



LOCAL AUDIT FRAMEWORK: TECHNICAL CONSULTATION

Issued 22 September 2021

ICAEW welcomes the opportunity to respond to the Ministry of Housing, Communities and Local Government's (MHCLG) **technical consultation on the local audit framework** published on 28 July.

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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 nine 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 8,000 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.

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We welcome the establishment of a system leader for local audit but question elements of the current design:

- The local audit and reporting system is in crisis. This consultation, emerging from the Redmond Review from last year, provides the opportunity to put in place tangible and constructive building blocks for improving this vital public area, which provides accountability for billions of pounds of taxpayers' money.
- ICAEW supports establishing a system leader as strong leadership and co-ordination is required to resolve the issues in local audit and reporting.
- It is vital that the system leader has sufficient expertise and appropriate governance structures to champion local audit and urgently tackle the significant challenges.
- Arrangements for local audit should mirror those for corporate audit as this was part of the justification for the abolition of the Audit Commission and reflects that they have mostly the same core requirements. The system leader needs to be a forward-looking regulator that supports local authorities and audit firms improve the quality of local audit and reporting.
- We are concerned that the Audit Risk and Governance Authority (ARGA) will not be established until 2023 at the earliest and the Department of Business, Energy and Industrial Strategy (BEIS) proposed audit and corporate governance reforms could overwhelm ARGA's capacity to be an effective system leader for local authority and health audits as well as a proposed expansion in the number of public interest entities (PIEs) in the corporate sector.

Local audit is important but more substantial action is needed to make it attractive and to strengthen capacity:

- We welcome MHCLG's recognition that there is a need to strengthen capacity in the local audit market. In its present state, it is not attractive for current players to remain or for new entrants.
- The government must seek to remove barriers to entry for new firms and enable staff to flexibly transfer between private sector and local authority audit, including by ensuring that the Key Audit Partner (KAP) eligibility criteria does not prevent suitably skilled and experienced auditors signing off local audits.
- We support proposals for MHCLG to fund the system leader directly rather than through a statutory levy but MHCLG needs to provide more support for local authorities to allow them to pay properly priced audit fees for a quality audit.
- ICAEW does not support a new public sector specific audit qualification as key audit skills are common to all audit but does strongly support additional training for auditors on sector-specific knowledge.
- As a key stakeholder, audit firms need to be represented on one of MHCLG's two committees monitoring local audit to ensure their views are understood and, where appropriate, incorporated into new proposals.

MHCLG and the system leader need to do more to improve the quality of local authority reports and financial statements and make them more accessible:

- High quality audit relies heavily on high quality financial reporting, but the proposals currently focus almost exclusively on audit and audit committees. ARGA needs to have adequate powers and resources to require improvements by preparers and not just auditors.
- The Redmond Review conclusion that local authority accounts are considered "impenetrable" has not received sufficient attention. The system leader should have specific objectives to promote improvements in the quality and understandability of local authority financial reporting to encourage greater readership, including carrying out periodic reviews of individual reports and financial statements.

- Redmond’s recommendations around financial reporting for a new summary statement and further streamlining should be implemented as soon as possible. The latter should include removing as many additional requirements to IFRS placed on accounts preparers as possible.
- The system leader should establish an easily searchable register of audited local authority accounts, providing better access to financial information by both local residents and other stakeholders as well as enabling late accounts and overdue audits to be monitored more easily.
- MHCLG should encourage and support local authorities to prioritise investment in their finance teams, in financial processes and controls, and in their governance.

The government needs to take action to improve the quality of local authority governance:

- We do not see the purpose of “strengthening” already clear audit committee guidance when several pieces of existing local authority finance guidance are not currently being followed.
- However, to improve governance, government should legislate on the form and composition of audit committees, including the inclusion of at least one suitably qualified independent member.
- The government should avoid placing additional requirements on auditors to compensate for weaknesses in local authority governance as detailed in response to question 18.

INTRODUCTION

1. We are responding to MHCLG's [consultation on the framework for local audit](#). The consultation covers the audits of bodies subject to the Local Audit and Accountability Act 2014, which includes local authorities, NHS bodies, drainage boards and police authorities.
2. The response was written before the government announced that the Ministry for Housing, Communities and Local Government (MHCLG) will become the Department for Levelling Up, Housing and Communities (DLUHC). We have referred to the Department as MHCLG throughout.
3. This response has been prepared in consultation with ICAEW's Public Sector Advisory Group, which includes representatives from audit firms and public sector bodies. It also takes into consideration results of ICAEW's engagement with audit firms and audited bodies as well as feedback received at the MHCLG-chaired stakeholder meeting on 15 September 2021.
4. The consultation is one of a series from MHCLG in response to the recommendations in Sir Tony Redmond's [independent review into the oversight of local audit and the transparency of local authority financial reporting](#). ICAEW provided a [response](#) to the Call for Views to support this review.
5. ICAEW has worked closely with MHCLG and other key stakeholders to develop proposals to implement the Redmond Review recommendations. ICAEW is represented on MHCLG's Local Authority Audit Monitoring Board and the newly formed MHCLG-chaired Liaison Committee. In addition, it is a member of the "auditor capacity and capability working group" set up by MHCLG as well as its sub-groups, considering changes to the KAP guidance and proposals for additional training.
6. The government did not accept Sir Tony Redmond's principal recommendation to set up a new body, the Office of Local Audit Regulation, to act as the systems leader for local audit, bringing together functions currently carried out by the FRC, ICAEW, National Audit Office (NAO) and Public Sector Audit Appointments (PSAA) Ltd. It was concerned that a new body would recreate the "costly, bureaucratic and over-centralised Audit Commission." The government's full response to the Redmond Review is [here](#).
7. The government committed to exploring the options for system leadership and [announced in a May 2021 update on implementation of the Redmond Review recommendations](#) that its preference is for ARGA to act as system leader.
8. BEIS consulted on proposals to establish ARGA to replace the FRC as well as wider reforms to audit and governance particularly for large companies in its consultation on [restoring trust in audit and corporate governance](#). BEIS intends to establish ARGA from 1 April 2023. In [ICAEW's response](#) to the BEIS consultation, we called for ARGA to be established as soon as possible and highlighted that there was a need to consider the public sector implications of the BEIS reforms.
9. We submitted a separate [letter to HM Treasury](#) (HMT) outlining the public sector perspective to the BEIS-proposed audit reforms and calling for urgent action to address capacity issues in the local audit market.
10. The government has decided the system leader should not take responsibility for procurement due to fears this could create a conflict of interest. It has confirmed PSAA as the appointing person for the next five-year appointing period starting 2023-24. ICAEW recently [responded](#) to PSAA's market engagement survey to inform the PSAA revised procurement strategy.

