

# Regulation of Auditors of Local Bodies

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

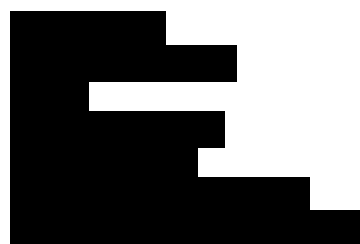
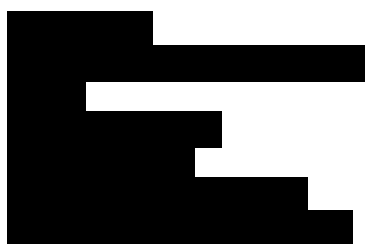
Response from the Chartered Institute of Public Finance and  
Accountancy

March 2022

**CIPFA, the Chartered Institute of Public Finance and Accountancy**, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at [www.cipfa.org](http://www.cipfa.org)

Any questions arising from this submission should be directed to:



CIPFA is pleased to respond to this consultation which proposes new routes to the role of Key Audit Partner (KAP) as a part of the Financial Reporting Council's (FRC's) *Guidance to Recognised Supervisory Bodies on the Approval of Key Audit Partners for Local Audit*.

CIPFA welcomes measures to address the Redmond Recommendation to ensure that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work by providing three new routes to KAP status.

Sir Tony Redmond found that eligibility criteria for appointment as a KAP act as a barrier to entry to new firms entering the local audit market<sup>1</sup> and that the number of KAPs who work for firms that hold contracts with PSAA declined by 13% between 2016 and 2020<sup>2</sup>. Since the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting (Redmond Review) was published, the Public Accounts Committee report on Local Auditor Reporting on Local Government in England found that most key audit partners are over 50 years old and expressed the view that audit firms consider there is a missing generation of auditors with specialist experience of auditing local authorities<sup>3</sup>, indicating that supply of local auditors may further deteriorate in the future. This evidence highlights the clear need for action to ensure the continued supply of suitably qualified local auditors. CIPFA would note that the situation in local audit has been exacerbated with only 9% of audits financial statements for 2020/21 meeting the publication deadline of 30 September 2021.

The Redmond Review highlighted concerns about complex local authority accounting arrangements and the capacity of external audit to "test and validate technically intricate accounting treatment without a familiarity with local authority finance and accounting"<sup>4</sup>. CIPFA was pleased that the Review's findings were that KAPs tend to be knowledgeable, skilled and experienced<sup>5</sup>. However, CIPFA notes the findings of the Redmond Review that the knowledge and expertise of local auditors below KAP level is a cause for concern<sup>6</sup>. This finding is important in the context of establishing routes to a KAP role. CIPFA would therefore emphasise the importance of the guiding considerations set out in paragraph 3.5 of the consultation document, in particular that there should be no reduction in audit quality as a result of widening access to include individuals with audit experience other than local audit.

Our detailed responses to the questions in the consultation paper are below. While CIPFA has supported the proposals generally including as a member of the working group, CIPFA would emphasise that no single measure is likely to resolve the ongoing problems in local audit in England. Additional routes to Key Audit Partnership may be part of the solution but will need to form part of a suite of measures around system leadership, specialist training and attractiveness of the profession for issues around local audit in England to begin to be addressed. CIPFA shares the concern of the Redmond Review that reduced audit fees for local audit relative to corporate audit<sup>7</sup> have harmed the attractiveness of the profession. This creates a risk that the number of auditors with appropriate skills, knowledge and expertise to apply for KAP roles will decline such that the quality of local audit will be adversely affected. CIPFA has been contributing to developments in all of these areas, and will continue to do so to support quality, effectiveness and transparency in public financial management. CIPFA is more than happy to discuss this response with FRC colleagues.

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<sup>1</sup> Redmond Review paragraph 3.1.1

<sup>2</sup> Redmond Review paragraph 3.1.2

<sup>3</sup> <https://committees.parliament.uk/publications/6672/documents/71757/default/>

<sup>4</sup> Redmond Review paragraph 7.4.3

<sup>5</sup> Redmond Review paragraph 4.3.3

<sup>6</sup> Redmond Review paragraph 4.3.4

<sup>7</sup> Redmond Review paragraph 4.6.2

## Question 1

***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?***

CIPFA supports the appointment of knowledgeable, experienced senior local auditors to the role of KAP and provided that audit quality is not compromised would generally support the aims of route 1. From its membership of the working group CIPFA has understood that the three alternatives outlined in the consultation paper are intended to be additional to the current route included in the extant guidance. It would be useful to see the proposed changes in the Guidance to properly consider their impact and interaction.

