlighted differences between auditing local audit clients and auditing private sector clients, for example the scope of a firm’s internal controls, or the application of independence requirements, and emphasised that it was important that the two were appropriately differentiated in a single transparency report.

FRC Response

2.12 We will proceed as proposed in our consultation document. However, we agree that it is important that if a firm produces a single transparency report to cover both private sector and

public sector audits, that the report should include all relevant information in relation to each type of audit and that it is separately identifiable. A relevant audit firm will have to meet the separate (albeit similar) requirements of both the Local Auditors (Transparency) Instrument and the (existing) Statutory Auditors (Transparency) Instrument. We propose therefore to emphasise in guidance that the transparency reporting audit firm must make clear what refers to public sector audits, what to private sector audits and what to both; and in particular that the disclosures for local audit and statutory audit in response to similar requirements may differ. For example, the local auditor's independence processes and systems need to recognise that issues may pose a threat to independence in relation to local audit even if the same issues would not pose an independence threat in relation to audits of private sector public interest entities.

Q4 Are there additional information requirements relating to local audit that we should include as statutory requirements for transparency reports?

2.13 Most respondents did not suggest additional requirements. However,

- The Department of Health suggested that there should be a specific requirement on the relevant audit firms to confirm that relevant partners and staff were suitably trained and up to date in relation to local audit work; that it should be clarified that the requirement to describe the internal quality control arrangements was specific to local audit; and that the FRC might consider requiring the disclosure of all local audit appointments.
- The Audit Commission also suggested that transparency reports should cover the firm's arrangements to ensure that those responsible for leading a local audit are competent to undertake that work.

FRC Response

2.14 We shall make minor changes to the requirements to take account of these specific points.

Q5 Do you have specific comments on the draft regulations at Annex A?

2.15 There are no substantive points not discussed under other questions.

FRC Regulations: Local Audit Register

Q6 Do you agree that the requirements for the Register of Local Auditors should match as closely as possible the existing FRC requirements for the Register of Statutory Auditors?

Q7 Do you have specific comments on the draft regulations?

2.16 There was broad support for the proposal that the Regulations match closely the requirements for the Register of Statutory Auditors. Three respondents (1 firm and 2 professional bodies) questioned the need to maintain separate registers for Local Auditors and

for Statutory Auditors, and considered that the Register for Statutory Auditors under the Companies Act could be adapted to show whether a firm's registration and the individuals able to sign audit reports on behalf of the firm related to local audit or statutory audit or both.

FRC Response

2.17 We consider that it is important to avoid confusion between registration as statutory auditors and as local auditors. The two registers should therefore be separate. However:

- The two Registers should draw information from a common database. We will work with those responsible for the two Registers to help ensure that the Local Audit Register can be set up in a cost effective way.
- The Local Audit Register and the Statutory Audit Register should each show against audit firms and individuals additional registrations for local audit or statutory audit as appropriate.

2.18 We do not consider that there is a need to change the draft Regulations.

FRC Guidance: Approval of Engagement Leads for Local Audit.

Q8 Do you agree with the overall approach that the RSB's requirements for approving Engagement Leads need to be rigorous but avoid being too complicated or overly restrictive on allowing access to the local audit market?

2.19 The responses were supportive of the principles on which the detailed proposals were drafted and recognised that there was a balance to be struck in particular between the need for rigorous requirements for Engagement Leads and avoiding requirements that would make it too difficult for firms to enter or remain in the local audit market and thus restrict or distort competition.

2.20 Several firms and professional bodies, whilst supporting the overall approach, expressed concerns that the requirements would prove too restrictive and could limit the pool of potential Engagement Leads to those firms currently conducting local audits under Audit Commission contracts. In particular the professional bodies argued that the requirements should not go beyond those that apply in relation to statutory audit, which were adequate. One body proposed that approval as a Responsible Individual (for statutory audit) and as an Engagement Lead (for local audit) should be interchangeable.

FRC Response

2.21 We welcome the support for the overall approach. The FRC has produced guidance on the approval of Engagement Leads for local audit which, in some respects, goes beyond the existing practice of RSBs on statutory audit. The requirement for such guidance is a specific provision in the Local Audit and Accountability Act that is not replicated in Part 42 of the Companies Act 2006. Its inclusion reflects in part, as explained in the consultation document, that the statutory requirements for approval to be the engagement lead for local audit are otherwise modest. In particular, under the transitional provisions, members (as at the date of Royal Assent of the 2014 Act) of the professional bodies named in the Audit Commission Act 1998, are deemed to hold a recognised qualification for local audit, regardless of whether or

not they have completed a formal period of practical training either in statutory audit or local audit.