QUESTION RESPONSES

Question 1: Do you agree with the proposed functions which the system leader for local audit needs to enable a joined-up response to challenges and emerging priorities across local audit? Please let us know any comments you have on the proposal.

11. ICAEW supports the proposal to establish a single system leader for local audit. We argued in our [submission to the Public Accounts Committee \(PAC\) inquiry](#) into the timeliness of auditor reporting on local government in England that recent timeliness issues are symptomatic of wider problems in local audit and financial reporting. The local audit and reporting system is in crisis, with many aspects failing to deliver. These wider problems include:
- Many local authorities have under-resourced finance teams which means they struggle to produce good quality working papers and manage their finances effectively;
 - Weaknesses in local authority governance including audit committees that lack sufficient independence or expertise;
 - Senior local authority finance staff viewing the audit and accounts, particularly the balance sheet, as a compliance exercise meaning they do not devote sufficient attention to the accounts and auditors do not feel valued for the work that they do;
 - Local authority accounts are unnecessarily long and complicated, meaning they are not transparent or understandable and therefore not used by citizens or their elected representatives as a means of evaluating the performance of local bodies;
 - There is currently insufficient capacity in the market as many KAPs are nearing retirement or leaving the market and only six firms currently undertake all local authority audits;
 - The barriers to entering the market are currently too high with strict eligibility criteria and challenges obtaining sufficient sector knowledge; and
 - The local audit market is not attractive to new entrants and there is a risk that existing firms could exit the market.

These issues are not simple to resolve and require the leadership of a single body that can co-ordinate all stages of the process.

12. The new system leader needs to be able to devote sufficient capacity to provide the leadership that local audit needs and resolve these challenging issues. In ICAEW Representation 63/21 in response to “Restoring trust in audit and corporate governance”, we raised concerns that the government risks overwhelming ARGA’s capacity by giving it an unnecessary extension of powers and making the criteria for PIEs too broad. We expressed concern that broadening ARGA’s remit could set it up to fail, which would not be in the interest of an effective and resilient corporate reporting and audit ecosystem. By extending ARGA’s remit still further to include local audits increases the risk of it failing to deliver.
13. It is important that ARGA’s local audit unit is provided with adequate resources and is given sufficient focus to ensure that improvements are made in both the quality and understandability of financial statements and in the quality and sustainability of local audit. The government needs to set out how it intends to achieve these objectives without distracting ARGA’s corporate teams from implementation of the proposed reforms to the audit and corporate governance of PIEs.
14. In Representation 63/21, we strongly opposed revocation of the ministerial direction that allows FRC delegation of regulatory tasks to RSBs without replacement in statute because it would result in capacity issues across the system. Similarly, the government needs to maintain the delegation to ICAEW in local audit, including the registration of audit firms and KAPs, to avoid unnecessarily distracting the system leader from the key issues.
15. Likewise, there are tasks that we believe the NAO should continue to carry out in the local audit system once the responsibility for setting the audit code passes to the system leader. For example, the NAO should still be able to produce reports relating to local audit, such as

its valuable piece on the timeliness of auditor reporting, continue to run the local auditor discussion networks and hold the central contracts that provide specific expertise including on legal issues and pensions valuation.

16. Furthermore, to avoid unnecessary complexity or distractions, the government should ensure that arrangements for local audit do not diverge from those for corporate audit except where there is a justification to do so. This is in line with the government's original objectives when it introduced the significant reforms to local audit including the abolition of the Audit Commission in the Local Audit and Accountability Act 2014. ICAEW's response to the BEIS consultation called for the government to "co-ordinate thinking across both the private and public sector as a means of driving forward audit quality".
17. On this basis, ICAEW supports the system leader assuming responsibility for the Code of Audit Practice and associated Auditor Guidance Notes, as it is consistent with the FRC, and in future ARGA, being the standard setter in the corporate world. FRC is ultimately responsible for the performance and oversight of audit regulation tasks in the corporate sector and the system leader needs to play a similar role in the local audit sector.
18. Given the need for alignment between local and corporate audit, we do not understand why the government proposes in the consultation "Restoring trust in audit and corporate governance" that ARGA will play a significant role in corporate reporting for PIEs but the proposals do not establish any role for the system leader in local authority financial reporting. Without responsibility for local authority financial reporting, the system leader will be largely powerless to address many of the wider problems that exist in local audit and reporting.
19. Audit does not exist in isolation from financial reporting. Timely and high-quality audit relies heavily on good quality accounting records and financial statements. The system leader should therefore be tasked with promoting the importance of local authority accounts and encouraging local authorities to use them. The accounts contain lots of valuable information that could improve evidence-based decision making and financial management within local authorities.
20. It is essential that there is greater readership of local authority accounts for the government to achieve the vision when it embarked on the audit reforms of a locally led audit regime that "unleashes an army of armchair auditors". To encourage this, the system leader should maintain an easily searchable public database of published audited local authority accounts along similar lines to the Charities Commission's register of charities accounts.
21. Factors that prevent local authority accounts being widely read or used by finance teams include that they are too long and too complicated, while they omit significant matters of interest to potential users. ICAEW agrees with Redmond's conclusion that local authority accounts are "impenetrable". As an example, one county council's 2020-21 draft statement of accounts consists of 253 pages and 42 notes to the main financial statements. By comparison, MHCLG's 2020-21 annual report and accounts consist of 168 pages with 24 notes to the main financial statements despite MHCLG spending over 50 times more than the county council. Despite – or perhaps because of – the length, local authority accounts do not provide users with valuable information like the expenditure incurred on key service areas such as libraries, parks or healthcare.
22. Redmond's significant conclusion on financial reporting has received insufficient attention. There are no proposals within the consultation to address this issue and his recommendations for a new summary statement and for CIPFA / LASAAC to consider how the accounts can be streamlined have not been implemented. We believe the system leader should work with CIPFA / LASAAC and other key parties to implement these recommendations and consider what further action can be taken to improve local authority reporting.
23. The system leader should use the database we are proposing to collect readership statistics and seek to better understand who is using local authority accounts and what information they require.
24. ICAEW supports maintaining IFRS as the basis of preparation because it provides the most accurate picture of a local authority's financial position, records the costs of decisions and