Given the similarities between the current guidance and the proposed route 1, it may be useful to consider whether these two routes should be rationalised or combined. The current similarities might lead to a more complicated process or cause confusion as to which route prospective KAPs should follow. We suggest that there should be consideration to how best to present the current route and route 1 in a way which prospective KAPs can understand the difference between the two routes.

CIPFA notes that route 1 mirrors the requirements in the corporate audit sector for RIs. CIPFA generally supports route 1, again provided audit quality is not compromised. However, CIPFA believes that route 1 as outlined in Paragraph 4.1 has the potential to disadvantage people, most likely women, who take family leave. Route 1 includes a proposed requirement to have gained local audit experience from a minimum of 10 engagements within the last two years. This proposed requirement potentially prevents otherwise suitable candidates who have recently taken family leave, and therefore reduced their workload, from applying for the role of KAP. Consequently, the potential pool of KAPs will be reduced.

CIPFA acknowledges that route 1 allows flexibility in the case of exceptional circumstances. However, CIPFA believes that maternity and paternity leave should not be viewed as exceptional, therefore the requirements should be designed to accommodate family leave.

CIPFA understands the need for requirements to avoid being overly complicated and supports this aim. However, in the case of route 1, CIPFA believes a change in wording would better support the overall aim of increasing capacity in local audit. CIPFA recommends that route 1 should be worded to require a prospective KAP to demonstrate at least 24 months' local audit experience at senior level in the last 4 years, with at least 12 months of that experience in the last 2 years. CIPFA believes this revised wording balances the need for a prospective KAP to be able to demonstrate recent relevant experience with the need to allow for family leave though CIPFA suggests that this be subject to review by an Equality Diversity and Inclusion expert.

## Question 2

***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?***

As noted above, complexities in local audit including technical issues such as the complex capital finance framework or areas where experience is required, such as additional statutory powers that local auditors have to report in the public interest or make statutory recommendations, as well as broader issues, such as the political environment in which local audit operates, require additional skills and knowledge of local auditors that are outside of the skills and knowledge required by corporate auditors. CIPFA recognises, however, in an IFRS based framework that there are transferable skills and agrees that an experienced RI should have had a minimum of five years' experience as an RI before becoming a KAP. RIs with this level of experience in corporate statutory audit work or similar can be expected to have the experience, detailed knowledge and in-depth understanding of the aspects of the RI role that are transferable to the KAP role and understand the risks and other aspects in complex audits. This will allow the RI to successfully identify and

concentrate on the aspects of the KAP role that are unique to local audit as they transition into the role and should also enable them to prioritise and identify areas where knowledge, skills and experience will need to be augmented.

### Question 3

***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?***

Yes, CIPFA supports this proposal.

CIPFA notes paragraph 4.6.3 of the Redmond review, which states that there is “some evidence that the reduction in fees has led to a decline in the number of examiners with appropriate skills, knowledge and expertise. This has had an impact on the timeliness of audits, the usefulness of auditor reporting to management and the quality of interactions between external auditors and local authorities.”

New KAPs will need to have knowledge of local authority audit, reporting and accounting requirements in order to address issues around quality and timeliness of local audit delivery. As noted in our response to Question 2 above, experienced RIs will have transferrable audit skills and knowledge that will be invaluable in their transition to local audit work. However, such transferrable knowledge and skills will need to be augmented by training on the local audit and wider regulatory framework, specialist local financial reporting and audit matters. To support this, CIPFA has led on developing options for technical training for experienced RIs in the Centre of Excellence Subgroup (which FRC colleagues will be aware operates under the FRC’s Capacity and Capability Working Group). Under CIPFA’s lead this subgroup has developed an outline diploma syllabus that contains the requisite information about local audit to allow experienced corporate auditors to move into local audit. This subgroup again as led by CIPFA has also developed proposals for a local audit technical advisory service designed to support KAPs and audit teams on an ongoing basis.

CIPFA believes that approved training, either via the aforementioned diploma or via accredited training routes, is essential to allow RIs experienced in corporate audit to successfully fulfil the KAP role without a deterioration in the quality of local audit.

### Question 4

***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?***

CIPFA agrees that an RSB should place an obligation on experienced RIs to have a minimum of their first two local audits hot file reviewed.

CIPFA does not anticipate that hot file reviews will identify significant issues in the work of experienced RIs. CIPFA anticipates that RIs will be keen to maintain the professional standards they have developed in their experience of corporate audit and in their KAP roles. However, knowledge of the unique aspects of local authority accounting is crucial to the success of a local audit. CIPFA therefore believes that the requirement for two hot file reviews is a proportionate quality control measure for a new KAP from a corporate audit background.

