



INDEPENDENT REVIEW INTO THE ARRANGEMENTS IN PLACE TO SUPPORT THE TRANSPARENCY AND QUALITY OF LOCAL AUTHORITY FINANCIAL REPORTING AND EXTERNAL AUDIT IN ENGLAND

20 December 2019

ICAEW welcomes the opportunity to comment on the Call for Views published on 17 September 2019 on the Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England by the Ministry of Housing, Communities and Local Government (MHCLG) and led by Sir Tony Redmond, a copy of which is available from this [link](#).

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators, businesses and it leads, connects, supports and regulates more than 154,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and to apply the highest possible professional, technical and ethical standards.

ICAEW is the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering approximately 3,500 firms and 9,300 responsible individuals under the Companies Act 1989 and 2006. ICAEW is also the largest RSB in England in respect of local public audit, registering 8 firms and 94 key audit partners under the Local Audit and Accountability Act 2014 (LAAA).

Audit has been undergoing an unprecedented level of scrutiny both in the private and public sectors in the last 18 months. In our response to Sir Donald Brydon, on the *Independent Review into the Quality and Effectiveness of Audit*, we stated:

'The natural and necessary complement to the work of the Independent Review of the FRC and the CMA should be fundamental and independent examination of the role of audit itself, together with a review of corporate reporting The expectations of investors and other stakeholders... have rightly increased in recent years, and the purpose, scope and practice of audit needs to keep pace. Sir Donald's Independent Review is therefore timely and has our full support. That said, we accept the analysis of the BEIS Committee that the audit sector currently shows evidence not just of an 'expectation gap, but a delivery gap'.

'ICAEW feels strongly that early and urgent action to address public concerns regarding audit – alongside wider issues of corporate governance and management accountability – is vital to maintaining confidence in business. It therefore makes sense for the Government to get the process of reform under way, and to achieve as much as possible, even in advance of any new legislation. Chartered Accountants acknowledge this is a watershed moment for their profession and are ready to be willing partners in change.'

ICAEW's view is that both these paragraphs apply equally to local public audit and our view is that the reforms in the public sector should be consistent and carried out in tandem with the wider audit reforms. Many of the issues identified under the Redmond Review chime with the issues in the private sector, especially those around: the sustainability of the audit market (competition and the ability for new entrants to come into the market), the expectations of auditors to provide assurance on more forward looking information (financial resilience), the quality of auditors work (leading to the skills and resources issue).

At the time of writing, we note that the Brydon Report, *Assess, Assure and Inform: Improving Audit Quality and Effectiveness*, and the *summary of recommendations* have been published (18 December 2019). The report contains a substantial number of recommendations, and cautions that any extension of assurance should be achieved proportionately where possible. It recognises that all the stakeholders in the audit process bear a level of responsibility. One of the most significant recommendations is that the Government gives serious consideration to introducing a UK version of Sarbanes Oxley, whereby the CEO and CFO make a controls attestation to the board. It also proposes measures for greater clarity in relation to the role of the audit committee. While the Brydon Report is aimed at the Corporate Audit market, ICAEW's view is that some of the suggested reforms within the Brydon Report will also flow through into public sector audit.

We therefore look forward to working with the key stakeholders to develop effective measures to

- improve the usefulness of the financial statements in local authorities for the wide range of users;
- clarify and enhance the roles and responsibilities of those charged with governance within local authorities;
- increase choice of auditors in the local audit market and improve audit quality; and
- ensure that local public audit meets the future needs of taxpayers, local and central government and wider society.

ICAEW has responded to a number of external reviews in relation to audit, namely:

Review of the Financial Reporting Council by Sir John Kingman (ICAEW [Representation 92/18](#));

Statutory Audit Market by the Competition and Markets Authority (ICAEW [Representation 123/18](#));

Review of the Financial Reporting Council by Sir John Kingman: Arrangements for Auditor Procurement and Remuneration (ICAEW [Representation 127/18](#));

BEIS Committee: Future of Audit Inquiry – Written Submission (ICAEW [Representation 07/19](#));

CMA Statutory Audit Services Market Study – Update Paper (ICAEW [Representation 13/19](#)); and

Independent Review into the Quality and Effectiveness of Audit (ICAEW [Representation 64/19](#)).

ICAEW has also, since the announcement to abolish the Audit Commission in 2010, contributed a number of responses to key stakeholders in the development of the new framework, namely:

Draft Local Audit Bill (ICAEW [Representation 130/12](#));

Future of Local Audit: Consultation on secondary legislation (ICAEW [Representation](#));

Local Audit (in relation to smaller authorities) (ICAEW [Representation 98/14](#));

NAO Code of Audit Practice (ICAEW [Representation 142/14](#));

Local Audit: Extension of Contracts (ICAEW [Representation 93/15](#)) – Our comments in this representation are pertinent to the current situation that is currently now playing out;

Auditors Work on Value for Money (VFM) Arrangements (ICAEW [Representation 133/15](#)); and

Developing options of a national scheme for local auditor appointments (ICAEW [Representation 169/16](#)) – this representation is also worth noting for the various options that we have outlined in our response.

ICAEW also published its *Local Public Audit: expectations gap* paper in October 2019.

SUMMARY OF RECOMMENDATIONS

Paragraph No.	Recommendations
	<p style="text-align: center;">Local Government Financial Reporting</p>
13 to 20	<ul style="list-style-type: none"> a. reporting deadlines need to be reviewed to bring them more into line with the corporate world (which is six months) which would see the publication deadline revert back to 30 September. b. CIPFA should consider making the current Local Authority Code of Accounting Practice and related guidance notes available online for free and only charging for hard copies. c. there needs to be a wider review of the overall financial reporting framework in local government, including simplification and streamlining of the accounts to make them more accessible to the public <p style="text-align: center;">Sustainability of the local public audit market</p>
8(1) and 8(2) 11 22 68 ad 69 76 to 84 89	<p>There are a number of stakeholders that have a responsibility in relation to the local public audit framework that need to play a part in putting short-term and long-term solutions into place:</p> <ul style="list-style-type: none"> a. Key responsibility lies with various Government Departments to take leadership, for example: <ul style="list-style-type: none"> ○ MHCLG and Department of Health and Social Care (DHSC) should take the responsibility for reviewing and making amendments to the eligibility criteria within the LAAA. ○ MHCLG should review the local government four month publication deadline and consider whether it is reasonable in comparison to the complexity and detail of local government services and the related accounting statements. The reporting deadlines should be brought more into line with the corporate world which is six months. This would see the publication deadline revert back to 30 September. ○ BEIS should consider amending the statutory audit framework to enable fluidity of auditors between private and public sectors and also enable the use of overseas staff with relevant qualifications and experience. b. The FRC, working with BEIS, should review the local public audit eligibility criteria to enable more firms and key audit partners to enter into the market. c. PSAA should review its framework contract approach to consider whether the current contracts could be legally varied, with a view to increasing the number of contracts and number of local auditors in the market place. d. MHCLG should consider making audit committees, within local government, mandatory, with a requirement for audit committees to have independent members (similar to audit committees in health). e. Those charged with governance (eg audit committees) within local government should ensure that they understand their roles and responsibilities within the local government financial reporting and audit framework. They should also consider: <ul style="list-style-type: none"> ○ whether they themselves are challenging and exercising appropriate scepticism;

- reviewing the culture and behaviours within their own organisations;
 - whether there is effective communication between all parties; and
 - whether staff and members of audit committees have the necessary skills and expertise to make appropriate judgements about the audit recommendations.
- f. RSBs should make changes to their systems and processes where legislation and/or regulations are amended.
- g. The accountancy firms need to recognise the criticisms that have been directed at them by many of the parties involved in the local audit regime and consider the next course of action within their own firms regarding resourcing of the contracts within the PSAA framework.
- h. there needs to be a consistent approach to public sector audit across the UK and in different parts of government and all auditors carrying out public sector audit should be subject to the same regulatory and eligibility criteria (which may also help to increase the number of people that can carry out public sector audit).

