



Financial Reporting Council

Regulation of Auditors of Local Bodies

**A Feedback Document on the
Consultation on the Revision
of the FRC Statutory Guidance
under the Local Audit and
Accountability Act 2014 in
response to the Redmond
Review 2020**

June 2022

Contents

	Page
Introduction	2
Responses and feedback	4
Impact statement	11

1 Introduction

- 1.1 On 28 February 2022, the Financial Reporting Council (“FRC”) published a consultation on proposed changes to the FRC’s “Guidance to Recognised Supervisory Bodies on the approval of Key Audit Partners for local audit” (“the KAP Guidance”).¹
- 1.2 The FRC set out proposals for the revision of the current KAP Guidance in response to the independent review by Sir Tony Redmond of the effectiveness of local audit and the transparency of local authority financial reporting.² 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”.³ The Government Response to the Redmond Review said that the Government would work with the FRC and the ICAEW to review KAP entry requirements.⁴
- 1.3 The Department for Levelling Up, Housing and Communities, the Government department responsible for local audit, asked the FRC to implement two of the recommendations made by the Redmond Review:
- 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 The consultation dealt only with Recommendation 8 which we proposed should be dealt with through amendments to the FRC’s existing KAP Guidance. Under the statutory framework,⁵ 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 KAP”) has an appropriate level of competence to carry out local audits. The rules must also comply with the KAP Guidance issued by the FRC.
- 1.5 We set out proposed amendments to the KAP Guidance which would:
- Introduce new routes to gaining recognition to be a Key Audit Partner (KAP) for local audit work. These routes would not replace the existing route to KAP recognition which will remain
 - Introduce greater discretion for the RSBs to give credit for previous practical experience, competence and skills

¹ [https://www.frc.org.uk/getattachment/84b307bc-6387-41ba-a05d-1ff8f590020e/Regulation-of-Auditors-of-Local-Bodies_February-2022\(1\).pdf](https://www.frc.org.uk/getattachment/84b307bc-6387-41ba-a05d-1ff8f590020e/Regulation-of-Auditors-of-Local-Bodies_February-2022(1).pdf)

² <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>

³ Redmond Review, para 3.1.1.

⁴ <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>

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

-
- 1.6 This Statement sets out the responses received to the Consultation and our decisions on the changes to the KAP Guidance.
 - 1.7 This Statement also contains our final impact assessment as a result of making the changes to the KAP Guidance.
 - 1.8 We expect to implement the revised KAP Guidance by the end of Spring 2022, and it will be applicable to all KAP applications made to the RSBs from the date of implementation.
 - 1.9 We have published the consultation responses on our website. One response contained confidential information and therefore has been redacted.

2 Responses

2.1 We received 11 responses to the consultation;

- 7 local audit firms
- 3 professional bodies
- 1 other

2.2 We have not received consultation responses from audit firms considering entering the local audit market. However, in the course of developing its proposals, the FRC has met such firms and discussed the proposed amendments. The FRC has taken account of these discussions when formulating its proposals.

2.3 In the Consultation document, the FRC proposed that the KAP Guidance should be broadened to include additional routes to KAP recognition. Two consultees seemed to misunderstand our approach and suggested that the FRC would remove the existing route to KAP recognition, rather than adding to it. During our discussions with interested parties ahead of the consultation we made clear that the current route, which allows experienced individuals with a proven track record in local audits to apply for KAP recognition if they are able to demonstrate experience in relevant audits over the previous 6 years, would be neither modified nor replaced. Our discussions with stakeholders and proposals in the consultation paper have been based on a proposed approach which supplements the current route to KAP recognition with additional routes.

2.4 The proposals put forward by the FRC aim to add new routes which sit alongside the existing route to KAP recognition and are intended at enabling a greater recognition of complementary skills and competence. These routes are designed to allow competent individuals to gain recognition for the skills and experience they already possess and/or to enable work to be passed to other qualified staff in order to free up existing KAPs to focus on work which only they may lead.