prevents local authorities using cash movements to distort net spending. However, CIPFA / LASAAC should review the additional requirements placed on local authorities by the Code that are not required by IFRS and consider whether any can be removed.

25. We fully appreciate that local authorities have faced constrained financial settlements for over a decade and that citizens wish to see prioritised investment in front-facing services. However, greater investment by local authorities in improving the quality and understandability of their reports and financial statements would pay dividends. It would make them more useful documents in supporting decision-making by councils, helping to improve value-for-money and effectiveness of expenditure, and in helping councillors, citizens, MHCLG and other stakeholders in holding local authorities accountable for how they have used local and central government funding to deliver public services.

Question 2: Do you have any comments on the proposed functions that ARGA should have alongside its new system leader responsibilities?

26. As we state in response to question 1, ARGA will not be able to address the issues in local audit without the power to address issues of local authority reporting, financial management and governance.
27. ARGA should establish an equivalent of the Financial Reporting Review panel for local authorities to drive improvements in the quality of the reporting. These reviews should also cover the annual report as Redmond raised concerns over their variable quality. The panel should publish examples of best practice and make recommendations to CIPFA / LASAAC if it identifies ways that the accounting framework and model financial statements can be improved.

Question 3: Do you agree that the system leader should conduct a full post implementation review to assess whether changes to the Code of Audit Practice have led to more effective external audit consideration of financial resilience and value for money matters two years after its introduction, with an immediate technical review to be conducted by the NAO? Please let us know any comments you have on the proposal.

28. Yes. We support the changes to the Code of Audit Practice introduced for the 2020-21 financial year for auditors to provide a narrative commentary on value for money rather than simply provide an opinion. This should help reduce the expectation gap that currently exists over the work done by local auditors on areas of particular interest to the public such as fraud and financial resilience. However, as these requirements are new, it is important to understand whether the Code changes have had the intended impact.
29. We agree with allowing two cycles before carrying out a full post implementation review as there may be varied interpretations in the first year that should be allowed to resolve themselves in the second year. An immediate technical review by the NAO could identify some of these issues.
30. There is still the potential for an expectation gap over the "limited assurance" nature of the value for money commentary. The Code states: "In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period. However, should evidence of poor value for money come to the auditor's attention during the course of the audit, the auditor should consider the implications of this for their work." ICAEW believes it is neither practical nor cost effective to ask auditors to obtain a higher level of assurance over value for money arrangements than is currently required but the review should assess whether the requirements are currently understood.
31. It is the role of accounts preparers rather than auditors to tell the financial story of an entity including how well they have used public money to deliver local services. The new value for money commentary is partly a symptom of the variable quality of the narrative report section of local authority accounts. This could perhaps be better addressed by the introduction of mandatory performance reporting in line with the requirements for central government departments. The full post-implementation review should consider whether the new

commentary has led to auditors providing information that should be better provided through the narrative report.

32. For the proposed review to be effective and balanced, it must consider the views of audit firms. The system leader should seek to understand how significant a burden the new requirements have been and whether fee increases have been sufficient to cover it. If its review concludes that there are gaps, it must consult with the firms before introducing new requirements.

Question 4: Do you agree with the proposals to ensure that ARGA has sufficient expertise and focus on local audit? Please let us know any comments you have on the proposals.

33. We agree that the system leader needs to be a separate unit within ARGA. Local authorities and large companies have different primary objectives and risks. Key issues for private sector auditors such as going concern and the legality of dividends are largely irrelevant to local authority auditors, whereas the value for money commentary and reconciliations between the accounting and budgeting basis would be unfamiliar to company auditors. For the new system leader to be credible, it requires the specific knowledge needed for local audit and needs to focus on the issues affecting the sector.
34. ICAEW is concerned that in seeking this expertise at a suitably senior level, the system leader risks exacerbating already severe capacity issues in the local audit market. There are currently fewer than 100 registered KAPs and many are close to retirement. Firms have raised concerns that there is a limited pipeline of potential KAPs and that they find it difficult to recruit and retain staff in their public sector team as it is not seen as an attractive career. Poaching of staff by the new system leader in order to increase its own capability will only serve to place further strain on capacity on the audit side. Capacity needs to be considered in a proactive, open and holistic manner.

Question 5: Do you agree with the proposed role and scope of the Liaison Committee? Please let us know any comments you have on the proposals.

35. We urge MHCLG to better clarify the difference between the newly formed MHCLG-chaired Liaison Committee and the existing MHCLG-led Local Audit Monitoring Board (LAMB) to avoid unnecessary duplication. The two groups contain broadly the same membership but neither includes the audit firms or local authorities. This limits the effectiveness of both committees as neither receives the views of the key bodies impacted when matters are discussed.
36. We share the **concerns raised by the PAC** that the Liaison Committee may not provide the strong leadership that the local audit system needs, particularly ahead of the Spending Review and the next appointing period. Until the new unit is set up in FRC in shadow form, MHCLG must devote sufficient attention to act as an effective interim system leader.

Question 6: Do you agree that the responsibilities set out above will enable ARGA to act as an effective system leader for local audit? Are there any other functions you think the system leader for local audit should have?