Financial Resilience and Scope of Audit

43 and 44
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CFOs want auditors to challenge their forward-looking plans and assumptions and comment on the financial resilience of the organisation. However the traditional statutory audit is a backward-looking engagement, reviewing historical information and is not designed to look forward and currently there are no audit or assurance standards that can adequately cover forward-looking information. Two solutions, therefore, are:

- 1) As CFOs want additional advisory work, rather than just the audit, they can separately hire consultants (either accountancy firms not providing the statutory audit or other business advisory organisations with the required competencies) to work alongside them in their financial resilience work and challenge their budget assumptions.
- 2) The wider profession (IFAC, IAASB, FRC, accountancy bodies) should consider whether audit, in its current form, is sustainable and fit for purpose. It is clear from the wider debate in relation to private sector audit, that stakeholders want greater assurance, through greater depth of testing, analysis and more detailed reporting of financial matters. It is perhaps, therefore, time to look at the wider scope of audit and whether that needs to change in the future. For example, could there be more value in auditors providing assurance reports on key risk indicators which have a greater future-looking focus, albeit based on historic data?
- 3) If the scope of audit and the VFM conclusion were widened, there would need to be consideration of:
 - a. the additional risks that auditors would be exposed to;
 - b. the impact on auditors' liability insurance;
 - c. the associated costs with carrying out additional work; and
 - d. the willingness of local authorities to pay for these extra costs.

The Brydon Report (published 18 December 2019) considers these issues in relation to corporate audit. It will take time to consider if and how some of the corporate audit reforms will filter through to the public sector.

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MAJOR POINTS

BETTER REGULATION PRINCIPLES

1. While we agree that there are a number of issues that need to be considered, which the Call for Views paper highlights, we do not think it would be cost effective to completely abandon the new regime, which has only been in place for a relatively short time, and go back to an Audit Commission style model, as may be suggested by other respondents. Many of the actors under the new regime, including ourselves, have made significant investment in our own systems and processes, in a bid to work with Government to make the new local audit regime work in the wider public interest. The overall cost of the package of the changes that were made is unknown, as many of the stakeholders absorbed the costs within their own organisations. While the profession will be willing partners in making further changes through the recommendations that have been published through the Brydon report and will be published through the Redmond Review, our view is that it would not be in the public interest to abandon the new local public audit regime and revert back to a framework similar to that which was previously in place. We believe that all stakeholders, including local government bodies, need to work together to put solutions in place to iron out the issues that local authorities and the local audit market are currently facing. Our recommendations are summarised on pages 3 and 4.
2. The problems that have been identified this year demand simple and robust solutions that focus on the sustainability of the local audit market and the core objective of audit quality. There is a need to take important actions to enhance and strengthen the future sustainability of the audit market. Consideration should also be given to the regulation of auditors and the role of those charged with governance (TCWG). But the scale of any proposals must be considered to ensure that they are properly framed and assessed with a rigorous upfront assessment of priorities. Without this, legislators and regulators will not have the capacity to do a proper job and public expectations of meaningful change will not be delivered.

THE ROLE OF THE PROFESSIONAL BODY IN FACILITATING CHANGE

3. As in our comments on the Brydon review, we recognise, in making our suggestions for the future sustainability of the local audit market and the future of local audit itself, our own role and responsibilities as the main RSB provides us with the potential to do more. To that end, we are bringing together a group of the main stakeholders in the local audit market at our London offices on Monday 13 January 2020 to discuss two key aspects:
 - a. short-term pressures on the local audit market; and
 - b. long-term measures for future sustainability.
4. At this meeting, we will put forward some solutions which we anticipate will be seriously considered by the key stakeholders whom, we hope, will commit to making the appropriate changes that will be needed in both the short and long-term.

RESOLVING PRESSURES ON THE LOCAL AUDIT MARKET

5. One of the short-term pressures is the inability for firms to easily register new key audit partners through the current legislation and subsequent regulations. One of the barriers to entry is the focus on specialist skills for local public audit. ICAEW raised concerns at several stages during the development of the new framework that setting the eligibility criteria too narrowly will result in barriers to entry and would be contrary to one of the original policy objectives in 2010, which was to open up the market to competition.
6. Unfortunately, the subsequent drafting of the legislation and the regulations for the eligibility criteria means that it is virtually impossible for any new firms that have not previously carried out public sector audit, to enter into the market and be recognised as local auditors without significant investment. Additionally, it is very difficult for firms to nominate key audit partners who do not have extensive experience of the public sector. There is also an additional disincentive created for firms trying to train auditors in both private and public sector audits

because currently the number of days of UK statutory audit experience, necessary for the achievement of the Companies Act audit qualification, does not include public sector audit (120 days out of the 240 days needed are out of reach). Paragraphs 8(2)b and 76 to 84 below, provide further information.

7. PSAA's framework contracts created another, perhaps inadvertent barrier to entry specifically for local government. These contracts concentrated solely on firms that had been in the local audit market previously (under the old Audit Commission regime) and did not fully recognise new firms that had made significant investment to enter into the market, who had met all the eligibility criteria and indeed were registered on the local audit register (See ICAEW's representation 169/16 to PSAA's consultation *Developing options of a national scheme for local auditor appointments*).
8. ICAEW's view is that:
 - 1) to overcome the immediate short-term resource issues (paragraphs 22, 68,69 and 89), PSAA should vary the current contracts, taking away a percentage (perhaps ten to twenty percent) of the current contracts and putting them back out to tender, allowing the other firms on the local audit register to bid for the work.
 - 2) for the longer term solutions (paragraphs 22, 76 to 84 and 89):
 - a. MHCLG should amend the LAAA to allow for relevant/equivalent overseas qualifications for key audit partners to be recognised (alongside the public sector audit experience);
 - b. BEIS should amend the Companies Act legislation to allow for public sector audit work experience to be included against the number of days required for UK statutory audit; and
 - c. The FRC should amend the local audit eligibility criteria to enable established and experienced private sector auditors to carry out public sector audits.
9. ICAEW believes that the recommendations above will help to open up the audit market, allowing more fluidity between private and public sector audit teams within the UK and enable firms to use relevant and equivalent skills from their overseas audit teams.
10. We understand that there are also similar pressures in relation to resourcing in the private sector, therefore making these amendments, and allowing easier movement of experienced auditors between sectors would help to ease these pressures as well as providing broader long-term career paths for future auditors.
11. One further aspect that ICAEW thinks needs addressing is that only local auditors in England are subject to such a tight eligibility criteria and regulatory regime. Auditors in other UK jurisdictions, along with auditors of central government bodies, have no such criteria or regulatory burden placed upon them in terms of qualifications and experience. For example, the NAO could procure any accountancy firm to carry out the audit of the Ministry of Defence, without going through any eligibility criteria and only be subject to voluntary regulation. However, the auditor of a small district council is subject to a stringent eligibility criteria and regulatory monitoring through the LAAA. In our view, there needs to be a consistent approach to public sector audit across the UK and in different parts of government and all auditors carrying out public sector audit should be subject to the same regulatory and eligibility criteria (which may also help to increase the number of people that can carry out public sector audit).

UK GLOBAL LEADERSHIP

12. In our response to the Brydon review, we stated that, '*While, we fully acknowledge the significance and impact of recent corporate failures, and acknowledge the need for fundamental change, it is important to recognise that the UK audit sector operates to rigorous professional and technical standards and is recognised internationally as high calibre.*' This is also true of local public audit work, which is wider in scope than private sector audit.

Alongside the work being undertaken on the wider private sector audit debate, this review on local public audit also provides the opportunity for the UK to show global leadership in the public sector to develop solutions to the issues under consideration, which may also be used as best practice in other countries around the world. We should therefore continue to develop this new model for public sector audit to make it work, while ensuring that the package of measures for change supports and strengthens the audit profession (both in the private and public sectors) and does not impede our international competitiveness in the audit market.

LOCAL GOVERNMENT FINANCIAL REPORTING

13. Local government accounts are long and complex (not dissimilar to corporate accounts) and for larger local authorities, they can run into hundreds of pages of information. While they are prepared in accordance with IFRS, there are other requirements specifically for local authority accounts which make them difficult to understand.
14. ICAEW agrees that it is important to have a good set of financial statements which play a key part in providing accountability to local residents and to other users on how public money has been spent. CIPFA has published best practice guidance on how annual accounting statements can be streamlined, focusing on some of the questions in this review. ICAEW's view is that there is merit in considering whether a simplified form of accounts might be suitable for local government.