Route 1:

2.5 The regulatory framework for local audit under the Local Audit and Accountability Act 2014 (the "LAAA" or "the 2014 Act") mirrors, to a large extent, the framework for statutory audits under Part 42 of the Companies Act 2006. In relation to statutory audit, RSBs grant the designation of Responsible Individuals ("RIs"), who are individuals who are responsible for the audit work in that firm.⁶ We consider that an RI is the Companies Act audit equivalent of a

⁶ See Rule 4.01 of the RSBs' Audit Regulations and Guidance: <https://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/working-in-the-regulated-area-of-audit/audit-regulations-and-guidance-effective-from-1-january-2021.ashx?la=en>

KAP for local audit and have, accordingly considered the criteria for the recognition of RIs when developing our proposals.

- 2.6 The criteria for the recognition of RIs⁷ require a prospective RI to demonstrate, within the previous two years, the attainment of recent, relevant, and sufficient corporate audit experience at an appropriately senior level of authority to be competent to conduct corporate audit work. Prospective RIs should be able to satisfy the Registration Committee of the RSB of the appropriateness of their recent experience of corporate audit work.⁸ In that context, in general, relevant experience must have been gained from a minimum of 10 engagements within the last two years.⁹ In 2015, when considering the initial KAP Guidance, the FRC considered that the number of individuals who would have been in a position to seek KAP status, had the requirements been the same for the local audit, would have been limited. Therefore, relevant experience gained over a longer period of time was considered to be a more appropriate measure of experience at that time.
- 2.7 We now wish to use this opportunity of the revision of the KAP Guidance to introduce a new route which mirrors the corporate audit RI recognition route.
- 2.8 Seven respondents agreed with this proposal but felt that the KAP Guidance should allow the RSBs to accept fewer local audit engagements if the experience gained from them could be demonstrated to have provided as much experience as 10 shorter engagements.
- 2.9 One firm argued that all RIs should be allowed to become KAPs without further requirements being placed on them. Individuals who meet the requirements to become RIs are not required to have had any training in local audit; either as a component of the examined part of their qualification nor their practical experience. We consider that allowing all RIs to become KAPs automatically without further requirements would be an unacceptable risk to local audit quality.
- 2.10 One respondent commented that although this proposal “allows flexibility in the case of exceptional circumstances ... maternity and paternity leave should not be viewed as exceptional, therefore the requirements should be designed to accommodate family leave”. The FRC’s overriding concern is ensuring the quality of local audit work. Any individual who is to be awarded KAP status should be able to demonstrate sufficient competence through recent, relevant experience. However, the FRC recognises that there is a range of circumstances where an individual may not be able to provide evidence of ten audit engagements in the preceding two years. Accordingly, the FRC intends to amend this

⁷ Reg 3(1)(f) of SATCAR 2016 requires the FRC (as the competent authority) to determine criteria for the purpose of determining whether a person is eligible for appointment as a statutory auditor. These eligibility criteria may be found: [https://www.frc.org.uk/getattachment/575f4a90-40f7-48a1-8b2f-ad84e9e534/ELIGIBILITY-CRITERIA-\(effective-from-IP-Completion-Day\).pdf](https://www.frc.org.uk/getattachment/575f4a90-40f7-48a1-8b2f-ad84e9e534/ELIGIBILITY-CRITERIA-(effective-from-IP-Completion-Day).pdf). The FRC has delegated to the RSBs the application of the eligibility criteria to determine whether persons are eligible for appointment as statutory auditors (see SATCAR 2016, reg 3(1)(g) and the Delegation Agreements: <https://www.frc.org.uk/auditors/professional-oversight/oversight-of-audit/delegation-agreements>). The Audit Regulations of the RSBs which determine the rules on how auditors are regulated and the guidance on how they should be followed, provide how the RSBs will apply the FRC’s eligibility criteria. Further guidance is provided by the RSBs within their RI application forms.

