



Financial Reporting Council

Regulation of Auditors of Local Bodies

**A Consultation Document
on the Revision of the FRC
Statutory Guidance under
the Local Audit and
Accountability Act 2014 in
response to the Redmond
Review 2019**

February 2022

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1 Summary and issues for consultation

- 1.1 The Local Audit and Accountability Act 2014 (the 2014 Act) introduced new arrangements for regulating auditors of local bodies in England (principally local authorities and health bodies other than Foundation Trusts), that applied after the abolition of the Audit Commission.
- 1.2 The Financial Reporting Council (“FRC”) is an independent regulator, with responsibility for exercising certain statutory functions in relation to local audits, including oversight of the Recognised Supervisory Bodies (“RSBs”) of auditors of local public bodies, monitoring the quality of major local audits and giving statutory guidance to RSBs on the approval of Key Audit Partners.
- 1.3 In June 2019, Sir Tony Redmond was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting under this new regime. His report was published in September 2020 and contained 23 recommendations covering external audit regulation, smaller authorities audit regulation, financial resilience of local authorities and transparency of financial reporting. The Department for Levelling Up, Housing and Communities (DLUHC) is the Government department responsible for local audit and responding to these recommendations. DLUHC has asked the Financial Reporting Council (FRC) to implement two of the recommendations made by Sir Tony.

Recommendation 8: Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

Recommendation 5: All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.

- 1.4 This consultation document deals only with Recommendation 8 which we propose should be dealt with through amendments to the FRC’s existing statutory guidance. Our proposals include requirements for additional training which we propose should be offered through the steps taken to address Recommendation 5.

This consultation

- 1.5 The FRC is consulting on proposed changes to its “Guidance to Recognised Supervisory Bodies on the approval of Key Audit Partners for local audit”.¹ This guidance has a statutory basis under the 2014 Act.²
- 1.6 We will consider amendments to the guidance in the light of the responses to this consultation. We will also publish on our website a response to points raised and the detailed comments received, other than where consultees have requested that their views are not published.
- 1.7 We expect to implement the revised guidance by Spring 2022, and it will be applicable to all KAP applications made to the RSBs from the date of implementation.

Regulatory Impact Assessment (RIA)

- 1.8 A draft provisional Regulatory Impact Assessment is attached at Annex A. In addition therefore to your comments on the principal issues set out in Section 4 below, we would welcome comments on the nature of the costs or benefits for your organisation, or generally, resulting from the proposals in this consultation document.

¹ <https://www.frc.org.uk/getattachment/8fc7ffa2-a609-4e5c-a3f8-5af2f043790d/FRC-Guidance-for-Local-Public-Audit.pdf>

² Local Audit and Accountability Act 2014, Sch 5, para 28; Companies Act 2006, Sch 10, para 7A.

2 How to Reply

2.1 We invite comments by 28 March 2022 at the latest. Earlier responses would be welcome.

Responses should be sent by email if possible to localaudit@frc.org.uk

Alternatively, you should send comments by post to:

Shazia Ahmad

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8th Floor

125 London Wall

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2.2 All responses will be acknowledged. We expect to make responses publicly available on the FRC website (www.frc.org.uk) unless respondents specifically request otherwise. If you send an E-mail response which includes an automatically generated notice stating that the content is to be treated as confidential, you should make it clear in the body of your message whether you wish your comments to be treated as confidential. We will process your personal data in accordance with UK data protection legislation. Please see our privacy policy.³

Queries

2.3 If you have queries about the issues raised in this consultation document, please email Shazia Ahmad at localaudit@frc.org.uk.

³ <https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc>

3 Background

Approval of Individuals as Key Audit Partners

- 3.1 Under the statutory framework,⁴ RSBs must have rules which deal with eligibility for appointment as a local auditor. These rules must provide that a firm is not eligible for appointment as a local auditor unless the individual identified by the firm as being primarily responsible for local audits (the Key Audit Partner (KAP)) has an appropriate level of competence to carry out local audits. The rules must also comply with guidance issued by the FRC.⁵
- 3.2 The FRC's current guidance provides, at paragraph 10, that RSBs' rules "should make clear ... as a minimum" the following entry requirements:
- "a Key Audit Partner must be able to demonstrate the attainment of at least two years post qualification experience of local audit and/or of similar audit work in a supervisory role which includes responsibility for significant judgements in the audit of the historical financial information of local public bodies. All of that experience must have been obtained within the previous six years; and
 - during the two years preceding the application, the individual must have undertaken adequate Continuing Professional Development appropriate to maintaining and developing competence for someone seeking the role of a Key Audit Partner".
- 3.3 The Redmond Review highlighted that the current eligibility criteria for appointment as a local auditor makes it "difficult for new entrants to enter the local authority market" because "audit firms not currently in the market are unable to gain the relative knowledge and expertise that would be required to become a KAP".⁶ The Government Response to the Redmond Review said that the Government would work with the FRC and the ICAEW to review KAP entry requirements.⁷
- 3.4 The FRC is now seeking views on how it might revise its statutory guidance to the RSBs on the level of competence and experience required for the approval of KAPs.
- 3.5 We have approached our proposed revision to the current guidance with three considerations in mind:
- The requirements for approving KAPs need to be rigorous if they are to provide well-founded confidence that KAPs have the necessary skills and experience for the role;
 - There is nevertheless a balance between setting rigorous requirements and requirements that that are practicable, not overly complex or restrictive of access to the market for local audit.
 - There should be no reduction in audit quality as a result of widening access to include individuals with audit experience other than local audit.
- 3.6 When formulating our proposals, we have considered the skills and practical experience which are essential for an effective KAP. We recognise that a Responsible Individual (RI) will exercise many of these skills and have comparable practical experience. Further, we recognise that audits of NHS Trusts, which are governed by the 2014 Act and involve KAPs, are similar in substance to audits of Foundation Trusts, which are governed by the Companies Act 2006 and involve RIs. The skills for auditing these entities are also broadly the same.
- 3.7 We propose that the guidance should be broadened to include two additional routes to KAP status and a third route to a new, more restricted tier of KAP, for the audit of NHS bodies under the 2014 Act.