Deadline for publication of financial statements

15. The **Accounts and Audit Regulations 2015**, in section 10 (1) made amendments to the deadline for publication of the audited set of local authority accounts to 31 July (previously 30 September) following the end of the year to which they relate. However, if the audit has not been completed by that date, according to section 10 (2), local authorities must publish a statement as soon as possible on or after that date, explaining that they have not been able to publish audited financial statements with an explanation for the delay. The 2018/19 audits have seen an unprecedented number of local authorities whose financial statement audits were delayed because auditors were unable to carry out the audit (due to resource issues at both the firms and many of the local authorities), as well as complexities in some of the financial reporting (such as Pensions, which arose as a result of the McLeod pensions ruling).
16. Local authority deadlines cannot be viewed in isolation. Firms' health audit portfolios, which have an earlier deadline of 31 May, create part of their resource issue. This tighter deadline is achievable because health financial statements are less complex and the health sector undertakes a hard close at month nine and a centrally managed agreement of balances exercise exists at year end which provides firms with strong audit evidence. In some instances, this then leaves firms with a two-month window to carry out local authority audits given the limited resource pool.
17. Bringing forward a deadline on a complex set of accounts has created undue pressure on both local authorities and on auditors (who face pressure to sign off their audits even if they are unable to). This deadline (of 4 months for publication) is out of sync with the corporate world (for example, private companies publish audited financial statements within 9 months of the accounting reference date and public companies, within 6 months of the accounting reference date¹).
18. ICAEW's view is that these reporting deadlines need to be reviewed again to bring them more into line with the corporate world (which is six months) which would see the publication deadline revert to 30 September. Further, our view is that meeting a deadline should not take priority over the auditors' judgement to carry out more work or the quality of the work itself.

¹ For all companies with listed shares (and not applying listed rule 17.3), and those with a retail listing of debt, the rules on financial statements are set out in the Disclosure and Transparency Rules. Annual reports are required within four months of the year end.

Availability of Local Authority Accounting Code of Practice

19. At the time of this response, ICAEW notes that the *Local Authority Accounting Code of Practice* is not freely available. We understand that because of the cost, many local authorities do not purchase updated versions of the Code, which could lead to quality issues with the draft financial statements and supporting working papers. We have been made aware that a local government objector, wanting to scrutinise a set of financial statements in order to exercise their rights under the LAAA to question an item of account, was advised that they would need to purchase the Code – at a current cost of £2,880 for both the **Code** and **guidance notes**. This is not cost-effective for either local authorities or indeed for users who wish to first understand the accounts before they exercise their rights under the Act. We note that health guidance notes, IFRS² and IPSAS are freely available online (some with registration) and only hard copies are chargeable. CIPFA should perhaps also consider making the current *Local Authority Code of Accounting Practice* and related guidance notes freely available online and only charging for hard copies.
20. ICAEW's view is that there needs to be a wider review of the overall financial reporting framework in local government, including simplification and streamlining of the accounts to make them more accessible to the public. There should also be consideration of whether a four month deadline for publication of the financial statements is reasonable in comparison to the complexity and detail of local government services and the related accounting statements (paragraphs 15 to 18 above refer). These complexities are only getting worse with increasing commercialisation to address reducing financial resources.

RESPONSIBILITIES OF KEY STAKEHOLDERS WITHIN THE SECTOR

21. While much is said about the failure of auditors in both the private and public sector when things go wrong, ICAEW's view is that it is important to concentrate on all the parties in the relationship.
22. There are a number of bodies that have a responsibility in relation to the local public audit framework that need to play a part in putting short and long-term solutions into place:
 - a. Key responsibility lies with various government departments to take leadership, for example:
 - MHCLG and the Department of Health and Social Care (DHSC) should take responsibility for reviewing and making amendments to the eligibility criteria within the LAAA and reviewing financial reporting aspects (including the accounts publication deadline); and
 - BEIS should consider how to amend the statutory audit framework to enable fluidity of auditors between private and public sectors and enable the use of overseas staff with relevant qualifications and experience.
 - b. The FRC, working with BEIS, should review the local public audit eligibility criteria to enable more firms and key audit partners to enter into the market.
 - c. PSAA should review its approach to framework contracts to consider whether the current contracts could be legally varied, with a view to increasing the number of contracts and number of local auditors in the market place.
 - d. MHCLG should consider making audit committees, within local government, mandatory, with a requirement for audit committees to have independent members (similar to audit committees in health).
 - e. Those charged with governance (eg audit committees) within local government should ensure that they understand their roles and responsibilities within the local government financial reporting and audit framework. They should also consider:

² The IFRS Foundation provides free access to the PDF files of the current year's consolidated IFRS Standards (Part A of the Red Book), the official pronouncements in English as issued by the Board, as well as available translations of Standards, excluding the accompanying documents (illustrative examples, implementation guidance and bases for conclusions).

- whether they themselves are challenging and exercising appropriate scepticism;
 - reviewing the culture and behaviours within their own organisations;
 - whether there is effective communication between all parties; and
 - whether staff and members of audit committees have the necessary skills and expertise to make appropriate judgements about the audit recommendations.
- f. RSBs have a key role to play in this dialogue in both their role as regulator but also when acting in the public interest. While ICAEW cannot instigate many of the recommendations outlined in this response, we can facilitate the dialogue between key stakeholders and make recommendations to put into place realistic changes to the current system which has shown signs of weakness. ICAEW can, and is willing to, make changes to its own systems and processes where legislation and/or regulations are amended. We are also amending our own training models to offer training to local government audit committees and finance directors on:
- understanding their roles and responsibilities;
 - helping them to identify cultural and behavioural issues;
 - to learn how to challenge and exercise scepticism; and
 - consider how effective their communications are with different parties.
- g. The accountancy firms need to recognise the criticisms that have been directed at them by many of the parties involved in the local audit regime and consider the necessary course of action within their own firms regarding resourcing of the contracts within the PSAA framework.
23. While recognising that the Redmond Review is in relation to local authorities, any recommendations made through this Review should also consider the impact on DHSC, as well as local government, to minimise further fragmentation.

ANSWERS TO SPECIFIC QUESTIONS

CHAPTER 1: DEFINITIONS OF AUDIT AND USERS OF THE ACCOUNTS

Q1. Who, in your opinion, are the primary users of/main audience for local authority accounts?

Q2. Who are the other users of local authority accounts? Are any of these other users of accounts particularly important?

24. We agree with the definitions in the Call for Views about who the primary and other users are. There are indeed many parties that have an interest in local authority accounts and will therefore have differing expectations of the information in the statement of accounts and the audit process.

Q3. What level of financial literacy/familiarity with accounts and audit is it reasonable to expect the primary users of accounts to have and what implications does this have for the information presented in accounts and/or the information that should be subject to external audit?

25. Local authority statements of accounts are complex and at times difficult to understand. While they are prepared in accordance with IFRS, there is a lot of other detailed information that only local authorities are required to include within the accounts. The uniqueness of the information within a local authority set of accounts, can make them harder to understand than other local public bodies and public sector organisations, and therefore less directly comparable.

26. It is also true that users may have differing levels of financial literacy depending on their background and the purpose for which they seek to use the information. This includes audit committee members / TCWG who may not necessarily have the skills due to the political nature of their appointments. This differs to audit committee members in the corporate world and in health bodies where non-executive directors are specifically appointed for their financial literacy/ familiarity with accounts and audits.

27. Other users may not have familiarity with accounts and audit, but it is not unreasonable for them to want to scrutinise the accounts and the LAAA allows for a resident of a local authority to question the auditor and/or object to an item in the accounts. It would therefore not be unreasonable for these people to expect to have access to a set of accounts that is more easily understood.

28. Our view is that more needs to be done to simplify local authority financial statements and bring them into line with other parts of government. This has to come from MHCLG carrying out a comparison of local authority accounts with other public sector financial statements. The comparison should identify the differences and similarities and then consider how they could make a set of accounts simpler which would provide residents of a local authority with the necessary and relevant information to enable them to exercise their rights. The outcomes from the Brydon Report (published 18 December 2019) may helpfully inform the direction of travel on this particular point.

29. MHCLG should also make the role of audit committees, within local government, mandatory. They should also include a requirement for the audit committee to have independent members (similar to the audit committees within the health sector).

Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

30. The scope of public sector audit across the UK generally (including local public audit in England), is already wider than the private sector, with additional opinions or conclusions required in relation to value for money (VFM) arrangements. The external audit of local

authorities covers the aspects required by the LAAA, the NAO's Code of Audit Practice, the international statements of auditing standards, and *Practice Note 10: Audit of financial statements of public bodies in the United Kingdom*.