⁸ See, eg, RSBs’ Audit Regulations, 4.05: “A Registration will need to be satisfied that the individual has had recent and sufficient experience of audit work before approving the application.”

⁹ See, eg, the ICAEW’s Application to appoint a responsible individual form. The ICAEW recognises that there is a wide range of individual circumstances where this will not be possible, and suggests that applicants may provide as many examples as possible, along with an explanation of the applicant’s circumstances.

proposed new route to provide the RSBs with the discretion to consider local audit experience gained over fewer assignments.

2.11 This approach would mirror the RSBs' approach in granting RI status. It would also allow RSBs to assess the quality of the relevant experience presented in support of a KAP application and address respondents' submissions that fewer local audit engagements should be accepted where those engagement provide sufficient experience. The RSB must be satisfied in any case that the individual has had recent and sufficient relevant experience, in accordance with the guidance, before granting the application for KAP recognition.

Route 2

2.12 The FRC proposed to introduce a new route for experienced RIs who have little or no local audit experience but would be able to manage the transition to local audit with additional support. Such support would include a mandatory training requirement to cover the areas of work to which a corporate auditor would not have been exposed previously and mandatory hot file reviews and Engagement Quality Control reviews ("EQCR") for their first local audit. The consultation requested views from respondents on which RIs should be given access to this route, and the mandatory requirements for approved training, hot file reviews and EQCRs.

2.13 The FRC proposal to enable experienced RIs with no local audit experience to make the transition to KAP was generally supported. However, our proposal to require a minimum of five years' experience was supported by only three respondents. A further five stated that no time limit should be placed on when the transition could be made.

2.14 Of the eight respondents who disagreed with the minimum time period as RI, five respondents felt that a principles-based approach should be used to assess suitability rather than a fixed time period. The other three believed that approved training and understanding local audit methodology was a preferable method of assessing suitability rather than a specified number of years of experience of corporate audits.

2.15 One respondent stated that firms were unlikely to support unsuitable individuals for KAP status. Two respondents stated that being an existing RI and relevant experience combined with quality reviews was sufficient.

2.16 Five respondents disagreed with having a requirement for hot file reviews although two stated that these were internal requirements of their firm. However, the other six respondents all agreed that hot file reviews should be necessary with two suggesting that the first two local audits should be hot file reviewed. One respondent suggested that after the two initial hot file reviews, the remaining local audits undertaken in the first year should be cold file reviewed. One firm suggested that all new KAPs should have their initial local audits hot file reviewed, even those who had two years' worth of local audit experience. Only one firm believed that hot file reviews should be undertaken externally.

-
- 2.17 Since this proposed route is intended for RIs with no local audit experience we have considered how the RSBs might take into account any relevant experience of RIs that do not have sufficient local audit experience to meet the current recognition requirements.
- 2.18 We do not consider that a newly qualified RI with no previous practical experience of local audit has the necessary skills to undertake local audits to a satisfactory standard. There are certain skills that can be taught through a training course but there are others which can only be gained through practice and experience. This is reflected in the current route to becoming a KAP under the KAP Guidance, which requires two years' worth of experience over six years. Having considered the feedback from respondents, the new proposed route for experienced RIs will be split into two lanes; one for those with no local audit experience at all and another for those with limited relevant experience. Individuals with no previous local audit experience will be required to have been an RI for at least five years. RIs with at least one year of local audit experience will be required to have been an RI for at least three years.
- 2.19 In addition, all experienced RIs with limited/no local audit experience looking to transition into local audit using this new route will be required to undertake an approved local audit training course¹⁰ and will be subject to hot file reviews of their first local audit. Any further requirement for hot or cold file review will be at the discretion of the RSB. The hot and cold file reviews may be undertaken internally by a recognised KAP of the local audit firm or local audit firms may work together to review each other's audit work. The firm must forward the name of the hot file reviewer and the outcome of the review to the RSB for consideration.
- 2.20 Four respondents disagreed that EQCRs should be mandatory for new KAPs following this route. A further two respondents felt that the procedures already followed by firms in accordance with ethical and quality control standards encapsulate this requirement, so that a new requirement was unnecessary. Two respondents stated that firms already have sufficient procedures in place to monitor the work of their staff. Only three respondents agreed that a new requirement for EQCRs should be mandatory for new KAPs who follow the Experienced RIs route (that is, route 2). One of these respondents said that the requirement should be on all new KAPs, regardless of the route followed, and another said the requirement should last for as long as hot and cold file reviews are required.
- 2.21 After considering the responses, the FRC has decided to require the RSBs to ensure that EQCR reviews are undertaken of the work of the new KAPs following the Experienced RI route for the duration of hot and cold file reviews but will not extend this to all new KAPs. Some respondents said that such a requirement would not be necessary because of their existing systems and procedures. For those firms, we consider that there will be no additional burden. However, we consider that this requirement is necessary for those firms for which such a requirement is not already covered by the firm's existing internal quality control requirements.