37. It is vital that the system leader promotes the importance of local audit and works to increase its attractiveness. It should conduct research to understand the barriers facing firms entering the local audit market and the challenges that existing firms have in recruiting and retaining sufficiently skilled staff.
38. The system leader needs to promote the importance of local authority audit and accounts to local authority finance teams and audit committees to ensure they devote sufficient attention to the audit and the auditors feel their work is valued. Auditors have reported that local authorities are primarily interested in their outturn against budget where auditors tend to focus more effort on the valuation of pensions or property as they would in a corporate audit. These are also the areas that are most likely to be the focus of Audit Quality Reviews. This disconnect can mean that local authorities view the audit as a compliance exercise, which can be demotivating for auditors. The view that balance sheet risks are unimportant is

incorrect as many high-profile financial sustainability issues in local authorities result directly from a failure of the authority to understand its financial position. The system leader therefore has a key role to educate local authorities about the importance of the accounts and the audit.

39. The system leader should champion the local audit perspective in wider audit reforms and the proposed strengthening of the audit profession. In a recent [letter to HM Treasury on the public sector implications of audit reforms](#), ICAEW called for a separate review of how the principles covered in “Restoring trust in audit and corporate governance” could apply in the public sector. A new system leader is well-placed to lead this review, in conjunction with HMT, MHCLG and BEIS.
40. The system leader needs to be a forward-looking improvement regulator designed to promote and share good practice. For example, as we suggested in our response to the BEIS White Paper on audit reform and corporate governance, it should maintain a fraud register with due safeguards and encourage the sharing of experience and best practice. It should support efforts to strengthen capacity in the market, such as the joint audits proposed by PSAA, and establish a culture that helps ensure the market is attractive for new entrants. The system leader must consider the inspection process and how this can strengthen quality, resilience and competition across the system without deterring new entrants.
41. ICAEW shares the widespread concerns about the timeliness of local authority audit opinions. It is unacceptable that there are local authorities that have not published audited accounts for several years. For example, Warrington Borough Council’s 2017-18 audit has still not been signed off. Warrington’s unaudited 2020-21 accounts show more than £1.6bn of borrowing and £722m of long-term investments; there are significant sums of taxpayers’ money potentially at risk in one authority’s accounts that would appear not to have been subject to external assurance. Such risk could be multiplied several times over in other local authorities.
42. The database of local authority accounts that we are proposing should include a single list of local authorities that have missed the relevant deadlines. The system leader should work closely with MHCLG to actively monitor the list to actively seek to understand the reasons for the delays. This monitoring could act as an early warning system of potential sustainability or governance issues within local authorities, which would allow the system leader to coordinate efforts to improve matters.

Question 7: What is your view on the proposed statutory objective for ARGA to act as system leader for local audit? Please include any comments on the proposed wording.

43. We believe the proposed system leader objective as drafted is unclear as it does not define the term “operates effectively”, nor does it address the key role that financial statements and local audit play in the accountability of local public bodies to their respective stakeholders and to the public more generally. It also does not provide a distinction between ARGA’s objectives as a regulator for local audit (encompassing the audits of both local authority and local units of central government departments) and its objectives as the systems leader for local authority audit. Hence, we suggest two distinct objectives, one concerning the quality of local public body financial reporting and of local audits generally, and a second objective concerning its responsibilities as a system leader for local authority audit, including driving improvements in the understandability and usefulness of local authority reports and financial statements as well as supporting a resilient and high-quality audit market.
44. As stated in answers to previous questions, audit does not exist in isolation from financial reporting or wider governance. We therefore believe that the current proposed objective that focuses solely on audit is too narrowly scoped. The system leader should also have specific objectives around encouraging wider use of the accounts by both the local authority itself and the wider public.
45. While the system leader has a major role in promoting effective audit, it requires other bodies to play their part in the whole local audit ecosystem such as sufficient investment from councils in finance teams, PSAA in procuring appropriate audit services and MHCLG

ensuring councils have sufficient resources to pay fees that reflect the work that needs completing. The current objective risks spreading the system leader's objective to areas where other bodies have statutory jurisdiction and weakening its focus.

Question 8: Do you agree with the proposal that ARGA will have a responsibility to give regard to the value for money considerations set out in the Local Audit and Accountability Act 2014? Please include any comments on the proposed wording.

46. We agree the system leader should have regard to the value for money considerations. They are an essential part of a local audit.
47. They play a major role in many of the issues that the new system leader will need to address such as timeliness of audit opinions, capacity in the market and whether audit fees reflect the full cost of the work that needs to be carried out. However, the system leader should not seek to create an unnecessary distinction between the financial audit and value for money commentary as they are part of the same engagement carried out by the same auditor.

Question 9: Do you agree that the proposals outlined above will provide an appropriate governance mechanism to ensure that the new system leader has appropriate regard to the government's overarching policy aims without compromising its operational and regulatory independence? Please let us know any comments you have on the proposal.

48. Given the differences between ARGA's core role as a corporate and corporate audit regulator and its proposed role as a regulator and system leader for local financial reporting and audit, we agree the need for distinct remit letters from the Secretary of State for MHCLG in addition to ARGA's primary remit provided by BEIS. However, local audit encompasses more than just local authorities and so it is important that ARGA develops appropriate accountability mechanisms for financial reporting and audit with NHS England and DHSC for health bodies, the Home Office for police authorities and with other departments as appropriate.

Question 10: Do you agree that ARGA's annual reporting should include detail both on the state of the local audit market, and ARGA's related activities, but also summarising the results of audits? Please include any views on other things you think this should include.