CIPFA believes that it is acceptable for hot file reviews to be undertaken internally by a KAP’s own firm, although consideration may need to be given to the practicality of this quality control measure in firms with small number of KAPs. Firms are regulated and their internal quality control measures

should be of a high standard. CIPFA expects that a requirement for an independent third party to conduct hot file reviews would be very difficult to provide in practice. Confidentiality agreements between audit firms and audited bodies provide a complex barrier to an independent third party from conducting an effective hot file review. Additionally, hot file reviews pose significant risks including reputational risks for independent third parties, who may be unable to offer such a service within the bounds of their internal risk management processes and professional indemnity insurance policies.

CIPFA does not believe that additional requirements for cold file reviews beyond the existing requirements will be necessary. Regular cold file reviews will form part of an audit firm's standard quality control process. Further, the FRC's Audit Quality Review acts as a second cold file review process for the audits included in the sample. CIPFA believes that application of a firm's standard quality control procedures, including the routine use of cold file reviews, are sufficient.

## Question 5

***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?***

CIPFA anticipates that the quality of a KAP's work, including a KAP who was appointed via the proposed Route 2, will be monitored through a firm's standard quality control procedures. The quality of local audit is also monitored by the FRC's annual audit quality review, providing external assurance on the overall quality of local audit. CIPFA is mindful that additional requirements may be perceived as being onerous and dissuade RIs with the necessary skills and experience from applying to be a KAP, which would work against the overall aim of the updated KAP requirements. Route 2 will only permit experienced RIs, with commensurate professional experience and an understanding of IFRS in the corporate sector, to a KAP role. Paragraph 4.2 proposes two hot file reviews for KAPs appointed via Route 2; CIPFA agrees with this proposal. CIPFA does not believe that additional quality control measures beyond those normally adopted by a firm will be necessary.

CIPFA understands that evidence from the Redmond Review on audit quality might indicate issues that suggest firm's internal quality control processes could benefit from being enhanced. However, CIPFA is aware that these quality control processes are often rigorous and notes Redmond's findings indicate issues in quality are more likely a symptom of underlying issues such as retention of staff/attractiveness of the profession<sup>8</sup>, a lack of specialist knowledge of accounting and other issues unique to local authorities<sup>9</sup> and a lack of resources in the framework. Work is underway to address these issues, including:

- proposals within this consultation to require specialist training and CPD for KAPs
- CIPFA's development of a diploma in local audit and a local audit technical advisory service for the Centre of Excellence Working Group
- the increased emphasis on quality over price in PSAA's current procurement strategy.

CIPFA would suggest assessing the impact on audit quality of other these measures before introducing requirements for quality control measures additional to those already employed by audit firms. In particular, CIPFA believes a holistic training programme providing an understanding of the local audit framework and audited bodies for new KAPs ahead of their first local audit is key to improving the quality of local audit work.

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<sup>8</sup> see, for example, Redmond Review paragraphs 4.3.8, 4.3.9 and 4.3.12

<sup>9</sup> see, for example, Redmond Review paragraphs 4.6.3, 4.3.4 and 4.3.6

## Question 6

***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?***

Yes, CIPFA supports the proposal for a new tier of KAP which is restricted to NHS audit work.

While it would be preferable to avoid complications by having an additional tier of KAP, CIPFA understands that the aim of Route 3 is to increase capacity. Given the problems currently faced by local audit, CIPFA believes that Route 3 is a pragmatic solution that allows RIs, particularly those with experience of NHS Foundation Trusts, to provide the necessary additional capacity, allowing existing KAPs the capacity to deliver audits of other local audits including those for local government bodies.

CIPFA is therefore comfortable that RIs with experience in NHS Foundation Trusts will have the necessary skills and knowledge to complete other NHS audits. The proposal that all RIs can apply to be an NHS KAP on completion of specialised NHS training appears reasonable, given that all RIs are currently permitted to audit NHS Foundation Trusts.

## Question 7

***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?***

CIPFA does not consider that the type of work which is currently accepted as providing relevant local audit experience is too narrow in scope. CIPFA would note that other types of public benefit or public sector audits are unlikely to provide comparable frameworks to the local audit framework so is of the view that any scope widening would not be appropriate.

There are differences between a local audit and the audit of a company. In order to ensure local audit is completed to a high standard, CIPFA believes prospective KAPs using Route 1 should be able to demonstrate relevant local audit experience.

## Question 8

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

CIPFA is involved in responding to issues in local audit via Liaison Committee Working Groups, therefore has been able to provide feedback on KAPs prior to this consultation and has nothing to add on the appointment of KAPs.

CIPFA notes, however, that long-term succession planning and a holistic approach to addressing the overarching issues in local audit is required to make the required step change needed to fix the current problems in local audit. CIPFA's Chief Executive, Rob Whiteman, has written more about the issues facing local audit for the Local Government Chronicle (full text in Annex 1 below). In this article, Rob discusses the importance of matters such as systems leadership and appropriate audit fees for the future of local audit. With this in mind, CIPFA emphasises its earlier comments that while additional routes to Key Audit Partnership may be part of the solution, a suite of measures around attractiveness of the profession will be needed to support the pipeline of KAPs into the future.

