

28 March 2022

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By email only to:

Dear Ms Ahmad

**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**

We welcome the opportunity to respond to this consultation.

In our responses to the Redmond Review and the (then) Ministry of Housing, Communities & Local Government's (MHCLG's) Local audit framework: Technical Consultation we set out our belief that, amongst a number of other factors, the existing Key Audit Partner (KAP) requirements in the FRC Statutory Guidance were causing some of the challenges with delivering timely local audits and supporting a vibrant, competitive market. The effect of the current guidance is not only that it is difficult for existing local auditors to identify new KAPs; potential new entrants into the market struggle to appoint KAPs from within and can only really hire from existing local audit firms, exacerbating those firms' resourcing plans. If not addressed, this presents a risk to audit quality.

We recognise that the FRC's guidance on KAP eligibility is set within the statutory framework of the Local Audit and Accountability Act 2014, and suggested in our response to the MHCLG Technical Consultation that changes to the law are also necessary. Our comments are therefore in the light of the existing legal regime; we have also suggested areas where, as the legislation to give ARGA a role as the system leader takes shape, further changes may be made. In the longer term, dual qualification between (say) CIPFA and another RSB could also be an attractive route towards qualifying, although practical experience is still key. Such a route might also provide an attractive qualification to increase technical financial reporting levels in local authority finance functions.

We have set out our answers to your formal consultation questions in the appendix to this letter.

If you would like to discuss our comments further, please contact



Yours sincerely



**Deloitte LLP**

## Appendix: Answers to consultation questions

**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 with this overall approach.

When deciding who can lead a local audit engagement, it is important to remember that the rules of the relevant RSB (which must comply with the FRC's guidance) are only one part of picture. Firms are also subject to ISQC (UK) 1 (and in due course ISQM (UK) 1) which requires them to have in place processes to ensure that those assigned to lead engagements have the appropriate competence and capabilities to perform quality engagements. Overly complex or restrictive rules on who an RSB may approve as a KAP therefore risk damaging the resilience, sustainability and competitiveness of the market.

Paragraph 3.7 of the consultation says that there will be "two additional routes... and a third route...", suggesting that all three proposed routes are in addition the current route. Were this the case, route 1 as described in paragraph 4.1 would never apply as it is tougher than the current requirement. Our comments below assume that the proposal is to replace the existing route with the route in paragraph 4.1.

Paragraph 4.1 says that other than in exceptional circumstances, the experience must have been gained from a minimum of ten engagements within the last two years.

- This does not appear in paragraph 10 of the existing guidance. The existing ICAEW KAP forms ask for ten examples of competence gained within the past six years.
- The ICAEW's RI application form say that you should "aim" for experience on ten engagements in the last two years but allow applicants to explain why this is not the case. We believe that mirroring the RI wording would be better, allowing applicants to justify their experience to the RSB – whether gained by working on more smaller engagements, or fewer larger engagements. For example – someone who has spent 80% of their time managing three large local audits should, we believe, have sufficient experience.
- We understand that the FRC's shortly-to-be-introduced PIE RI status will not include a requirement for at least ten engagements in two years, for similar reasons (individuals may work on fewer larger engagements).

We suggest that it would be preferable to retain the existing KAP requirements rather than replacing with the requirements in paragraph 4.1.

If the intention is to introduce tougher requirements and to reduce the period over which applicants have gained their experience, we suggest that route 1 therefore should mirror the ICAEW's position on RIs:

- "aim" for experience on ten engagements in the last two years; and
- allow applicants to justify why they have fewer engagements – with guidance explaining that factors such as scale will be useful to explain in that guidance.

**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?**

No. We think a shorter period would be appropriate; perhaps two years, given that they will also be required to undertake specialised local audit training at an appropriate level (see Q3 below). Otherwise – for example – a KAP candidate who had spent all their recent time on “work similar to local audit” could qualify under route 1 without any specified local audit training, whereas an experienced corporate audit partner, well used to adapting to different types of audited entity, would need to both have five years as an RI *and* be trained.

In due course (broader than the extent of this consultation) a more wide-reaching review of the law around qualifications might also usefully be undertaken by BEIS, ARGA and other interested parties – as there are increasingly situations where a qualification is needed to sign reports in other sectors where experience in that sector cannot count towards obtaining the qualification.

**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 have not yet seen details of what this training will look like – will this be the potential new CIPFA qualification? Or might it be internal training as long as approved by the relevant RSB and/or FRC/ARGA?