¹⁰ Training courses will be mandatory for all individuals who follow this route to KAP status. These courses will contain local audit specific content which has been approved by the FRC/RSB. The courses may be run by the firms internally and evidence of participation will be required as part of the KAP application.

Route 3

- 2.22 As identified in the Redmond Review, the local audit sector has a capacity issue. The FRC proposed to ease the workload of existing KAPs by introducing a new, more restricted tier of KAP with responsibilities limited to NHS audit work. 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 if they were able to demonstrate the attainment of pre-approved specialised NHS audit training or provide evidence of experience of Foundation Trusts ("FTs") audits at an appropriate level. The consultation sought views on whether the proposal for a new tier of KAP was supported.
- 2.23 Our intention had been to free up capacity for existing KAPs by allowing RIs with experience of FTs to use that experience to undertake NHS audit work currently reserved for KAPs. This would have allowed KAPs to focus their attention on other local audit work which we consider requires more specific experience and expertise than NHS audit work. We consider the similarities between FTs and NHS trusts are such that an RI who is familiar with FTs could transfer their skills to NHS trusts audits without concern over the impact on audit quality.
- 2.24 Of the nine respondents to this question, only three agreed with our proposal for the introduction of a new tier of KAP to undertake NHS audit work. Respondents noted the existence of a capacity issue in the audit of corporates and suggested that diversion of resource from corporate to local audit would be unlikely to make a significant difference, if at all, and may even lead to other unintended consequences such as diverting people from applying for full KAP status. Respondents did not indicate how many RIs who might have considered full KAP status would choose to remain at the restricted KAP status if this proposal were to be taken forward.
- 2.25 One respondent submitted that the proposed new tier of KAP introduced additional barriers to entry, making it more difficult for prospective KAPs to achieve the necessary level of competence and experience. We do not consider that this proposal would introduce significant new barriers because an RI who already audited FTs would face no further requirements to audit NHS trusts. The mandatory NHS audit training for those with no previous FT experience would be less onerous than the mandatory training required under Route 2 yet provides a partial solution to the capacity issue.
- 2.26 Two respondents commented that they did not understand how this route could be a springboard to full KAP status. By enabling RIs with FT audit experience to also undertake NHS audits the necessary experience could be built up in time to allow these individuals to submit applications for full KAP status. It is not our intention that anyone should think they need/are required to follow this route to get to full KAP status.
- 2.27 At this stage, the FRC has decided not to take forward this proposal, but we may reconsider in the future, particularly if a capacity issue remains in the local audit market.