2.22 We consider concerns with specific proposals under Q9.

Q9 Do you support the detailed proposals [set out in paragraphs 4.18 to 4.28 of the consultation document] for the experience and practical training requirements individuals should have to meet for approval?

2.23 There were a number of comments on the detailed proposals. In particular:

- A number of consultees argued that the proposal that the local audit engagement lead should have two years' experience of local audit and similar audit work within the previous five years, and that no more than two years should elapse since that experience was obtained, was too restrictive and would have unintended consequences. In the context of tendering for local audits, which is typically on a three to five year cycle, this requirement could exclude firms that are unsuccessful in a particular tender from being able to participate in the next tender round.
- Several consultees commented that the requirement that the experience was gained in "local audit and similar work in a supervisory role" was too restrictive and should be extended either to include statutory audit work or should at least make it clearer that it includes certain other audit work, for example audits in the education sector, or in the public sector in other parts of the United Kingdom.
- One consultee expressed concern that experience of local audit gained elsewhere in the EEA could count towards the required level of post qualification experience, noting in particular that it would be difficult for the RSB to assess such experience.
- Some consultees expressed the concern that the proposals did not go far enough in recognising some of the specific aspects of local audit, for example public interest reports and hearing of objections.

FRC Response

2.24 We agree that, as drafted, the time limits for gaining the relevant audit experience could adversely affect competition in the local audit market by making it difficult for firms to bid in a tender round where they have been unsuccessful in a previous round. We conclude that the balance of advantage favours a somewhat more flexible requirement which, provided that there are safeguards, allows that experience to have been gained within a longer period.

2.25 We shall retain the requirement but introduce greater flexibility into the statutory guidance, to extend the periods within which relevant local audit experience must be obtained, for example allowing relevant post qualification experience gained within the previous six (as opposed to five) years to count provided that the firm has an appropriate support programme in place for the Engagement Lead (This could include for example CPD relevant to leading local audits, the appointment of a mentor, or a quality review of the Engagement Leads' work after the first year.)

2.26 We shall also clarify the kind of experience that amounts to local audit experience, taking into account the suggestions made. We do not propose, however, to include statutory audit experience.

2.27 It is not practicable to include specific requirements for different types of local public audit; to do so would overcomplicate and make the requirements difficult, if not impossible, for an RSB to apply in practice. There are other ways of trying to ensure that those undertaking a specific local audit have the necessary competence and experience.

2.28 The inclusion of local audit experience gained elsewhere in the EEA is necessary under EU law and do not propose to change that provision.

Q.10 Do you support the proposal that there should be a requirement on an RSB to place a specific obligation on a firm undertaking local audit work to satisfy itself that the Audit Engagement lead has practical auditing experience of the regulatory and reporting requirements relevant to that audit engagement?

2.29 Most consultees supported this proposal. However, several consultees considered that this issue was already addressed through standards and that, if interpreted narrowly, could mean that someone with experience of auditing for example an NHS Foundation Trust would not be able to act as an Engagement Lead for the audit of an NHS Trust.

2.30 The Consultation Document also sought views on the possibility that RSBs should be required to approve Engagement Leads in relation to specific types of local audit engagements. Most consultees agreed with our assessment that this would complicate the arrangements considerably, add to regulatory costs and differentiate the requirements for local audit significantly from what applies to statutory audit and were therefore opposed to the inclusion of such a requirement.

FRC Response

2.31 We consider that it is helpful to underline in the statutory guidance the importance of the Engagement Lead having adequate knowledge and experience of the reporting and regulatory requirements relevant to the local audit engagement, given specific requirements, for example in relation to the arrangements for securing value for money and public interest reporting. We shall therefore proceed as proposed, though shall amend the wording to avoid too narrow an interpretation being placed on it, so that it would read: “The RSB should place a specific obligation on a firm undertaking local audit work to satisfy itself that the Audit Engagement lead has adequate knowledge of the regulatory and reporting requirements relevant to that audit engagement and sufficient relevant practical experience.”

Respondents to the consultation

Firms

BDO

Deloitte

Grant Thornton

KPMG

Mazars

Moore Stephens

PwC

Professional and Representative Bodies

Association of Accounting Technicians (AAT)

Association of Chartered Certified Accountants (ACCA)

Chartered Institute of Public Finance and Accountancy (CIPFA)

Healthcare Financial Management Association (HFMA)

Institute of Chartered Accountants in England and Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

Public Sector Bodies

Audit Commission

Dartford and Gravesham NHS Trust

Department of Health

London Borough of Sutton

Other

Ichabod's Industries Limited



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