49. Because of the importance of local audit in ensuring democratic accountability, the effectiveness of a new system leader for local audit will be of significant interest to parliamentarians. We are concerned that reporting on its role as system leader in a separate annex risks the impression of local audit being an afterthought for ARGA. Instead, the system leader should be disclosed as a separate operating segment and have a dedicated section within the performance report so parliamentarians can understand its performance.
50. We believe that as the system leader ARGA should provide Parliament with summary information on the results of local audits, highlighting trends in reports, financial statements and audit opinions. This should be in addition to its reporting on its regulatory responsibilities on the outcomes of the reviews it performs of the quality of annual reports and financial statements and of the quality of audits. Where appropriate, MHCLG and other relevant departments should be required to report to Parliament on systemic actions that may be needed to respond to the issues raised.
51. For the report about the results of local audits to be widely read and useful, it needs to be timely and concise. We believe therefore it should be a separate document from ARGA's annual report and accounts. The reporting timetable for the annual report and accounts means that it will not be available until nine months after the current 30 September deadline for local authority audits. Depending on capacity, the system leader should be able to report summary information on the results of local audits within three months of the audit deadline.
52. Any reporting should be in addition to the register of audited local authority accounts that we are proposing. This should be an easily searchable and downloadable resource that contains details about the results of audits as well as those that have missed the deadlines. This will

be a valuable resource to government departments which monitor local authority accounts as well as researchers and other bodies interested in local government.

Question 11: Do you agree with the proposal outlined above relating to board responsibility for local audit? Please let us know any comments you have on the proposal.

53. It is important that strategic decisions concerning the local audit system leader function within ARGA involve individuals with specific sector knowledge and, as a consequence, we would recommend a specific subsidiary board within ARGA to oversee the system leader.
54. The main ARGA Board will be stretched by the need for it to establish itself as a strong regulator and implement the proposed reforms to the audits and governance of PIEs. The nominated member responsible for the system leader will have a key role in ensuring sufficient attention is paid to local audit.

Question 12: Do you agree that ARGA's local audit functions and responsibilities should be funded directly by MHCLG rather than a statutory levy?

55. Yes. ICAEW supports the proposal for MHCLG to fund the system leader. We agree with the consultation that it would not be sensible to place further costs on local audit firms as this could encourage an acceleration of market exit and act as an additional barrier to entry. This is particularly important ahead of the opening of the procurement round in the new year for the appointing period for 2023 onwards as it could undermine PSAA's objectives to increase capacity in the market.
56. Local audit firms will need to recoup any additional costs from new levies in the fees they charge to local authorities. However, it is unlikely that it would be possible for the system leader and MHCLG to calculate the levy in time for the firms to submit bids for the procurement round. This could store up problems for the future as it could mean that the fees that firms set in their bids either will not recoup the costs should MHCLG proceed with a levy, or factor in a levy in their price proposals, thereby unnecessarily increasing the cost of audit. Suitable notice of intent will ensure prices are reasonable.
57. Given the fragile state of the local audit market and the fundamental importance of high-quality local audit in ensuring accountability, ICAEW believes that MHCLG should provide permanent support to local authorities to allow them to pay audit fees that are priced for quality audits. The £15m additional support for 2020/21 audits was welcome but such additional support needs to be increased and made permanent. We have received feedback from member firms that the current fees are unsustainably low for local authority audits, such that they often do not recover the full costs they incur.
58. Local authority audit fees are lower than the fees for similar sized bodies in central government or the private sector, despite the complexity of local authority accounts and the additional value for money commentary requirements. For example, the fee for the audit of Manchester City Council for 2019-20 was £159,000, compared to £500,000 for Premier Foods, a FTSE 250 company. Both bodies are classified as PIEs but Manchester Council generated over double the level of revenue in 2019-20 and had 70% more in recorded assets.

Question 13: Do you agree that ARGA should also take on system leader responsibilities for health audit? Please let us know any comments you have on the proposal.

59. We do not believe ARGA needs to be given additional responsibilities for health audit and reporting in addition to assuming responsibility for the Code of Audit Practice and maintaining FRC's current regulatory responsibility. Otherwise, there is a risk of conflict with NHS England and DHSC's responsibilities for the NHS and DHSC consolidated financial statements for which DHSC is ultimately accountable to Parliament.
60. System leadership for health bodies is a further substantial undertaking as NHS bodies spent over £62bn in 2019-20. This risks further overwhelming ARGA. We are concerned about the practicality and capacity issues arising from a single body being responsible for the system

leadership for the audits, governance and reporting of all PIEs, NHS bodies and local authorities.

61. We understand the need for close alignment between health and local government audit. Both types of bodies are audited under the Local Audit and Accountability Act. Issues such as capacity in the local government audit market also affect health audit as the same public sector teams within firms audit both types of body. The firms tend to perform NHS audits first and then commence council audits. If NHS audits are delayed, this has a direct knock-on impact on the timeliness of local government audits. Therefore, the system leader will need to work closely with the NHS to ensure these issues are resolved together.

Question 14: If you agree that ARGA should assume system leader responsibilities for health audit, do you think any further measures are required to ensure that there is alignment across the broader system?

62. No. There are areas where alignment would not be appropriate. For example, we agree with the government's position of not establishing a national appointing body for health audits along the lines of PSAA. While we understand there have been cases where NHS bodies have struggled to appoint auditors, this reflects wider capacity issues in the market and would not be solved by the establishment of a national appointing body. NHS England has successfully supported NHS bodies to identify auditors and there has not been a case when an auditor could not be found.
63. It is important that existing rules are maintained which mean KAP requirements do not apply to the audits of NHS Foundation Trusts. This has allowed a new entrant to the market in 2020-21 and could act as a route into the market for other firms in the future.
64. Health body annual reports and accounts are simpler, easier to understand and usually shorter than those of local authorities. This is because NHS bodies prepare their annual report and accounts in line with DHSC's Group Accounting Manual (GAM), which are instructions based on the central government Financial Reporting Manual (FRoM). Anyone familiar with private sector or central government accounts is likely to be able to understand most of a health body's accounts and it is relatively easy to compare the financial performance of two NHS trusts or clinical commissioning groups. NHS bodies benefit from audit committees appointed because of their expertise rather than their political affiliation. We urge MHCLG, the system leader and other important players such as CIPFA / LASAAC to consider what can be learnt from the accounting and governance for health bodies.

Question 15: Do you agree with the government's proposals for maintaining the existing appointing person and opt-in arrangements for principal bodies but with strengthened governance across the system, including with the new system leader? Please let us know any comments you have on the proposal.