## **Annex – Local Government Chronicle Article Full Text**

### **Rob Whiteman: We can turn around the problems of local audit**

15 March 2022

#### **A function that is integral to accountability, transparency and the financial substantiality of councils is not in good shape, writes the chief executive of the Chartered Institute of Public Finance & Accountancy.**

There has been much debate about issues relating to local audit of late, and since Sir Tony Redmond, CIPFA past president, issued his [recommendations](#) the overall picture appears to be getting worse.

Only 9% of 2020-21 local audits were complete by the statutory publication date. Although this position has since improved, backlogs from previous years' audits will mean that systemic improvement is likely to take more than one year.

Late last year, the government announced its [measures](#) to address this critical situation.

At CIPFA we have supported CIPFA LASAAC (Local Authority (Scotland) Accounts Advisory Committee) in issuing its emergency consultation on exploratory measures to change the local authority accounting code of practice to alleviate local audit pressures.

#### **A critical test**

CIPFA LASAAC received over 200 consultation responses and will soon issue its feedback statement on the outcomes of the consultation.

But why is local audit so important? The way in which local authorities have supported communities during the pandemic has demonstrated how essential they are to the locality, but they also have key placemaking roles and will be essential to the post-Covid recovery and levelling up.

With net expenditure of over £100bn, local audit's role is vital as it provides a critical test and assurance to support the systems of local democracy and public accountability. Local auditors deliver an independent professional opinion on financial statements, demonstrating that the resources have been spent as reported.

Local authorities can be justly proud of the useful information they produce at the financial year end and the external audit function is essential in verifying this. Local authorities produce International Financial Reporting Standards-based financial statements, which include valuable information on how resources have been deployed.

The external audit function provides assurance over service expenditure and the further billions of resources local authorities hold within their balance sheets. Furthermore, auditors provide essential information on how assets are used by the authority and its level of indebtedness.

#### **Part of the financial accountability armoury**

Local audit also has an integral role in demonstrating local authority financial sustainability. Although most councils will already know their financial position because of the budgetary and other financial management processes, local audit is an essential part of the financial accountability armoury to confirm a local authority's own assessment.

In our recent publication [Managing Public Finances to Achieve Fairer Outcomes](#) we argued that it is the resilience of local communities and regions that will allow for more effective engagement with whatever funds are available. The capacity to anticipate future shocks or cope with them when they arise will affect governments' (including local government's) ability to maintain good financial



performance and deliver on service or wider political objectives. The accounting and audit profession can better equip governments to withstand such challenges by identifying possible areas of financial vulnerability.

### **Growing complexity**

The local audit work on an authority's arrangements for value for money are equally as important. The local auditor has statutory duties in respect of the local government's arrangements to secure value for money through the economic, efficient and effective use of its resources. Local auditors provide assurance on the arrangements for financial sustainability, governance and how local authorities improve the way they manage and deliver services by means of economy, efficiency and effectiveness.

Local auditors use a wide range of information to provide their report on a local authority's arrangements for value for money. This includes, but is not limited to, the audit of the financial statements, governance information reported by the authority and reports of the inspectorates. This assists local government bodies in considering whether their arrangements are effective. We have seen more reporting on this issue from local government of late, including key public interest reports that have identified significant governance issues in some local authorities.

It is important to keep in mind that local authorities are complex entities, and this complexity is growing. In recent years local authorities have extended into areas of commercialisation and partnerships. The local audit function provides an essential service in giving confidence that there are appropriate arrangements in place for the local authority to do this effectively. There are arguments that value for money audit could be widened even further and provide an active assurance.

### **Fees too low**

CIPFA is committed to supporting local audit. Its function is integral to both accountability and transparency and the financial substantiality of local authorities. CIPFA notes that the government recognised its importance in a pre-Christmas [announcement](#) to provide further funding of £45m over the course of the next spending review period to support the issues arising from the framework.

In line with comments in the Redmond Review, CIPFA recognises that fees for local audit have become too low in comparison with the increasing financial resilience and regulatory risks faced by local authorities and local auditors, respectively. It is clear a balance must be struck that reflects the need of the sector. CIPFA is supportive of this measure.

Local audit is a critical function, but as it currently stands it is not in good shape. CIPFA welcomes the announcement of Neil Harris as the first director of local audit at the Financial Reporting Council. CIPFA considers this role to be integral to systems leadership. Strong systems leadership supported by all key stakeholders, including local authorities and their auditors, can turn this around. CIPFA will take every opportunity to play its part.