31. There could be a wide range of interests of the primary users and it would be difficult for an audit to attempt to cover the interests of all potential users. Local authority audit already benefits from the ability of the primary users (eg local residents) to question the auditor and object to items of account which could lead to a number of outcomes:
- a. additional work on aspects of the accounts;
 - b. changes to scope of VFM work;
 - c. public interest reports; or
 - d. statutory recommendations.

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it?

32. The work required to conclude on the going concern assessment for the financial statements audit opinion and the work on financial resilience as part of an auditors VFM arrangements work are linked but have distinct considerations.

Going Concern

33. Generally, the going concern principle is fundamental in compiling the financial statements of any entity. It assumes that the reporting entity will continue for the foreseeable future, unless there is an intention to liquidate that entity, or for it to cease operating, or if there is no realistic alternative but to do so. Where there are material uncertainties that cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties need to be disclosed and particular accounting treatments may be required.
34. Going concern has generally been less relevant in the public sector than in the private sector because of the general longevity of governments, the long-term characteristics of many public sector programs and the very broad tax-raising powers of national governments. In the past, if local authorities experienced financial difficulties, their main service delivery commitments continued to be funded or transferred to restructured successor bodies, rather than lapsing completely.
35. While the going concern principle may be of less significance in the public sector, the long-term sustainability of key programs is of increasing relevance in the current environment where austerity has been a key government policy and public sector spending has continued to be cut.
36. In the current turbulent financial climate, the financial consequences of many decisions made today will only become clear years or even decades into the future, therefore prospective financial information covering lengthy time horizons is necessary for accountability and decision-making purposes. This obviously has implications for the scope of financial reporting and therefore the going concern concept should not be dismissed as being meaningless when assessing a local authority's financial resilience.
37. According to IPSAS 1, Presentation of Financial Statements, those responsible for the preparation of the entity's financial statements are responsible for the preparation of an assessment of the entity's ability to continue as a going concern (for the next twelve months (at the reporting date)) and indeed financial statements are normally presented on this basis. Only if the organisation is deemed to be a going concern, will management include a statement that the entity will continue to operate and meet its statutory obligations for the foreseeable future.
38. In the public sector, this assessment is not usually based on solvency tests (as applied in the private sector), but other factors will be considered, such as the entity's ability to levy

business rates or taxes, multi-year funding agreements or other arrangements that are in place which demonstrate that the entity will continue to operate.

VFM arrangements

39. The auditor's work is limited to the statement made by management (the CFO), usually through the value for money arrangements conclusion. It is not possible under current international audit, assurance and ethical standards for auditors to provide an opinion or comment on management's processes in this respect or of the local body's strategy or policies or future management plans, which is one of the issues that the CFO feels is missing from the audit.
40. In ICAEW's publication, *Local Public Audit: Expectations Gap*, we made a number of recommendations in relation to the financial resilience point:

Future Financial Viability of local public bodies

Local public bodies are being asked to deliver more with less and be more innovative and commercial. CFOs are, of course, nervous at taking risks in the current environment and therefore would like more involvement by their auditors. They want auditors to challenge their forward-looking plans and assumptions and comment on the financial resilience of the organisation. However the traditional statutory audit is a backward-looking engagement, reviewing historical information. It is not designed to look forward and currently there are no audit or assurance standards that can adequately cover forward-looking information.

Two solutions, therefore, are:

- 1) As CFOs want additional advisory work, rather than just the audit, they can separately hire consultants (either accountancy firms not providing the statutory audit or other business advisory organisations with the required competencies) to work alongside them in their financial resilience work and challenge their budget assumptions (indeed, NHSI and NHSE routinely do this where CCGs or trusts are struggling).
- 2) The wider profession (IFAC, IAASB, accountancy bodies) should consider whether audit, in its current form, is sustainable and fit for purpose. It is clear from the wider debate in relation to private sector audit, that stakeholders want greater assurance, through greater depth of testing, analysis and more detailed reporting of financial matters. It is perhaps, therefore, time to look at the wider scope of audit and whether that needs to change in the future. For example, could there be more value in auditors providing assurance reports on key risk indicators which have a greater future-looking focus, albeit based on historic data?

41. We note that the consultation on the NAO's next Code of Audit Practice is considering widening the scope of the work underpinning the VFM conclusion. However, the current legislative requirement is in relation to auditors assessing the arrangements that the local authority has in place. To bring in a wider scope of work and a different reporting requirement would require a change in legislation.
42. The wider audit debate and reforms are already considering similar issues. It is therefore necessary to make sure that the recommendations for local public audit align with the reforms that are carried out in the wider audit market.
43. Our recommendations in this area therefore remain as per our publication (*Local Public Audit: expectations gap*) which are:
- 1) As CFOs want additional advisory work on their financial resilience, rather than just the audit, they can separately hire consultants (either accountancy firms not providing the statutory audit or other business advisory organisations with the required competencies) to work alongside them in assessing their financial resilience work and challenge their budget assumptions (indeed, NHSI and NHSE routinely do this where CCGs or trusts are struggling).

- 2) The wider profession (IFAC, IAASB, accountancy bodies) should consider whether audit, in its current form, is sustainable and fit for purpose. It is clear from the wider debate in relation to private sector audit, that stakeholders want greater assurance, through greater depth of testing, analysis and more detailed reporting of financial matters. It is perhaps, therefore, time to look at the wider scope of audit and whether that needs to change in the future. For example, could there be more value in auditors providing assurance reports on key risk indicators which have a greater future-looking focus, albeit based on historic data?
- 3) In addition, if the scope of audit and the VFM conclusion were widened, there would need to be consideration of:
 - a. the additional risks that auditors would be exposed to;
 - b. the impact on auditors' liability insurance;
 - c. the associated costs with carrying out additional work; and
 - d. the willingness of local authorities to pay for these extra costs.

CHAPTER 2: THE EXPECTATION GAP

Q6. In your opinion, what should an external audit of a set of local authority financial statements cover?

44. In ICAEW's view, the audit of a local authority's financial statements needs to cover what is laid out in the legislation, ISAs and the Code of Audit Practice.
45. We will be interested to see others' response to this question.
46. There is, of course, a call for a wider scope of audit both in the private and public sectors. ICAEW is supportive of moves to review the scope of audit in the UK, however, first there needs to be clarity regarding what it is that users want and the underlying information and paperwork that organisations will need to provide to enable auditors to carry out a wider scope of audit.
47. We would urge that any reviews and recommendations in relation to the scope of local audit remain consistent with the wider audit reforms, to ensure that practices in both sectors remain aligned.

Q7. In your opinion, what should the scope of the external auditor's value for money opinion be?

48. In ICAEW's view, the current scope of the auditors VFM conclusion should be what is laid out in legislation and the Code of Audit Practice.
49. However, we acknowledge that there is a call for extending that scope to include more detailed considerations of financial resilience. We will be interested to see the response from others' to this question.

Q8. What is your view on the scope of an external audit engagement as described in Chapters 1 and 2 of this Call for Views? If it is different from your expectations, does this have implications for the reliance you place on external audit work?

Q9. Should the external audit engagement be extended? If so, which additional areas/matters are most important for external auditors to look at? What would be the cost implications of extending the engagement to the areas/matters you consider to be most important be?

50. The decision, by the then Secretary of State, to abolish the Audit Commission in August 2010 was a radical move. Indeed, the vision appeared to be for the sector to be innovative and create some serious change (for example to create and increase competition in the audit market, allow local bodies to choose their own auditors, etc). However, the reforms that were eventually put into place did not create the innovation that was envisaged. The opportunity was lost. Instead, aspects of the old Audit Commission approach (appointment of auditors by a sector-led body through framework contracts) have been put into place under a new and fragmented audit and regulatory framework.
51. Trust and confidence in public spending needs a framework of accountability, transparency, governance and ethics. Local public bodies need to demonstrate that they have spent public money economically, efficiently and effectively on the services that are needed for their residents. The strength of the local audit arrangements is that there is a wider scope of audit and local public auditors have wider reporting powers.
52. The Call for Views paper articulates the many examples of expectations of auditors that are not matched. It also highlights that users may perceive the expectations gap to be a gap in relation to audit quality, that auditors of local authorities have inadequate sector knowledge, inadequate skills, inadequate resources or inadequate systems to fulfil their statutory responsibilities. This is not a view that ICAEW supports.