65. We agree that ARGA should not both act as regulator for audit quality at the same time as negotiating individual audit fees or appointing audit firms, as this could compromise its independence. Procurement should remain separate.
66. PSAA have already been confirmed as the appointing body for the upcoming round of audit appointments and have published a draft prospectus. ICAEW has contributed views in a response to PSAA's market engagement exercise. We expressed broad support for the objectives outlined by PSAA and welcomed its proactive attempts to strengthen capacity in the market. However, we raised concerns about the transparency of the procurement and measures designed to seek to artificially lower the prices of the audits. ICAEW has also liaised closely with PSAA to feedback the importance of the procurement not locking out firms that are unsuccessful in the procurement round or not in a position to bid until the next appointing period.
67. It is important that MHCLG helps ensure PSAA appoint auditors at sustainable prices that support high quality audits and market sustainability by providing councils with resources to pay market prices. Benefits of central procurement for local authorities include a reduced administrative burden and some consistency but there has been an excessive focus on

reducing audit fees, arguably to the detriment of other factors. The consultation document notes that the cost of local audit has reduced since the introduction of the Local Audit and Accountability Act. Whilst savings from efficiencies are to be welcomed, MHCLG needs to consider whether some of these savings have potentially contributed to the current crisis in the local audit market.

68. The FRC, before its formal and statutory introduction as ARGA, also needs to champion the measures to support market sustainability outlined by PSAA, including reassuring firms that they, as the regulator, support the joint audit arrangements outlined by PSAA. Firms have fed back to ICAEW that they are reluctant to engage in new initiatives until they know they have the support, or at least agreement, of the FRC.
69. Without the firms represented, it is unclear how government expects the Liaison Committee to act as a forum to ensure objectives are aligned. All the key stakeholders share the same ambitions of strengthening capacity in the market and driving up audit quality.
70. We are unclear what "strengthened governance" over the appointing body the government is proposing as the consultation document does not contain any specific proposals. This uncertainty needs to be clarified.

Question 16: Do you agree with the proposal for strengthened audit committee guidance? Please let us know any comments you have on the proposal.

71. We believe that any strengthening of audit committee guidance should be accompanied by a legislative requirement for there to be independent audit committee members with appropriate expertise.
72. Local authority audit committees should provide independent assurance to the Council that its control environment and risk management procedures are operating effectively. Where they work well, they provide a valuable source of challenge to council leadership and both internal and external auditors. Where they do not provide adequate scrutiny, this can be a key contributing factor in financial management failures in local authorities as [research from Grant Thornton on recent public interest reports](#) highlights. The role of audit committees in local authorities is particularly important as local councils face reduced resources, engage in more commercial and somewhat riskier investments, tackle the enormous challenge of helping their areas recover from the COVID-19 pandemic and play a major role in helping the UK achieve the ambitious target of carbon neutrality by 2050.
73. Unlike the members of audit committees for private sector, central government or NHS bodies, local authority audit committee members are currently appointed because they are elected councillors rather than because they have any relevant expertise. The audit committee membership of the council will often reflect its political balance, thereby potentially undermining the perception of its independence of mind. The committee membership may also change each year because of elections and changes in councillor roles.
74. ICAEW shares the concerns of Sir Tony Redmond about the skills and expertise of some of these members and the partisan composition of some committees. Redmond stated that some local authorities provide training to audit committee members but it was not "possible to assess how comprehensive or effective this training is". MHCLG, working alongside the LGA and the system leader, needs to conduct an assessment of the effectiveness of audit committee training and consider whether additional centralised training is required. All audit committee members need a sufficient understanding of their role to discharge their important duties effectively.
75. We strongly support Sir Tony Redmond's recommendation that all local authorities appoint at least one suitably qualified independent member. However, we believe this should be made mandatory through legislation.
76. CIPFA's existing guidance is already clear and it is not obvious to us how it can be strengthened. CIPFA's Audit Committees: Practical Guidance for Local Authorities and Police (2018 Edition) already reflects the elements listed in paragraph 97 of the consultation. It states that "CIPFA endorses the approach of mandating the inclusion of a lay or independent member and recommends that those authorities, for whom it is not a requirement, actively

explore the appointment of an independent member to the committee". This recommendation is not being followed as Redmond found that only about 40% of local authority audit committees contain independent members.

77. More attention needs to be given to ensuring authorities follow existing guidance rather than producing unnecessary new guidance. For example, CIPFA has issued guidance aimed at encouraging local authorities to remove immaterial disclosure notes including "Streamlining the Accounts: Guidance for Local Authorities". However, most local authority accounts still include immaterial or irrelevant notes such as, for example, contingent asset notes, despite most authorities not holding any contingent assets.

Question 17: Do you have any views on whether reliance on auditors to comment and recommend improvement in audit committee arrangements is sufficient, or do you think the Department should take further steps towards making the committee a statutory requirement?

78. ICAEW believes that it should be a statutory requirement for all local authorities to have a suitably independent audit committee. Most councils have some form of audit committee but these are often not set up in line with best practice. Redmond noted that local authority audit committees often have much wider remits than the CIPFA guidance recommends, reducing the time they have available for their core purpose and sometimes engaging in functions that create potential conflicts of interest. There are few cases where such wider remits or conflicts of interest could be considered appropriate, so we are not convinced there is an advantage for councils to maintain "flexibility" in how they interpret the guidance.
79. We are unclear what changes to the role of auditors regarding audit committees that the government is proposing. The revised Code of Audit Practice requires auditors to provide a narrative commentary covering governance and the Auditor Guidance Note 03 makes clear that this covers audit committees. As the Code is newly revised for this year, it is too early to tell the extent to which auditors will provide information about inadequate audit committee arrangements nor whether any commentaries will have an impact.
80. It is unclear that an authority which chooses to disregard the clear CIPFA guidance on appropriate audit committee structures would change course if this issue was reflected in the narrative commentary. It seems unlikely that there is a wide enough readership of council accounts for a public clamour to develop for their authority to set up an audit committee in line with the guidance. Elections are not determined by composition of committees, despite the importance of good governance to the management and reporting of taxpayers' monies. Furthermore, delays to audit opinions could mean the commentary comes too late to cause a change in governance arrangements before a financial management failure occurs. Our view is this risk can be mitigated through making a suitably independent committee a statutory requirement.
81. ISA 265 already requires auditors to report significant deficiencies in internal control to those charged with governance. The lack of an effective, independent audit committee would fall within the scope of a significant deficiency in internal control if the auditor believed it was likely to result in material misstatements in the financial statements. Auditors usually meet this requirement through including a management letter in the audit completion report submitted to audit committees. As audit committees are a meeting of a formal Council committee, these reports need to be published on the local authority's website.