If the intention of this process is to provide solution to the short term problem of firms resourcing audits, and enable their participation in the current PSAA procurement round, it will be important that details of this are clarified quickly to enable firms to decide who may be able to apply for KAP status, over what time scale, and therefore which lots they are able to bid for. Ideally this would include an indication of:

- time commitment (how long might be needed for classroom/online learning, private study etc.);
- how many sittings a year, and when these might be; and
- cost.

**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?**

No. This requirement is not imposed on RIs signing audits for the first time, even if they are signing audits in a very different industry sector to the one they worked in prior to getting RI status. Consistent with that approach, firms should be able to propose what they believe is an appropriate set of conditions for the individual KAP, given their background and experience. For example:

- an RI who has lots of local audit experience, but not in the last two years, may need less monitoring; an RI with none may need more;
- a firm with lots of local audit experience (or work similar to local audit) with individuals experienced in carrying out monitoring under the existing local audit rules should be able to perform internal hot reviews. A firm with no experience may need to bring in an external reviewer who does have such experience.

**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?**

No. As in our response to Q4, this would not necessarily be imposed on an RI signing audits for the first time, even if they were signing audits in a very different industry sector to the one they worked in prior to getting RI status. As in Q4, firms should propose to the RSB what they believe is an appropriate response, given the individual's proposed portfolio, scale of engagements and risk.

Any rules or guidance should refer to both EQCR and EQR, given that ISQM (UK) 2 and the revised ISA (UK) 220 will be coming into force very shortly.

**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?**

Not at the current time. We believe that:

- those already signing NHS Foundation Trusts should already be able to qualify under Route 1; and
- those not signing NHS Foundation Trusts are unlikely to find this a useful stepping stone to being able to sign local authority audits – it being better to use route 2. Our view might be different if the training were significantly narrower, but we suspect that (other than local authority challenge work, for which separate training is already provided) it will not be. This is because:
  - VFM audit is unlikely to have been experienced outside the world of local audit and NHS FT audit (and individuals with that experience will be able to use route 1);
  - Whilst the detail of the accounting regimes for NHS bodies and local authorities differs, the core principles (e.g. how to assess valuation of specialist assets, consider impairment in a not-for-profit world, assess going concern where a service is likely to continue even if it transfers to another body) are similar across the whole of the public sector.

We are not aware of similar resource constraints in the NHS market, noting that FTs can be signed by statutory audit firms (and, indeed, RI status is not required to do so). We believe that the public interest is also served by the ISQC (UK) 1 and ISQM (UK) 1 requirements to allocate only competent individuals to lead specific audits.

If, in future, the NHS FT audit regime were to be brought closer to the rest of the NHS regime (and we have called for this since the 2014 Act was being drafted, it being unclear why there should be any differences) then it may be worth exploring this separately.

Our comments on conditions, hot/cold reviews and EQCR/EQR in our response to Q5 apply equally here.

**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?**

See our response in Q8 in relation to local authority pension funds.

We think it would also be worth considering the audit of not-for-profit universities, and potentially significant charities, as part of the experience mix. Whilst these do not include VFM audit, university auditors will have experience of the audit of regularity (and therefore familiarity with PN10) – useful for NHS audits and local government challenge work, and of considering valuations and impairments in a not-for-profit world (similarly to the various NHS and local government accounting regimes).

**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 believe one further category of KAP should be considered – for those giving an opinion on local government pension funds.

- the skills, knowledge and experience needed to sign these (other than in respect of challenge work) are the same as those gained auditing private sector pension funds – and require far less understanding of the specifics of local government – the accounting requirements also being (in effect) broadly the same as those of the Pensions SORP;
- cases of challenge (objections and questions) are almost unheard of in relation to local authority pension funds – and pension fund KAPs could work with the generalist KAP leading the audit of the authority's general fund in this area.

This route should need suitable CPD, but not a specific additional bridging qualification. It may, in turn, allow a KAP to then move through route 1 in a couple of years (assuming they also work on the general fund audit).

This would be particularly useful if our suggestion in earlier responses (including to the Redmond review, the (then) MHCLG technical consultation and the CIPFA emergency update consultation that the local authority pension fund and general fund accounts be decoupled is taken forwards. Whilst we understand that CIPFA believe legislative action may be needed to achieve this, situations where the audit of a scheduled body is held up because of delays in the audit of an administering authority could be reduced significantly.