53. The audit expectations gap is not new. In our paper *Local Public Audit: Expectations Gap*, we touch on a number of the issues that are highlighted in the Call for Views paper. The expectations gap was also discussed in the Brydon Review. As outlined in our response to Brydon, it is true that there are multiple expectation gaps and the gaps vary over time and by stakeholder. The fact that whatever steps are taken to reform audit, that there continues to be these expectations gaps, is of serious concern.
54. It will be interesting to see the answers from users of the accounts to the questions in this Call for Views, which will hopefully help the profession to understand what it is that users believe they are not receiving from the current scope of audit. It will then be a matter for the Redmond Review to consider, with the profession, what is feasible to include within the audit engagement, whether there are existing auditing standards that can be applied or whether new standards would need to be set, and indeed what the content of those standards might be within which the additional work would need to be carried out. There will obviously be cost implications if the scope of audit were to be increased and this then brings questions of the willingness of local authorities or those other stakeholders who require additional assurance, to pay for the additional reports or an increased scope.
55. Reforms to local public audit depends largely on two things:
 - 1) the appetite for stakeholders to be willing to change; and
 - 2) the development of a new framework that works for all stakeholders.
56. Future changes need all stakeholders to review some of their long-held assumptions to work together to achieve the required outcomes. It is easy to fall back on old ways of doing something and it is easy to point to legislative, regulatory or international standards which may currently be restrictive and potentially not fit for purpose in the current environment, as a backdrop to not making changes. But to really overcome some of the challenges identified in this paper, these barriers need to be broken down and more innovative solutions are needed to make any real change. We discuss these further in this response.

CHAPTER 3: AUDIT AND WIDER ASSURANCE

Q10. Should the scope of the vfm opinion be expanded to explicitly require assessment of the systems in place to support the preparation of some or all of the reports that statute requires to be presented to full Council? If you do, which reports should be within scope of the external audit vfm engagement? If not, should these be assessed through another form of external engagement? If you believe that the vfm opinion should be extended to cover these reports will there be implications for the timing of audit work or auditor reporting?

57. ICAEW's view is that to bring reports that MHCLG or other government departments require into the scope of the statutory audit would only seek to confuse the expectations gap regarding 'what is an audit' even more.
58. If MHCLG and/or other government departments require assurance on other areas which fall outside of the scope of audit (which is specifically defined in the legislation), then it is possible for those departments to set up separate assurance frameworks which can be tailored to the specific requirements. It may be worth considering the purpose, scope and form of report that would be required for each of these other statutory areas which fall outside the scope of audit.
59. In addition, extending the scope of the auditors' work on the VFM conclusion – which is currently in relation to the adequacy of the local body's arrangements in place – would require there to be a change in the legislation. There would also need to be specific standards and/or detailed guidance for auditors on the scope of work, the level of testing and the form of report so that all parties are clear about the new framework and what is expected from auditors.
60. We note that the NAO has a specific team dedicated to carrying out high level local government reviews. This team has carried out a couple of relevant reviews over the last eighteen months, on the **financial sustainability of local authorities** (at a macro level); and a more recent report on **local authority governance** (again at a macro level).
61. ICAEW's view is that it could be worth MHCLG engaging with the relevant NAO team to carry out these reviews at a local level, targeting individual local authorities, perhaps on a sample basis.

Q11. Should external auditors be required to engage with Inspectorates looking at aspects of a local authority's service delivery? If you believe that this engagement should happen, how frequent should such engagement be and what would be the end purpose of doing so?

62. The answer to this question depends on what is meant by 'engage'. We agree that there should be dialogue between auditors and inspectors to inform each other's work and have regard to significant financial or operational risks. However, we do not think that there should be any formal reliance or reporting responsibilities in relation to each other's work.
63. The auditors' responsibilities are in relation to the audit of the financial statements rather than the service delivery aspects. Inspectorates were set up because it was felt that they were best placed to consider service delivery aspects. To include this engagement as part of the audit of the statement of the accounts would increase the scope of the audit into areas where auditors do not have the necessary service level skills or expertise. It would also confuse the 'what is an audit' part of the expectations gap.
64. When the Audit Commission existed, this engagement was carried out at a higher strategic level based on the VFM studies that the Audit Commission itself used to carry out through its VFM studies directorate. However, this activity was at that time deemed, by the then Government, to be going beyond the Audit Commission's role and remit.
65. If there is a view that auditors should engage with Inspectorates who are looking at a local authority's service delivery, it would need to be clear what the purpose of this engagement

would be, what it is that the auditors should engage on and how that engagement would fit into the scope of audit on the financial statements and the adequacy of VFM arrangements.

CHAPTER 4: THE GOVERNANCE FRAMEWORK FOR THE AUDIT SYSTEM

Q12. Does the current procurement process for local authority audit drive the right balance between cost reduction, quality of work, volume of external audit hours and mix of staff undertaking audit engagements?

66. We are aware that there are concerns in the current local audit market under the first year of the PSAA contracts. Therefore it is clear that the current contractual framework between PSAA, the firms and local bodies is not working as intended. In order to consider how these issues might be resolved, it is crucial to understand what has gone wrong and why, before solutions can be developed.
67. The drive to reduce fees, since the announcement of the abolition of the Audit Commission in 2010, took on greater significance in the local audit market, arguably to the potential detriment of other factors such as quality of work. In the development of the new regulatory and audit regime for local public bodies, a low audit fee was seen as a good thing without there being sufficient debate or discussion about the 'value of audit' and what local bodies (and indeed what other stakeholders) might actually want from auditors' reports. In our paper *Local Public Audit: expectations gap*, we discuss the issue of decreased audit fees (pages 15 and 16).
68. ICAEW's view is that, in the short-term, to overcome the current resourcing issue that the firms are experiencing, the contracts with the current firms may need to be varied (paragraph 8 (1) and paragraph 22c refers). This may need legal advice. Our recommendation, subject to agreement by all parties and any contractual requirements, would be that a proportion of each contract (the exact proportions to be agreed with and between the parties) should be taken back by PSAA (thereby reducing the number of audits within a contract) and these should be put back out to tender in the open market allowing other firms on the local audit register, to bid for the work.
69. ICAEW had, in its **response** to PSAA's consultation on *Developing options of a national scheme for local auditor appointments*, made suggestions for the future sustainability of the local audit market. Our view is that having additional, perhaps regional, contracts, would allow more local auditors into the market which in turn will make the local audit market more sustainable.

Q13. How should regulators ensure that audit firms and responsible individuals have the skills, experience and knowledge to deliver high quality financial and vfm audits, whilst ensuring the barriers to entry do not get too high?

70. To bring more firms and individuals into the local audit market, and to ensure that the relevant skills, experience and knowledge are available, it is necessary to understand the barriers to entry in relation to the eligibility criteria that currently exist and to consider how these can be removed as a matter of priority.
71. Currently the eligibility criteria is set through the LAAA **Section 5 (9)** and the FRC's **Guidance to Recognised Supervisory Bodies on the approval of Key Audit Partners for local audit**. While RSBs carry out the approval and checking process, they are required to follow both the legislation and FRC's Guidance.
72. ICAEW in its initial first round of approvals of local auditors and key audit partners, approved nine firms in England: (EY, PwC, KPMG, Deloitte, BDO, Mazars, Grant Thornton, Moore Stephens and Cardens). A further firm was approved by ICAS (Scott Moncrieff). A merger in 2019, of Moore Stephens with BDO, has reduced the number in England to eight. Scott Moncrieff is now part of Baldwins and a decision regarding their ongoing registration is yet to be made.
73. Currently there are 97 Key audit partners (KAPs), but this number will decrease in the near future as many of the current KAPs are coming up to retirement or moving onto other (non-

audit related) jobs. It should also be noted that with the many risks associated with local public audit, plus the tight eligibility criteria, and the intense pressure around deadlines, local audit is not seen as an attractive career option.