Question 18: Do you agree with the proposals that auditors should be required to present an annual report to Full Council, and that the Audit Committee should also report its responses to the Auditor's report? Please let us know any comments you have on the proposal.

82. We do not believe that requiring auditors to present their annual report in person to a meeting of the Full Council will materially assist councillors in fulfilling their duties as in most cases this would be a formality that does not add any additional information beyond that already provided in the written reports submitted by the auditor. We also do not believe it is

appropriate nor sustainable to place additional requirements on auditors to compensate for the governance weaknesses highlighted by Redmond where Full Council is unaware of modified audit opinions.

83. However, we do agree that the audit committee should provide a report to Full Council on how it has discharged its responsibilities, including reporting on matters identified by the auditor and how they have been responded to by the council's leadership, officers and management team.
84. The narrative commentary on value for money introduced this year through changes to the Audit Code may provide more useful information but there is a risk of excessive focus on the value for money arrangements at the expense of the important financial audit work carried out by auditors. Our view is this could be resolved by the introduction of graduated audit findings for local authority accounts as we set out in our letter to HM Treasury on the public sector implications of BEIS's proposed audit reforms. Our view is this could create a more informative document for Full Council.
85. We agree that where the audit committee refers a non-standard audit opinion to Full Council, this should be at the first meeting following the audit committee. Due to the current level of audit delays, this could be significantly after the 30 September date proposed by Sir Tony Redmond. Our view is that audit committees should be required to notify Full Council at the first meeting following 30 September if the audited accounts have not been published and explain the reasons why. This will give Full Council the opportunity to understand the issue and provide necessary support to the finance team as appropriate.
86. This question could be clearer in distinguishing the audit committee's responsibility for oversight of audit and governance with the primary responsibility of the council leadership, officers and management team for establishing and operating financial controls, controls over financial reporting, and governance more generally. It is for management to respond to the auditor's recommendations and for the audit committee to review those responses.

Question 19: Do you have any comments on the proposals for amending Key Audit Partner guidance or addressing concerns raised about skills and training?

Question 20: Are there other changes that might be needed to the Local Audit (Auditor Qualifications and Major Local Audit) Regulations 2014 alongside changes to the FRC's guidance on Key Audit Partners?

87. ICAEW welcomes the government's acknowledgement that there is a need to strengthen resilience, competition and capacity in the local audit market. We have participated in MHCLG's Capacity and Capability working group and on the sub-groups considering the KAP eligibility criteria and potential additional training.
88. We do not believe a mandatory public sector specific qualification is needed in order to ensure high-quality local audit. It could add an additional unnecessary barrier, which would further undermine and weaken capacity in the market.
89. The core skills required for local audit including professional scepticism, attention to detail and the ability to communicate effectively are common to all audits. The ACA is a robust qualification designed to focus on these core skills required to be an accountant and auditor in any sector, including local audit. We review the content and structure of the ACA regularly, including an annual consultation with key stakeholders covering the syllabus and skills grids, to ensure that the qualification remains fit for purpose.
90. ICAEW's Code of Ethics, by which all our members are bound, includes professional competence and due care as one of its five fundamental principles. ICAEW members are therefore required to engage in continued professional development (CPD) and maintain sufficient knowledge of the sector within which they are working. Our member firms have an obligation to ensure their staff comply with these requirements. Due to the significant public interest in local audit, firms are fully aware of the significant reputational risks from poorly conducted audits. This means that firms ensure suitable review mechanisms are in place and that the staff working on these engagements have adequate skills and resources. Redmond

noted a lack of continuity in audit staff from year-to-year but this is also common across the private audit sector as firms try to give their staff, particularly at a junior level, a breadth of experience across different sectors.

91. Sector-specific knowledge is required to conduct local audit, as it is for many sectors including charities and financial services. We therefore support proposals for additional training and technical support. Several firms have told us that as they have small public sector teams, it can be expensive to provide the necessary public-sector specific training and technical support. Providing shared training could reduce the costs for individual firms and remove a significant barrier for potential new entrants. Such training should however be optional and firms should be able to choose to use their own equivalent internal training if they wish.
92. Firms have welcomed the principles of the training offer but it is essential that they are now consulted on the proposals in full to determine the full scope of training and technical support and to establish the resource requirements. It is important that MHCLG provides sufficient initial funding and the FRC works to resolve potential issues around how some of the ideas, such as a technical advice service, will interact with audit quality reviews.
93. We support the proposals of the sub-group that training should be offered to accounts preparers and audit committees as well as to auditors. As we have stated previously, the audit is part of a wider system of local authority financial management and accountability. High-quality audit relies on good quality financial management, record-keeping, accounts and governance. This training could help address timeliness issues by focussing on preparing for audit and establishing appropriate accounting policies. In addition to auditor file reviews, we propose periodic financial statement reviews to provide feedback to preparers about how their accounts could be made more user friendly.
94. There is a need to review the KAP criteria as our research suggests this is a barrier to entry for new firms and for existing firms to expand their capacity. ICAEW, as RSB, carries out the approval and checking process but we are bound by the FRC guidance and requirements of the Local Audit and Accountability Act. We have concerns that the current criteria unnecessarily prevent individuals with sufficient skills and knowledge from signing off local audits.
95. The proposals under consideration are an important step in the right direction. We welcome proposals for training to provide an alternative route for existing RIs to become KAPs as this could become an important entry route for new firms whose staff are not able to gain public sector audit experience under current rules as well as help existing firms attract senior staff working on corporate audits to their public sector teams. We also think mirroring the RI requirements for KAPs is important as the eligibility criteria for local authority auditors should not be more burdensome than those for the signatories of the audits of large PIEs.
96. However, a more thorough review is required of the audit qualifications required to be approved as a KAP. ICAEW submitted a paper to MHCLG in April 2020 setting out suggested changes including:
 - MHCLG should work with BEIS to amend the Companies Act to ensure that the rules do not deny those who work primarily on local audit the opportunity from being KAPs because they have insufficient company audit experience. Under current rules, ICAEW members must obtain at least 120 days of statutory company audit work out of a minimum of 240 days appropriate work experience to obtain the audit qualification required to be a KAP. The number of days of local audit experience counting towards statutory audit experience for the audit qualification should be increased. The RI process for signing rights for company audit would still ensure that no backdoor would exist into the company audit space for those who had not gained sufficient relevant experience.
 - Changes to legislation and guidance are required to allow those with equivalent overseas accountancy qualifications to become KAPs. Some firms have reported that current rules are a major barrier to senior staff with significant UK local audit experience becoming KAPs because those staff hold an overseas qualification. Given that there are many overseas qualifications which follow similar standards to the UK,

