



THE REVISION OF THE FRC STATUTORY GUIDANCE UNDER THE LOCAL AUDIT AND ACCOUNTABILITY ACT 2014 IN RESPONSE TO THE REDMOND REVIEW 2019

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ICAEW welcomes the opportunity to respond to the Financial Reporting Council's (FRC) [consultation document on the Revision of the FRC Statutory Guidance \(the "guidance"\) under the Local Audit and Accountability Act 2014 in response to the Redmond Review 2019](#).

The proposed changes seek to address recommendation 8 in Sir Tony Redmond's [independent review into the oversight of local audit and the transparency of local authority financial reporting](#) (the Redmond Review) that "statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work".

For questions on this response please contact our Public Sector team at representations@icaew.com quoting REP 32/22.

- ICAEW welcomes the Department for Levelling Up, Housing and Communities (DLUHC) and the Financial Reporting Council (FRC) taking action to address the pressing problems in local audit, including the recent announcement of the appointment of a Director of Local Audit at the FRC.
- Measures to alleviate capacity are an essential part of the 'whole-system response' required. We therefore support the proposed changes to the statutory guidance to RSBs on KAP eligibility and the development of a central training offer to provide an alternative route to KAP status for Responsible Individuals (RIs).
- We do not believe that the proposed reforms will result in a reduction in audit quality. Not addressing capacity and timeliness issues poses a far greater risk to audit quality.
- We are against creating unnecessarily burdensome requirements in local audit where there are no equivalent requirements in corporate audit. For example, we do not support requiring additional hot file reviews than would be required under ISA 220 and ISQM 1.
- Although we welcome the changes to statutory guidance, we believe that changes to legislation are also required to implement the Redmond Review recommendation. This includes permitting experienced local authority auditors with equivalent overseas qualifications to become KAPs.
- We are concerned that the ongoing procurement of local authority auditors creates a barrier for new firms from entering the market until 2028, undermining the effectiveness of the proposed changes.
- We believe that the capacity crisis in local audit demands radical solutions. We, therefore, recommend the new system leader review whether it is necessary or desirable for local audit to have unique and restrictive eligibility criteria when there are

no equivalent requirements for audits in other specialist sectors (such as financial services for example) and the core professional skills required are the same.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

As a regulator of the accountancy and audit profession, ICAEW is currently the largest Recognised Supervisory Body (RSB) for local audit in England. We have ten firms and over 90 KAPs registered under the Local Audit and Accountability Act 2014.

ICAEW's Public Sector team supports members working in and with the public sector to deliver public priorities and sustainable public finances, including over 9,000 in ICAEW's Public Sector Community. ICAEW engages with policy makers, public servants and others to promote the need for effective financial management, audit and assurance, financial reporting and governance and ethics across the public sector to ensure public money is spent wisely.

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

INTRODUCTION

1. We are responding to the FRC's [consultation document on the Revision of the FRC Statutory Guidance under the Local Audit and Accountability Act 2014](#), published on 28 February 2022.
2. This response has been prepared by ICAEW's public sector team in consultation with ICAEW's Public Sector Advisory Group, which includes current Key Audit Partners (KAPs) and public sector bodies. We have also consulted with member firms considering entering into the local audit market for the first time.
3. The consultation proposes changes to the FRC's statutory guidance issued to RSBs regarding the approval of KAPs. ICAEW is currently the only RSB for local audit in England.
4. An individual must be registered as a KAP to sign off the audits of local authorities, NHS bodies and other bodies within the scope of the Local Audit and Accountability Act 2014. It does not apply to the audits of smaller authorities or NHS Foundation Trusts. Only firms with KAPs can register with ICAEW to perform local audits.
5. ICAEW has worked closely with the Department for Levelling Up, Housing and Communities (DLUHC) and other key stakeholders to develop proposals to implement the Redmond Review recommendations. ICAEW is a member of the FRC-chaired "auditor capacity and capability working group" and the sub-group specifically looking at KAP eligibility guidance.
6. We welcome that the FRC is taking forward reform to KAP eligibility criteria ahead of it assuming the role of system leader for local audit. ICAEW believes this is a necessary part of the reforms required to improve the attractiveness of the local audit market and strengthen local authority financial management, governance and reporting to address the crisis in the sector.
7. ICAEW has advocated reform of the KAP eligibility criteria in letters to government, Parliamentary enquiries and responses to consultations relating to local authority audit:
 - Our [response](#) to the Redmond Review's request for views called for the FRC to reform KAP eligibility guidance and for the government to amend the relevant legislation to allow entry for a wider pool of auditors.
 - ICAEW's Director of Public Sector wrote a letter to the Deputy Director of Local Communities at DLUHC, and copied to the Department for Business, Energy and Industrial Strategy (BEIS), setting out policy proposals to open up the local audit market including specific suggestions to increase KAP eligibility.
 - ICAEW's [response](#) to DLUHC's [technical consultation on the local audit framework](#) called on the government to make the local audit market more attractive including through changes to the KAP guidance.
 - Our [submission](#) to the House of Commons Public Accounts Committee inquiry into the timeliness of local auditor reporting on local government highlighted that the requirement to qualify as a KAP acts as a significant barrier to entry into the local audit market.
 - Our [letter to HM Treasury](#) (HMT) published alongside ICAEW's response to BEIS-proposed reforms to audit and corporate governance underlined the importance of staff being able to flexibly transfer between public sector and public interest entity audits.
 - Our [response](#) to Public Sector Audit Appointments Limited (PSAA)'s market engagement survey ahead of the procurement for the next appointment period expressed concerns that the five year contract length risks locking firms out of the market and undermining the effectiveness of these proposed KAP eligibility changes.