74. In the procurement process carried out by PSAA in 2016, the criteria for eligibility for its contracts were narrower than that of the legislation and regulations, which resulted in the newest firm in the market (which had already met the tight eligibility criteria through the registration process) being ineligible to apply for any of the PSAA contracts. This inevitably creates a significant barrier to entry for any new firm trying to enter the market. It is questionable whether this narrowing of the eligibility criteria is appropriate in the context of the better regulation provisions of the Legislative and Regulatory Reform Act 2006 section 21, though PSAA may be outside its reach.
75. The approach is also suppressive of innovation and cross-learning across the different spheres of audit as best practices in other jurisdictions are inhibited from being translated into the market and methodologies.
76. ICAEW's view is that the Legislation (both Companies Act and the LAA) and FRC Guidance need to be amended to allow entry for a wider pool of auditors: for example, currently the qualifications for a key audit partner (KAP) only allow for UK accountancy qualifications, however some of the firms in this market are global firms and move their global audit staff around. Currently, if the firm puts forward an individual who has been working on local audit engagements (therefore having the necessary experience) but who has an overseas qualification, they cannot be approved as a KAP unless they obtain a UK 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, it doesn't make sense to restrict this requirement to UK qualifications. In ICAEW's view, the wording of the legislation and/or regulations could be amended to allow for wording such as 'or equivalent overseas qualification'.
77. A further challenge in the market to ensuring that a healthy supply of qualified people can become eligible to sign local public audit reports concerns an experience barrier which currently exists, but which, in our view, is removable, in whole or in part. The audit qualification for companies under Schedule 11 of the Companies Act 2006 has been in the past, and remains today, a relevant qualification to become a 'Key Audit Partner' (KAP) for local public audit. Someone holding a local public audit qualification must then meet additional criteria, including experience, to become a KAP.
78. The regulatory bottleneck here is that in order to gain the (company) audit qualification, it is necessary to have achieved as part of the qualification process at least 120 days of experience (out of 240 days) under supervision in "UK statutory" company audit³. Experience in local public audit currently does not count towards this 120 days.
79. As audit is becoming an increasingly specialist service across types of industry and unique types of asset and liabilities, the lock into generic experience is proving, in certain jurisdictions, to be counter-productive. In the Isle of Man, for example, limited capacity for auditors to gain PIE audit experience is leading to audit firms putting forward proposals for work on local 1931 company audits to be counted for equivalent experience based on common standards and reporting. The commonality of many of the competencies required for both regimes make this a practical solution facilitating the continued sourcing of this

³ Per the criteria, you must have completed an appropriate period of work experience:

- a minimum of three years general training and work experience obtained within an ICAEW Authorised Training Employer (ATE).
- at least two of the three years must have been completed within a EU firm of registered auditors.
- achieved a minimum of 240 days appropriate audit experience. This experience can be gained both during training or post qualification whilst in membership. Of the 240 days audit work experience:
 - at least 120 days must be in statutory audit work as defined in the Companies Act 2006, and;
 - the rest must be in either statutory audit work or other audit work similar to statutory audit work, where the nature of such work conforms to the definitions agreed by ICAEW and the Financial Reporting Council.

service in the island and promoting competition. ICAEW believes similar commonality of competencies exist between public and private sector audit.

80. In addition it should be noted that since the issue of the eligibility criteria in 2014, IESBA have tightened up the requirements for records of experience on audits by KAPs for CPD purposes to support ongoing competence.⁴ Such records now facilitate the illustration of the competency build across a number of audit areas on common standards as well those specific to the local audit environment.
81. It is counter-intuitive and counter-productive that someone holding the audit qualification has to gain additional experience specifically in local public audit in order to become a KAP, but that experience in local public audit cannot be used by itself in order to gain the underlying regulatory qualification. The consequence of this is that trainee auditors working largely or exclusively on local public audits - which might be thought excellent preparation for life as a local public auditor - cannot gain the audit qualification. This in turn has created difficult and perverse circumstances with certain specialist audit employers, where despite their expertise it is very difficult for their staff to become appropriately qualified. It is strange that the national company audit work of several European countries has been accepted by the FRC as counting as "UK statutory" for the purposes of an audit qualification application, but the local public audit experience from the UK is not accepted.
82. If the FRC accepted, on the basis of its similarities, that local public audit experience could be counted as "UK statutory" - possibly up to a cap of a certain number of days - this would significantly help audit firms to support and increase the education of quality staff as local public auditors. The "Responsible Individual" (RI) process for signing rights for company audit would still ensure (together with any imposed cap) that no backdoor would exist into the company audit space for those who had not gained sufficient relevant experience.
83. This issue has been going on for a number of years. ICAEW has raised the possibility of local public audit experience counting towards the audit qualification with the FRC on a number of occasions. Our view is that it is now time to make those changes.
84. ICAEW's view is that the recommendation above in relation to putting into place more framework contracts (thereby opening up the market to more local auditors), and the repositioning of the eligibility criteria through both the Companies Act and the LAAA, will allow more fluidity between private and public sector audit teams within the UK and also enable firms to use relevant skills from overseas.

Q14. What metrics should regulators use when assessing whether financial and vfm audits are delivered to an appropriate level of quality?

85. The quality reviews of the financial and VFM elements of local authorities under the LAAA and under the new regulatory framework will be carried out for the first time in January 2020. Therefore there is no evidence to suggest that the metrics that will be adopted are not working. The metrics applied by the regulators will be consistent to those used in the private sector for years and will assess quality against accounting and auditing standards and compliance with the Code of Audit Practice. This meets the original policy objective of having a consistent regulatory regime across the public and private sector.

⁴ International Educational Standard 7 (as amended)

Q15. Do you agree with the Independent Review of the Financial Reporting Council's findings and recommendations; and why do you agree/not agree? If you agree with the recommendations do you think the 'single regulatory body' should be the "successor body to the FRC" or a sector specific entity? If you do not agree with the recommendations are there any other changes you would make to the regulatory framework for local authority audit?

86. In the private sector audit reforms, the CMA has argued that *'an absence of choice, coupled with a market dominated by the same firms, are not best serving those who rely on audit to assure the accuracy of company accounts. They also argue that the market as it currently stands does not provide resilience, or an environment in which dynamic new players can enter, compete on quality, or invest for the future. It is certainly true to say that in recent years the public's trust in audit has decreased – and that is reason enough to be concerned.'* This is also true of the local audit market.
87. In 2010, one of the policy objectives was to open up the market and abolish the Audit Commission, which was a single regulatory body and was a sector specific entity. While PSAA has been put in place to appoint local auditors to opted in authorities, set fee scales for those audits, oversee the independence of auditors and monitor compliance against contractual obligations, it does not have the full powers that existed with the Audit Commission, nor does it have the necessary resources or funding to enable it to take on a bigger role than it currently has.
88. ICAEW is not clear what the benefit would therefore be, of having a single regulatory body or a sector specific entity when Government made a decision in 2010 to abolish the body that was previously carrying out this role. Our view is that, under any reforms and changes to a framework, there will be initial teething problems. It would be prudent to attempt to resolve the parts of the new framework that are not currently operating properly, to make them work before trying to make further reforms and change a regime that has not fully bedded down yet.
89. ICAEW's view is that (as outlined in paragraphs 8, 68, 69, and 76 to 84), the first steps for a sustainable local audit market are through:
- changing the number and structure of the PSAA contracts;
 - opening up the market to allow more local auditors to take on local public audit work through changes in the PSAA contract framework; and
 - making changes to the eligibility criteria through legislation and the FRC regulations both through the Companies Act / the LAAA and the Statutory Audit Qualification, enabling fluidity of experienced auditors to move between the private and public sector audits and enabling trainees and newly qualifieds to also move between the two sectors (thereby building up a breadth and depth of skills in different sectors).

CHAPTER 5: AUDIT PRODUCT AND QUALITY

Q16. Do external audit firms have enough understanding of the local authority regulatory framework to focus audit work on the right areas? How do they/should they demonstrate this? Who should regulate this work?

90. Yes. All the firms that are currently registered for local public audit have enough understanding of the local authority regulatory framework to focus audit work on the right areas. They demonstrate this in the work that they carry out.
91. This work is currently regulated by both the FRC and the RSBs depending on the size of the local body that is being audited. We assume that, the FRC responsibilities will transfer to the new body, ARGA. However, we are not yet clear about the extent of those changes and how they will affect the local public audit regulatory framework. It would seem sensible to let the current regulators continue to regulate this work, rather than try to make further changes to an audit and regulatory framework that has not yet had a chance to bed down.

Q17. Do auditing standards have a positive impact on the quality of local authority financial audits?