and staff move around the world, and there is a common use of international auditing standards, and similar financial reporting standards, it doesn't make sense to restrict this requirement to UK qualifications.

Question 21: Are there other changes that we should consider that could help with improving the future pipeline of local auditor supply?

97. All stakeholders have a role in promoting the importance of public sector audit and the key role it plays in promoting democratic accountability. As we state in our response to the BEIS consultation and in our separate letter to HMT on the public sector implications, it is important that government considers local authority audit as it introduces wider audit reforms. New requirements for PIEs must not decrease the ability of staff to flexibly transfer between public sector and PIE audits.
98. In addition, MHCLG should work with BEIS to ensure that all bodies subject to the Local Audit and Accountability Act are explicitly excluded from the scope of the PIE criteria. A small number of local authorities are currently classified as PIEs due to historic issues of securities to fund civic building construction or legacy war bonds. The risk compared to other similar public sector bodies does not justify the additional regulatory burden faced by the auditors of these bodies. The reforms offer the chance to remove this anomaly.
99. One of the reasons that the local authority audit market is seen as unattractive is that the bodies carry a relatively high inherent risk compared to similar sized companies due to under resourced local authority finance teams, weak financial positions, fraud risks from grant expenditure, increasingly complex transactions and investments and the rising possibility of the council's section 151 officer being forced to issue a section 114 notice.
100. Despite the high level of risk, audit fees remain substantially lower than in other sectors. MHCLG needs to provide funding to councils, particularly in more remote areas, to pay fees that reflect the level of risk and costs that firms are incurring. PSAA should be discouraged from engaging in measures that seek to artificially lower prices such as price caps.
101. One of the risks for the market is that the upcoming procurement round potentially excludes firms until 2028. This could result in measures like reformed KAP criteria and newly introduced training not having the intended positive impact on market capacity. MHCLG needs to consider what can be done to assist firms reach a position where they can submit high quality bids in time for PSAA's procurement or to enter the market during the appointing period. We welcomed PSAA's proposal for a dynamic purchasing system to mitigate this risk and hope this will be supported by the system leader and MHCLG.
102. The system leader needs to work with MHCLG to identify how it can simplify the local audit requirements and better align them with the corporate audit sector. This includes reviewing whether all the current quasi-judicial functions placed on local auditors are appropriate or whether this accountability can be better provided through a different route.
103. In addition, it is vital that the system leader works proactively and positively with CIPFA / LASAAC to ensure action is taken to address the length and complexity of local authority accounts. This includes assessing whether all notes designed for monitoring by central government departments, such as those on the Better Care Fund, need to be contained within the accounts as opposed to a separate return and whether it should bring forward legislation that allows pension fund accounts to be published in a separate document. Pension fund accounts are audited as a separate engagement but often unnecessarily delay the publication of the main audited local authority accounts.
104. MHCLG and other parties need to encourage local authorities to invest in their finance teams to improve their financial management, increase the quality of accounts and reduce audit risks. Grant Thornton's [statutory recommendations report](#) for Slough Council highlighted how significant weaknesses in the finance team led to both audit delays and major financial sustainability issues. While Slough is a well-publicised example, under-resourced finance teams are a common cause of delays or poor financial management practices.
105. MHCLG need to provide support to councils, including ensuring they have adequate funding to recruit and retain suitably skilled finance teams. They need to work with HMT to simplify

how local authorities are funded to prevent the need for so many complicated adjustments between the accounting and budgeting basis as well as provide more funding certainty for local authorities.

Question 22: Do you have any comments on the proposal to require smaller bodies to publish their budget statements and variance explanations alongside the Annual Governance and Accountability Return to aid transparency for local service users?

106. This proposal could improve the transparency of AGARs as they are currently difficult to understand.
107. However, the system leader, CIPFA / LASAAC and MHCLG must prioritise reforms to the reporting of principal local authorities rather than smaller bodies as there is much more public interest in these bodies.

Question 23: Is the current threshold of £6.5 million still right? If you think a different threshold would be more appropriate, please provide evidence to support this.

108. No. We believe it should be aligned with the thresholds in the Companies Act, which exempts an organisation from a full audit if it meets two of the following:
- an annual turnover of no more than £10.2 million
 - assets worth no more than £5.1 million
 - 50 or fewer employees on average.
109. This would address situations where there are other factors that might justify an audit such as the value of assets and employee numbers.
110. PSAA recognise that audit fees for small bodies often do not reflect the full cost and therefore have proposed a minimum fee for all audits in the draft prospectus ahead of the next appointing period. This is symptomatic of the issues of attempting to conduct ISA-compliant audits on very small bodies.
111. ICAEW research suggests only one principal local authority in England, the Council of the Isles of Scilly, would be brought below the turnover threshold. Based upon its importance to local democracy, there may be a case for requiring all principal English local authorities to have a full audit irrespective of their size.

Question 24: Do you have any comments on the proposal for a requirement for smaller bodies to transfer to the Category 1 authority audit regime only once the threshold has been breached for 3 years in succession?

112. ICAEW supports this proposal which we consider sensible and proportionate.