⁴ See the Companies Act 2006, Sch 10, para 7A, as modified by the Local Audit and Accountability Act 2014, Sch 5, para 28.

⁵ The Secretary of State's functions under this provision have been delegated to the FRC: see SI 2014 No 2009, arts 1(2) and 2(1).

⁶ Redmond Review, para 3.1.1.

⁷ <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-government-response-to-the-redmond-review/local-authority-financial-reporting-and-external-audit-government-response-to-the-independent-review>

4 Proposals for revision of the FRC guidance

- 4.1 **Route 1:** To mirror the requirements in the corporate audit sector for RIs we propose to require a prospective KAP to demonstrate, within the previous two years, the attainment of recent, relevant, and sufficient local audit experience at an appropriately senior level of authority to be competent to conduct local audit work. They should be able to satisfy the Registration Committee of the appropriateness of their recent experience of local audit work. In this context, except in exceptional circumstances, relevant experience must have been gained from a minimum of 10 engagements within the last two years?

For individuals following this route, during the two years preceding the application, the individual must have undertaken adequate Continuing Professional Development appropriate to maintaining and developing competence for someone seeking the role of a KAP.

- 4.2 **Route 2:** We propose to allow certain experienced RIs to become KAPs (since an RI has already reached the equivalent status of KAP for corporate statutory audit). The RI must be able to demonstrate the attainment of specialised local audit training at an appropriate level. An experienced RI is one that has been in that role for a minimum of five years and has spent the majority of his/her time in corporate statutory audit or work similar to corporate or local audit.

For individuals following this route, once the RI has undertaken the pre-approved training and applied to be a KAP, Continuing Professional Development relevant to local audit should commence immediately. Under the proposed amended Guidance, the RSB will require these newly appointed KAPs to be subject to hot file reviews of their first local audits which may be followed by further hot and / or cold file reviews.

The amended Guidance would require RSBs' rules should include requirements on firms to monitor, at least annually, how effectively the firm is complying with the body's rules and take action to address any issues identified. Where experienced RIs are proposed for a KAP role the firm should commit to all conditions imposed by the Registration Committee on the individual and the firm. This may include a requirement to subject an experienced RI 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 / cold file reviews.

- 4.3 **Route 3:** We propose to introduce a new tier of KAP, NHS KAP, which is restricted in the type of work for which responsibility may be taken. This new tier of NHS KAP would be open to all RIs and would allow them to take responsibility for the audits of NHS entities only under the 2014 Act. The RI must be able to demonstrate the attainment of pre-approved specialised NHS audit training or provide evidence of experience of Foundation Trust audits at an appropriate level.

Once RIs following this route have undertaken the pre-approved training for NHS audit work⁸, or provided evidence of experience of Foundation Trust audits, and applied to be an NHS KAP, Continuing Professional Development relevant to NHS audits should commence immediately. The amended Guidance will {allow/require} the RSBs to require these newly appointed NHS KAPs to be subject to hot file reviews of their first local audits which may be followed by further hot and / or cold file reviews.

The amended Guidance would also require RSBs' rules to include requirements on firms to monitor, at least annually, how effectively the firm is complying with the body's rules and take action to address any issues identified. Where RIs are proposed for an NHS KAP role, the firm should commit to all conditions imposed by the Registration Committee on the individual and the firm. This may include a requirement to subject an RI to

⁸ The approved training for Route 3 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 and would not be required to be repeated if an NHS KAP later decides to apply for unrestricted KAP status.

regular engagement quality control reviews undertaken as part of the firm's engagement management procedures for a specified period of time.

Route 3 is intended as a springboard for NHS KAPs to move onto unrestricted KAP status as and when they meet the requirements if they choose to apply. 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.

Questions for consultation:

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?

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?

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?

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?

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?

Q6. 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?

Q7. Do you have any additional suggestions of how the level of competence and experience required for the approval of KAPs might be addressed?

Annex A

Preliminary Impact Assessment

Revision of FRC Guidance on Approval of KAPs for Local Audit

The statutory guidance on the approval of KAPs for local audit does not have an existing parallel for company audit work.

Our proposals for revision of this guidance to enable more individuals to become KAPs in the short term would impose additional costs of compliance for the individuals, the firms and for the RSBs, in particular in respect of:

- the requirement for experienced RIs to undertake pre-approved training to bridge their knowledge gap. If the training is to be provided in-house, there will be a cost of compliance and oversight and if external provided then a cost of attendance and time out of office
- the requirement to have initial audit work hot / cold file reviewed
- the requirement for 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/cold file reviews.

We consider that these requirements are proportionate to the need to ensure that KAPs are likely to have the necessary training, skills and experience to take on that role without a reduction in the quality of local audit work.



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