92. Auditing standards are a necessary part of any audit. They bring about consistency in approach within and between firms and allow regulators to monitor quality against the standards. Without auditing standards, it might be difficult to know what it is that auditors' work is being measured against and could lead to large variations in the work that is carried out. It would also be difficult for regulators to carry out their regulatory function as it would not be clear what it is that they are measuring quality against. With increasing commercialisation within local authorities, there may also be challenges if different audit standards were applied to corporate entities operating within a local authority group structure. Where joint ventures are undertaken between local authorities and the private sector, it could be confusing if the audit opinion needed for both entities was arrived at on an inconsistent basis.

Q18. Do audit firms allocate sufficient resources to deliver high quality and timely audits? How is consistency and quality maintained in external audit work? To what extent is there consistency in audit teams year on year? What more can be done to ensure consistency between firms?

93. The question with regards sufficiency of resources is for the firms to confirm.
94. From a regulatory perspective, the International Standard on Quality Control 1 (ISQC1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements* requires firms to only carry out audits when they have sufficient resources and competences.
95. It is not clear whether the question about 'consistency in audit teams year on year' is referring to the work that auditors are doing or the level of resources. If the question is in relation to consistency of resources in audit teams, it would be difficult to try to predict what the level of resources might be year on year. However, when planning their workload, resources need to be planned out over the course of the year, rather than concentrated in one time period.
96. In local government, the timetables for publication of accounts being brought forward affected local authorities as well, with many struggling to have all the necessary working papers to support the financial statements. The quality issue is not just about the work of auditors – the working papers that they are sometimes provided with to support the financial statements should also demonstrate a reasonable level of quality that enables the audit to be carried out properly.

97. Consistency and quality is maintained through auditing standards. However, there does need to be a level of judgement for each audit client based on the auditors' knowledge and experience of the client and their risk assessment of that client.

Q19. To what extent are senior audit staff, particularly the responsible individual signing the audit certificate, visibly involved in audit work? Who do senior audit staff meet with?

98. Ultimately, this is for firms and local authorities to comment on.

99. ISQC1 requires a firm to:

establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

(b) Reports issued by the firm or engagement partners are appropriate in the circumstances.

100. This requires the firm to ensure that the key audit partner responsible for the engagement is a key part of the overall audit engagement. While the detailed audit work may be carried out by a combination of junior and senior staff, the key audit partner will be involved in discussions, reviewing of files and making key decisions about the audit.

Q20. Should external auditors consider financial resilience as a key factor when designing their vfm work programme? If so, what factors do they/should they consider as indicative of a lack of financial resilience?

101. See previous comments on financial resilience (Q 5 (paras 32 to 43) and Q10 (paras 57 to 61) and our *Local Public Audit: expectations gap* paper.

Q21. Does the Code of Audit Practice provide enough guidance on how much work needs to be done to support the vfm opinion? If not, what should it cover?

102. It is not for the Code to provide guidance on how much work needs to be carried out as the amount of work needed at any audit is based on the auditors' judgement. The current Code of Audit Practice is under consultation and the scope of work in relation to the VFM conclusion is currently under review. There will be additional guidance provided to supplement the requirements within the Code.

Q22. Do auditing standards provide appropriate guidance on quality standards for vfm audits? If not, is guidance needed and should it be included in the Code of Audit Practice or elsewhere?

103. Currently auditing standards do not provide guidance in relation to VFM specifically. However, we understand that the NAO will, once the Code has been approved, update its guidance to reflect the changes that they are putting into place to provide audit firms with a framework to follow when carrying out their work for the VFM conclusion.

Q23. What is the current relationship between external and internal audit? How should that relationship be developed to add most value to local authorities and local residents?

104. The existing boundaries between internal and external audit are clear to the key players, including internal and external audit, directors and audit committees. However, they may not be clear to all users.

105. A key distinction between internal and external auditors is the independence requirements for external auditors, which are important to address any conflicts of interest, so that there is trust and confidence in the audit process, the financial statements, management and those charged with governance. The audit of the financial statements requires an external and independent opinion on the financial statements and VFM arrangements.

106. Internal audit is internal to organisations (even if provided by an external provider) and forms part of the corporate governance framework of an organisation.
107. External auditors will liaise with the internal auditors if they feel that it is necessary to inform their work. However, internal audit work cannot be a substitute for the external audit work as both roles are different and not necessarily complementary to each other.
108. ISA 610 **Using the work of internal auditors** deals with the external auditor's responsibilities if using the work of internal auditors. It should be noted within this standard that '*Nothing in this ISA (UK) requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains a decision of the external auditor in establishing the overall audit strategy.*'

'The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement. Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements.'

109. We recognise that local bodies may wish external auditors to make greater use of the work of internal auditors to save on time and cost. However currently there are factors which compromise internal auditors' objectivity, including the control of their budgets, their remuneration, performance assessments and hiring and firing of heads of internal audit – all of which is carried out within the local body.

Q24. What should happen when a regulator finds that a local authority audit has not met quality standards? Where should the balance between ensuring effective enforcement action against auditors and maintaining participants in the audit market lie?

110. When we, in our role as an RSB, identify that a local authority audit has not met quality standards, our first consideration is to identify the underlying causes of any significant weaknesses through discussions with the KAP. This is an important aspect of the review because, to be effective, any actions planned to address the findings need to be aimed at the underlying causes. The underlying causes are different for each firm and depend on the training, procedures and controls that the firm has selected to achieve compliance and how they are operating. We would seek to identify the most dominant underlying causes by considering what changes to resources, organisation, culture, training, procedures or controls are most likely to enable the firm to correct an issue. Ineffective quality control (for which the KAP is ultimately responsible) is always a contributory factor but, where possible, a more thorough analysis of other factors is more useful to the firm.
111. Having given the firm an opportunity to respond to our findings, conduct their own root cause analysis and set out their action plans, we would then assess the firm's commitment and ability to address the issues raised, before deciding upon any additional action necessary. There may be cases where the firm's response to the visit demonstrates clear commitment and ability to comply with regulations but audit quality failings are so significant that further action is still appropriate and required to be considered by the Audit Registration Committee.
112. The ICAEW Audit Registration Committee will consider reports on all accountancy firms undertaking local public audit, as they do for similar sized firms undertaking corporate audits. Where additional follow-up action is deemed necessary the Committee has the ability to:
- Request additional detail or evidence of the firm's actions agreed in its responses to further demonstrate its commitment and ability to correct the issues raised.
 - Impose conditions and restrictions where non-compliance is likely to be serious or extensive and/or the firm's responses may be inadequate, raising doubts about the firm's

ability or willingness to make the necessary improvements. Such conditions and restrictions will provide a strong framework for the committee to monitor the firm's actions and can include additional training, hot or cold file reviews or improved internal systems of quality control. The committee may warn the firm that it considered withdrawing the firm's audit registration in the more serious cases.

- Withdraw a local auditors registration. Such action is reserved for the most serious situations. Circumstances when this would apply may involve a wilful disregard for the requirements of the audit regulations or extensive and serious non-compliance, combined with an unwillingness or lack of ability to make the necessary improvements. Failure to comply with conditions or restrictions imposed by the committee following a previous visit may also be a feature.

113. The committee also has the ability to issue regulatory penalties or refer firms for investigation if issues are persistent or relating to significant ethical principles or poor professional conduct.

114. The above can apply to both individual KAPs and/or the local audit firm.

CHAPTER 6: AUDITOR REPORTING

Q25. Do you think that the format of the vfm audit opinion provides useful information? If not what would you like it to cover?