CONSULTATION QUESTION RESPONSES

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?

8. Yes. ICAEW supports reform of the KAP eligibility criteria as our research suggests that the current requirements are a major barrier to entry for new firms and for existing firms wishing to increase their portfolios. The current lack of audit market capacity has contributed to the severe audit timeliness issues and poses a significant risk to audit quality. Urgent reforms are needed to encourage new market entrants and increase the overall number of KAPs to strengthen capacity and resilience in the market.
9. We agree that the requirements for KAP approval should not be overly complicated or restrictive. The eligibility requirements to sign off local audits should not be more burdensome than the requirements to sign off the audits of multi-national public interest entities. As such, we support the KAP requirements mirroring the requirements for corporate Responsible Individuals (RIs). To obtain RI status, applicants must have a relevant qualification and demonstrate they meet the professional competence required under IES 8.
10. However, the proposed "Route 1" for KAPs is currently more prescriptive than the wording on the RI application form that it is designed to mirror. The RI application form states that:

"You should aim to provide details of at least 10 audit engagements carried out during the last 24 months. However, we recognise that there is a wide range of individual circumstances where this will not be possible and if this is the case, please provide as many examples as you can in section 1 of this form, and provide an explanation of your circumstances in section 2".

11. We believe that the same flexibility should be given to the RSB to make judgements over whether an individual has sufficient local audit experience without it being limited to "exceptional circumstances". It may be difficult for staff in the smaller firms to meet the minimum 10 audit engagements in two years in the proposed KAP guidance, especially if they work part time or are absent for a period due to illness or parental leave.

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?

12. No. ICAEW does not believe it is necessary for the guidance to set out how much experience an RI has before seeking to become a KAP.
13. As we stated in response to question one, we do not support the requirements for KAPs being more burdensome than the requirements to sign off the audits of bodies in other specialist sectors. For example, there is no equivalent statutory requirement for a certain level of experience before signing off the audits of, for example, central government entities or major financial services companies so we do not see why this requirement is necessary for KAPs.
14. Audit firms already have a duty to assign staff with sufficient expertise and experience to sign off audits. ISQM 1.32 paragraph a) requires that firms ensure that staff have the "knowledge or experience relevant to the engagements the firm performs" and paragraph d) requires that "Engagement team members are assigned to each engagement, including an engagement partner, who have appropriate competence and capabilities". ISQM 1 applies to all audit firms in the UK and so we do not believe permitting the eligibility of RIs with less than five years' experience poses a meaningful risk to local audit quality.
15. The current wording of the proposed "Route 2" is insufficiently clear and could lead to different interpretations between the Registration Committee, the FRC and potential applicants. For example, it does not specify whether the five years' experience needs to have

been obtained recently, whether the experience is only relevant if it was obtained in the UK or whether the experience would need to be obtained with a single firm. Accountancy firms are global businesses and regularly ask RIs to work on non-UK based audits.

16. We believe the requirement for the individual to have “spent the majority of his/her time in corporate statutory audit or work similar to corporate or local audit” could be difficult to achieve in practice. Other relevant responsibilities such as training auditors, working in professional standards, or leading non-audit assurance work, secondments or other absences could mean someone who has been an RI for five years does not meet this requirement. It is also unclear how it is intended to apply to part-time workers. We urge the FRC to remove this element of the guidance and provide flexibility to the Registration Committee to make judgements over whether applicants have sufficient experience.

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?

17. ICAEW strongly supports the creation of an alternative route to KAP status for existing RIs who complete sufficient training alongside the development of centralised of local audit training **announced** by the government in December. We believe this could reduce a significant barrier to entry for firms that do not currently undertake local audit work.
18. The current guidance, requiring experience of local audit or similar public sector work, acts as a major barrier for these firms. The only way they can enter the market at present is by hiring individuals with local audit experience from one of the eight firms that currently perform local audit work. With so few firms in the market and the total number of KAPs around 90, this is unsustainable.
19. We agree with the wording in the proposed guidance that the training should bridge a “knowledge gap” rather than develop professional skills. The core professional skills required for local audit, such as professional scepticism and clear communication, are common to all audits. There are, however, unique aspects of the local authority and NHS financial reporting frameworks and additional audit responsibilities that require specialist knowledge obtainable through training.
20. We do not know what is meant by the “pre-approved training” mentioned in the draft guidance. We support the creation of centralised training as this could support new entrants that may lack the resources or experience to provide this training in-house. However, we also believe that those firms able to provide in-house training to bridge the knowledge gap for RIs looking to move into local audit should be able to do so.
21. RSBs do not currently “pre-approve” training in relation to corporate audit, including for those wishing to sign off audits in specialist sectors. Instead, they assess the Continued Professional Development records of those applying to become RIs and consider factors such as the findings of reviews of firm-wide procedures relating to internal training. We would support alignment with these requirements for the requirements for KAPs.

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?

22. No. ICAEW does not support placing additional burdensome requirements on KAPs that are not mirrored in the requirements for RIs.
23. As in the corporate sector, firms have detailed risk management and quality control procedures. They do not give new KAPs their most complicated audit assignments, and they will have their own hot and cold file review arrangements to respond to quality risks in line

with ISQM1. The compliance with these requirements will be checked during audit quality reviews. We therefore do not support placing additional responsibilities on the RSB that duplicate existing practice.

24. We are particularly opposed to requiring the hot file reviews to be carried out by an independent third party as we believe it is impractical. There are unlikely to be sufficient independent third parties that would be willing and able to conduct hot file reviews to meet potential demand.
25. We believe the requirement for hot and cold file reviews should be aligned with corporate audits, where the RSB has full discretion about the monitoring required where there are concerns about an applicant's experience or the quality of their work.

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?

26. No. Requiring engagement quality control reviews (EQCRs) on top of hot file reviews is a duplication and places additional requirements on local auditors to those that are required by the ISAs or ISQMs. There is already a concern that the audit requirements are overly burdensome, particularly related to property valuation, and there is a risk that additional EQCR requirements exacerbate this perceived issue.
27. There is no current requirement for local audits to be subject to EQCRs so we do not understand why the FRC would seek to increase requirements at a time when the biggest risk to quality relates to a lack of market capacity and when the most recent set of audit quality reviews indicated improvements in audit quality.
28. We believe that it is important that the requirement on firms to determine the characteristics of an audit that requires an EQCR is maintained. These characteristics could include that the engagement partner is a new KAP but this will be part of a wider assessment of the risk profile of the audit.

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?

29. ICAEW is concerned that a new tier of KAP adds another layer of complexity with different requirements for signing the audits of NHS Trusts and local government bodies in addition to the existing different requirements for the audits of NHS Foundation Trusts. ICAEW does not support unnecessary fragmentation between NHS and local government audits as much as it does not support unnecessary fragmentation between local and corporate audits.
30. We do not understand how the NHS KAP status will act as a "springboard" to full KAP status as the guidance is currently drafted. "Route 2" does not offer any concessions for those that initially become NHS KAPs. If the implication is that experience of NHS audits provides the knowledge required to do local authority audits, this does not support creating a separate tier of KAPs.
31. ICAEW believes that a better solution would be to align the requirements for signing NHS Trusts and Clinical Commissioning Groups with the requirements for signing Foundation Trusts. We agree with the statement at 3.6 of the Consultation Document 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."
32. This approach would recognise that the audits of NHS Trusts and Clinical Commissioning Groups require less sector-specific specialist knowledge than the audits of local government bodies. NHS accounts are closer to company accounts in that they do not contain statutory overrides and auditors of NHS bodies do not have to respond to objections from electors.

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?

33. ICAEW supports accepting the widest possible scope of relevant experience to reflect that the core skills required for local audit are common to all audits and to address market capacity issues. As suggested by our response to question 3, we believe that training can bridge sector knowledge gaps.
34. We are unclear what the current guidance is designed to test. It allows other public sector audit work including the audits of central government or other publicly funded bodies, as relevant audit experience. However, it is not clear that these audits provide any more relevant experience for some of the unique features of local audit, such as the powers to issue a public interest report, than the audits of companies.
35. As local authorities have made greater commercial investments in recent years and audit risks have arisen due to movements in the value of investment property, for example, a case could be made that experience of corporate audits is more relevant for a KAP. In addition, there is an argument that experience of limited assurance engagements over grant payments or even internal audit demonstrates more relevant experience for being able to carry out the assessment of value for money arrangements than the audit of financial statements.

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?

36. As we have stated in our response, ICAEW believes revisions to the FRC's statutory guidance to RSBs around KAP eligibility criteria are an important step in the right direction to strengthen capacity in the local audit market. However, they do not fully implement the Redmond Review recommendation that "**statute be revised** so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work".
37. We believe the current severe capacity problems in local audit, as evidenced by the publication of only 9% of 2020-21 local authority audited accounts by the 30 September 2021 deadline, demand more radical long-term solutions than amendments to eligibility guidance.
38. We are also concerned that the effectiveness of the proposed changes to the guidance, in increasing market capacity, is undermined by the timing of the proposals. The PSAA have already commenced the procurement for the appointment of auditors for all local government bodies that have opted-in to their scheme for the next appointing period from 2023 to 2028. The deadline for firms to have submitted their application to ICAEW for registration and their selection questionnaire to the PSAA is 18 March 2022, when this consultation will still be open. This means that some firms could be excluded from the audits of local government and limited to the audits of NHS bodies until 2028, reducing the incentive for them to seek to enter the local audit market. In addition, the PSAA have not awarded contracts in the past to firms with only one KAP, potentially excluding a further two firms. We believe that this situation also supports the case for more radical action.
39. ICAEW welcomes the proposed creation of a system leader for local audit as this creates a single body that can take a holistic view of the issues facing the sector, including the attractiveness of local audit and the barriers to entry.
40. Amongst the radical solutions to KAP eligibility that the system leader may want to consider amongst other measures to improve the attractiveness of local audit:
 - Working with BEIS to amend the Companies Act to ensure experienced local auditors with equivalent overseas qualifications are not prevented from becoming KAPs, as we called for in our [response](#) to DLUHC's [technical consultation on the local audit framework](#).
 - Further amending the Companies Act to allow local audit to count towards the required 120 days of statutory audit required to obtain the Audit Qualification. We believe this

could make local audit more attractive at the junior level as it could allow staff to flexibly transfer between company and local audit work, while it would also remove the anomaly whereby some experienced local auditors are denied the opportunity to become KAPs because they lack sufficient company audit experience.

- Working with DLUHC to amend the Local Audit and Accountability Act 2014 to remove from the scope of KAP criteria audits that do not require specialist local audit knowledge, including the audits of pension funds. RIs with significant experience of private sector pension schemes have sufficient expertise to sign off local authority pension fund accounts. Combined with the decoupling of pension fund reporting from the main local authority financial statements that we called for in our **response** to a recent CIPFA / LASAAC consultation, we believe this could have a significant impact in reducing audit delays.
- Exploring whether it is necessary for local audit to have its own specific restrictive eligibility criteria when there is no equivalent for audits in other specialist sectors such as central government, banking or charities. We believe the current restrictive requirements undermine the ability of auditors to flexibly transfer between the public and private sector. We believe that local audits could benefit from the experience of corporate auditors in areas that have been the subject of recent quality findings, such as the audit of financial investments.

41. ICAEW would welcome the opportunity to meet with the new FRC Director of Local Audit, once they are in post, to discuss these ideas in more detail. We believe that our ideas could increase audit quality by boosting capacity and competition in the local audit market, while making it more attractive to talent. As we stated in response to question 3, the core skills required in local audit are common to all audits. We are not suggesting that anyone should be able to sign off local audits as, if our proposals are adopted, the audits will be signed off by RIs, who have demonstrated their professional competence to a relevant RSB.
42. We are confident that these proposals will not lead to auditors lacking the specialist knowledge required to perform local audits. Potential entrants have expressed significant support for the development of specific local audit training and believe that this could provide their staff with the knowledge required.
43. All audit firms have a responsibility under ethical and quality management standards to ensure that those working in local audit have the specialist knowledge required to perform their work to the highest standards. The audit quality review process acts as a significant deterrent for firms from departing from this as it means there are significant reputational and financial risks for firms from poor quality audits.
44. The most difficult area of local audit for those without experience of the sector is the quasi-judicial powers of local authority auditors to respond to objections from electors or issue public interest reports or statutory recommendations. However, we do not believe that this alone justifies specific and restrictive eligibility criteria. In these cases, local auditors, regardless of experience, would seek legal advice or other specialist support. In addition, some of the measures announced by DLUHC, including a potential technical advisory service, are specifically designed to support new market entrants with these difficult judgements.
45. We would also note that most audit quality issues identified by the FRC or ICAEW's QAD file reviews in recent years relate to the audit of valuation of non-current assets or liabilities and not transactions or balances unique to local audit. The 2019-20 and 2018-19 audit quality reviews of major local audits contained no findings relating to the audit of value for money arrangements, despite this being the specialist area of local audit. This suggests that the segmentation of local audit from other audits in terms of eligibility criteria is unnecessary.