Relevant practical experience

- 2.28 The FRC has from time to time been asked by the RSB on behalf of local audit firms with prospective KAP applicants to consider whether different types of work and experience could be recognised as providing relevant local audit experience for the purposes of obtaining KAP recognition. The consultation asked respondents whether the current requirements are too narrow and whether there are other types of work which could provide appropriate relevant experience.
- 2.29 Only three respondents felt that the current restrictions on the type of work which is currently accepted as providing relevant experience of local audit were sufficiently broad for the purposes of ascertaining if a potential KAP applicant had sufficient relevant experience.
- 2.30 Five respondents said that the scope of work should be broadened; two wished to see non-UK experience being recognised, one argued that corporate experience was more relevant for understanding the audits of local authorities as these make more commercial investments and one wished to include the audits of universities and significant charities. Only one respondent felt that there should be no prescription at all; arguing that RIs have transferable skills and appropriate sector specific training across all levels of staff was sufficient.
- 2.31 Having carefully considered the responses, and mindful of the fact that the issues are not directly addressed as part of the KAP Guidance revision, and that significant resources and time are required to consider them fully, we are of the view that these issues are best addressed in the longer-term and perhaps as a wider set of reforms when ARGA has been established.

Additional considerations

- 2.32 Respondents were invited to make suggestions on other changes which might address capacity issues in the local audit sector. Individual respondents raised a few issues for consideration. One respondent argued for the audit of local government pension funds to be added as a new category of KAP. One respondent suggested that the corporate audit qualification and its requirement for corporate audit experience (which requires staff to spend time in the corporate audit sector away from local audit) is the largest barrier and another suggested that overseas qualifications should be considered for KAP recognition. A respondent also asked for the audit of Government pension funds to be considered as another KAP Tier.
- 2.33 Although the audit of local authority pension funds is outside the scope of this consultation the FRC is already considering the issue and whether it is necessary for KAPs to be responsible for these.
- 2.34 The corporate audit qualification is seen by two respondents to be a barrier to local audit and KAP status because of the mandatory requirement to have gained experience in corporate

audit work. Without corporate audit experience, these trainees cannot be awarded the audit qualification (although they would still be awarded their accountancy qualification). Without the audit qualification, they cannot achieve KAP status. However, there is at least one RQB which offers a qualification with an emphasis on local audit, which would enable trainees to focus on local audit work, rather than corporate audit work.¹¹

- 2.35 The current legislation¹² requires all KAPs to hold a UK audit qualification, that is one offered by the Recognised Qualifying Bodies¹³ (RQBs) for corporate audit or the RQB for local audit. There is already a process which enables individuals holding overseas qualifications to seek to convert their qualifications to a UK qualification by meeting the requirements of the RQBs. This will generally require them to undertake theoretical examinations and meet the practical training requirements of the RQB. This ensures that the base requirements for this reserved area of work are met.
- 2.36 In order to consider overseas qualifications, there would need to be an initial comparison between the UK qualification and individual overseas qualifications and regular assessments thereafter to ensure no divergence. In addition, we note that in the statutory audit sector, overseas qualifications are not automatically given UK recognition. Therefore, we do not think that this would be an appropriate route to pursue, especially when overseas-qualified individuals are already able to convert their qualifications to a UK qualification.

¹¹ CIPFA was recognised as an RQB under the 2014 Act and offers a qualification focused on local audit.

¹² Local Audit and Accountability Act 2014, s 18, Sch 5, paras 1, 9, modifying Companies Act 2006, s 1219.

¹³ The RQBs for corporate audit are; Association of Chartered Certified Accountants (ACCA), Association of International Accountants (AIA), Institute of Chartered Accountants in England and Wales (ICAEW), Chartered Accountants Ireland (CAI) and Institute of Chartered Accountants of Scotland (ICAS), and the RQB for local audit is Chartered Institute of Public Finance and Accountancy (CIPFA)

3 Impact statement

- 3.1 Revision of the FRC Guidance on Approval of KAPs for Local Audit: The statutory KAP Guidance on the approval of KAPs for local audit does not have an existing parallel for company audit work.
- 3.2 Our proposals for revision of this KAP 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. If the training is provided externally then a cost of attendance and time out of office would arise.
 - 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. Only those firms that do not already have a EQCR process for new KAPS will incur an additional cost.
- 3.3 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.



Financial Reporting Council

**Financial
Reporting Council**

8th Floor
125 London Wall
London EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk