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Private & confidential

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Dear Shazia

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

We appreciate the opportunity to comment on the above consultation document issued by the FRC.

Our responses to the specific questions raised in the consultation document along with any relevant observations are as follows:

Q1. Do you agree with the overall approach at para 4.1 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?

Whilst we are wholly supportive of the FRC's aim of ensuring a rigorous but uncomplicated and unrestrictive regime for approving KAPs, we believe the route described at 4.1 of the consultation document would put this aim at risk through creating unnecessary barriers to entry which do not always support increased quality.

As the FRC will be aware, pressures in the local audit market will not be helped by raising barriers to obtaining KAP status, and the proposed threshold of ten engagements over two years would be onerous for both prospective KAPs and to those firms with a limited number of local audit contracts or potential market entrants. This is especially the case for local audit where audits are typically performed concurrently to meet a pre-determined sector deadline.

Furthermore, we believe the requirement for prospective KAPs to deliver ten engagements over two years would have an adverse impact on audit quality. This requirement (whether annually or over the period) would result in reduced senior

manager time on each audit engagement, and hence threaten the quality of the audit work.

Firms, like us, who currently only operate in one of the local audit sectors would struggle to meet the ten-engagement threshold as we do not allocate such a large portfolio to our senior managers considering that level of workload to be not conducive to improving audit quality.

Should the FRC insist on a minimum number of engagements, we would recommend a lower number of engagements, clarity over how the engagements can be accrued and what qualifies as a relevant engagement. For instance, whether there was an expectation that the ten engagements were delivered each year for two years or whether they should be delivered over the 24 month period. It could also incorporate elements of the other aspects of relevant auditing as referenced in Question 6.

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?

We would caution against a threshold of five years' experience as meeting the definition of an experienced RI.

We believe the judgement of what constitutes an experienced RI is best placed in firms' accreditation and performance monitoring systems. For instance, a higher performer with a track record for delivering quality but with four years' experience could be a much better KAP than a lower performer with more experience.

Furthermore, whilst the FRC does anticipate training (see question 3) for RIs following this path, simply having experience in corporate statutory audit for a long period of time would not mean the RI is sufficiently competent at displaying the skills required in local audit. For instance, an RI who spent their career auditing companies in financial services may not have sufficient experience in auditing organisations with substantial property, plant and equipment or infrastructure assets such as a local authority.

Therefore, simply making such an RI eligible because they have been an RI for five years runs the risk of KAPs being appointed who are insufficiently experienced to perform the work required. In our view the KAP application should also be augmented with relevant experience and the outcome of any quality reviews during that period. As stated above and RI who is a strong performer and with a strong quality record could be given KAP status sooner than five years.

Q3. Do you support the proposal, set out at para 4.2, 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 support the proposal that experienced RIs should complete an approved training course prior to being appointed as a KAP. However, we believe this path would have limited utility as it is unlikely many RIs will follow this path considering the similar challenge in resourcing audits in the corporate audit market. This may be relevant to a small number of RIs working in smaller/new entrant firms in the local audit market but is unlikely to have a significant impact.

It is our view that any pre-approved training course should be the responsibility of the firms to design and deliver, subject to FRC approval. Any training course will have the greatest value if it covers both the technical differences of local audit vs corporate audit as well as how the firm's systems, policies, and procedures are followed to execute a high-quality local audit. This would likely comprise the main technical challenges of local audit (e.g. capital/reserve accounting in LG) along with the relevant technical updates from accounting SORPs and audit codes.

Also, a training course as proposed risks becoming a "one size fits all" solution which fails to respond to the training needs of the prospective KAP. For instance, a RI with experience of aspects of public sector audit engagements may require less training compared to someone who's experience is more distant – e.g. an individual who has been the RI for a number of housing associations would already have some experience of elements of local authority operations.

Consequently, we would recommend that firms have the flexibility of tailoring the training requirements based on the needs identified for the prospective KAP, for instance through the firm's existing accreditation and appraisal processes. The FRC can then observe the adequacy of those training arrangements as it does with other aspects of quality arrangements.

Q4. Do you support the proposal at para 4.2, 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?

Whilst the FRC's proposal is for hot reviews where an experienced RI becomes a KAP, we would support such a review taking place for all new KAPs. We suggest that these reviews be delivered and evidenced internally as firms are already required to implement hot review processes as part of their quality management controls, which are already considered by the FRC.

Consequently, if the FRC are happy with a firm's existing hot review procedures we do not see why this hot review being performed internally, by someone who is not involved in the audit, would not also be acceptable.

Furthermore, a firm would be better placed to build these reviews into a broader support package for new KAPs.

Q5. Do you support the proposal at para 4.2, 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?

We support this proposal for the same reason set out in question 4, and again we would suggest reviews are performed for new KAPs irrespective of the route of admission. However, we again believe that such reviews are best delivered within the firm under the existing quality management regime.

However, we do believe that these reviews should be carried out by KAPs or those with local audit experience and we would support an obligation being placed on RSBs to ensure this is the case.

Q6. Is the type of work which is currently accepted as providing relevant local audit experience too narrow in scope? If so, are there other types of work which challenge a potential KAP and provide the same level of experience of risk and complexity which are not currently accepted as providing relevant local audit experience?

We believe that knowledge from a wide range of audit engagements would provide sufficient experience to support a KAP for NHS audit, and likely also local government audit should CIPFA simplify the more complex areas of local government accounting – in particular capital and reserve accounting.

However, a few engagements we would highlight as providing suitable experience may include:

- Audits involving defined benefit pension schemes (specifically in terms of providing experience in auditing local government pension scheme funds);
- Audits involving valuation of PPE; and even
- Reports on certain regulatory returns, for instance housing benefit subsidy

Furthermore, if there is a training and “probationary” regime in place with hot and cold reviews, a reconsideration of the relevant experience prior to becoming a KAP could be possible, particularly if the individual has met the firm’s own accreditation requirements.

Q7. 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 that auditors improve performance when they can execute audits in a consistent manner. Therefore, we believe a critical way to ensure that potential KAPs have a sufficient level of competence and experience would be better driven by ensuring NHS and local government audit codes are consistent and simplifying local government accounts so they better reflect NHS and other IFRS accounts requirements.

Raising the barrier to KAP status, especially by introducing restricted or NHS only KAPs will, in our view, make it harder for prospective KAPs to achieve the necessary level of competence and experience by introducing more barriers to entry. Firms need encouragement now to enter a beleaguered local government and increasingly strained NHS audit market and whilst appreciating audit quality is paramount, making it more difficult and costly to do so risks having the opposite impact that the Redmond Review intended.

If you have any questions about our response or wish to discuss any of our observations in more detail, please contact me directly.

Yours sincerely



Tim Cutler
Partner