115. See previous comments on financial resilience (Q 5 (paras 32 to 43) and Q10 (paras 57 to 61) and our *Local Public Audit: expectations gap* paper.
116. Currently the VFM conclusion is based on the adequacy of the local authority's arrangements to secure VFM.
117. CFOs have expressed the view that the VFM conclusion does not provide them with any useful information (that they do not already know). They would like auditors' work to go beyond the adequacy of arrangements into financial resilience aspects, to review the underlying activities (rather than just the systems and processes) and challenge management on their assumptions. They would like auditors to challenge them on the financial sustainability of the organisation at an early stage to enable them to remedy the underlying problems.
118. However, currently auditors find it challenging to meet the CFO's expectations to review forward looking assumptions and material uncertainties that underlie management's forward planning. Auditors do not feel that they have the necessary information or insight to challenge overly optimistic (or unrealistic) assumptions. If the scope of the VFM conclusion were to be widened, there would need to be consideration of:
- a. the additional risks that auditors would be exposed to;
 - b. the impact on auditors' liability insurance;
 - c. the associated costs with carrying out additional work; and
 - d. the willingness of local authorities to pay for these extra costs.
119. We believe there is a strong case for a more forward looking audit, assuming that there is sufficient demand for it. What is not clear, however, is what the information is that local authorities could provide (in a consistent way) that could be subject to a more forward looking audit. This is a key part of the expectation gap.
120. Therefore before key change can be made on the audit side it might be useful to consider, with CIPFA and/or MHCLG, the content, structure and format of the forward looking information that CFO's might provide and publish so that standard setters can consider the auditing standards and/or guidance that would need to be developed to enable auditors to carry out work on the financial resilience and financial sustainability aspects of the local authority.
121. In the meantime, there is nothing to stop CFOs, that want auditors to carry out more work to challenge their assumptions, engaging separately with an accountancy firm or other assurance providers to carry out additional assurance work to provide them with a report on their underlying activities.

Q26. Do you think the vfm opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate?

122. No, the two opinions are not related and are arrived at with different methodologies. See our response to question 11.

Q27. Do you think that the vfm opinion is presented at the right point in a local authority's annual financial management and budgeting cycle? If not when do you think it would be most useful?

123. Economies of scale in the audit work are achieved when the work is carried out at one or two stages, interim and final. The interim audit may only occur with the larger audits. It would be

up to the parties involved in the contract to decide the timings of the reporting and we assume that, where interim work is carried out by the local auditor, they will report their initial findings at the interim stage and follow up at the final stage.

124. Moving the deadline for the work on the VFM conclusion could mean that the audit work to support the conclusion would need to be carried out at another time. We are not convinced that, with the current resourcing and cost issues, it would be practicable or feasible to move the deadlines for one aspect of the audit work.

Q28. Where auditors have identified significant issues, audit certificates and reports have often been delayed? Why do you think this is and can changes be made to the framework to encourage earlier reporting of significant issues?

125. Delays could be for many reasons. For example:
- a. the working papers provided by local bodies may not have been sufficient and auditors are having to wait for more information;
 - b. additional work needs to be carried to assess the level and extent of any issues that may not have been known at the start of the audit or which have been identified during the course of the audit, or
 - c. auditors may be discussing the issues with management in order to get commitment to make changes.
126. Auditors need to have sufficient discretion to carry out the work that they consider necessary to support their audit opinion.
127. In ICAEW's view, while timeliness of audit opinions is important, it should not take priority over the quality of the audit (and any additional work that may need to be carried out, by either the local body or the auditor).

Q29. In your view, what sorts of issues should Public Interest Reports be used to highlight?

128. Public interest reports are raised on any significant matter that comes to the auditors attention during the course of an audit. Issuing a public interest report can be expensive. In our publication, *Local Public Audit: Expectations Gap*, we discussed the issues that auditors had raised in relation to this point. They highlighted that the issues that are usually raised for PIR consideration are those that are already in the public domain and will already have been discussed extensively at a local level. In auditors views' PIRs have the most impact where there is a disagreement or denial by the local public body. Both local public auditors and management believe that auditors' other powers, such as statutory recommendations, are more effective tools in raising and alerting stakeholders about issues of concern.

Q30. Statistics demonstrate that very few Public Interest Reports and Statutory Recommendations have been issued. Why do you think this is? Does it indicate an issue with the framework or common behaviours? If you think this is an issue, what can be done to incentivise more frequent and timely reporting of significant issues?

129. As above and as noted in paragraphs 30 to 31, ideally, when issues arise, auditors should be having a dialogue with management about the issues and therefore statutory recommendations and PIRs should only be used as a last resort if there are disagreements or denial by the local public bodies. If these powers were used regularly then there is a danger that they stop becoming useful tools in highlighting the seriousness of concerns and instigating change. We discuss the auditors' other powers and duties in our *Local Public Audit: expectations gap paper* (pages 12 to 14).
130. In its report, *Local Authority Reporting in England 2018*, the NAO highlighted that local authorities do not appear to take notice of recommendations by auditors and no action is taken to remedy issues identified. It would be useful to find out from those authorities that are

not taking actions, why they do not take auditors' recommendations seriously and why they do not seek to instigate change.

Q31. Does a publication summarising the results of local authority audits add value? If so who should publish it and what information would they need to have access to to perform this function effectively?

131. Under the previous regime, the Audit Commission used to take on this role. With the lack of an organisation that takes the lead in this work, this part of the old regime has fallen away. There is no doubt that this information would be useful. However there would be a resource and cost issue in collecting and analysing that information and distilling it into a format that would be useful. Previous such reports, highlighting the sort of information that could be useful, can be found on the Audit Commission archives:

<https://webarchive.nationalarchives.gov.uk/20150325145826/http://archive.audit-commission.gov.uk/auditcommission/audit-regime/support-guidance/auditing-the-accounts/Pages/auditing-the-accounts-1112.aspx.html>

132. ICAEW's view is that this could be a role for MHCLG as it is responsible for oversight of local government generally.

CHAPTER 7: THE FRAMEWORK FOR RESPONDING TO AUDIT FINDINGS

Q32. To whom should external auditors present audit reports and findings; is it the audit committee, to full council or equivalent or another committee? If findings are not presented to full council or equivalent what information (if any) should full council or equivalent receive?

133. Usually auditors present their audit reports and findings to management first and after discussion, they would normally present their final audit report to audit committees.

134. At a minimum, if findings are not presented to full council or the equivalent, then the full council should at least be alerted to any significant matters that were raised during the course of the audit and indeed any recommendations that have been made.

Q33. In your authority, what is the membership of the audit committee (number of members, how many are independent etc) and which officers typically attend?

N/A

Q34. How should local authorities track implementation of recommendations made by internal audit, external audit and relevant statutory inspectorates? What should the external auditors do if recommendations are not being implemented?

135. It should be the responsibility of TCWG to track implementation of recommendations made by the various stakeholders and to ensure that recommendations are implemented.

136. External auditors are not responsible for implementation of recommendations from various stakeholders. If their recommendations are not being implemented, they should highlight to the audit committees and consider reporting them again in the following year.

Q35. Should there be a role for an external body in tracking action taken in response to modified audit opinions and/or statutory recommendations and public interest reports? If so should that responsibility sit with MHCLG, the sector specific oversight body recommended by the Independent Review of the Financial Reporting Council or another body?

137. Yes, there could be a role for an external body in tracking action taken on audit opinions, PIRs, and statutory recommendations. However, we do not think that it needs to be a sector specific oversight body.

138. As the Secretary of State for MHCLG has overall responsibility for local government spending they would need to be aware of any high-level issues raised at any local authority for the purpose of informing the MHCLG accounting officer. It could therefore be a team that sits within MHCLG that is given specific responsibility for collating this information from local public bodies, analysing it and following up with each local body to find out what actions had been taken.

CHAPTER 8: THE FINANCIAL REPORTING FRAMEWORK

Q36. Do local authority accounts allow the user to understand an authority's financial performance and its financial resilience? If not, how could they be revised to be more understandable? What information could be presented to enable users of the accounts to understand whether the financial position of a specific LA is getting better or worse?

Q37. The UK Government is committed to maintaining IFRS based accounting for the UK public sector. Given this, how would you recommend resolving the mismatch between the accruals and funding basis to improve the understandability of local authority accounts?

Q38. Do you think that summary financial information should be reported in the annual report section of the accounts? If so, on what basis and should this information be covered by the financial audit opinion?

Q39. If you think that summary financial information should be reported in the annual report section of the accounts, should it be presented with performance information? If so, what performance information would be of most interest to stakeholders?

139. Local authority accounts are long and complex (not dissimilar to large corporates' accounts) and for larger local authorities, they can run into hundreds of pages of information. While they are prepared in accordance with IFRS, there are other requirements specifically for local authority accounts which make them difficult to understand.

140. We agree that currently it is difficult for users to gain an understanding of a local authority's financial statements and financial resilience. Dissatisfaction with local authority financial statements is not new. This debate about the usefulness of the information provided in the current local authority financial statements has been ongoing for some time. ICAEW agrees that it is important that a good set of financial statements should play a key part in providing accountability to both local residents and to other users on how public money has been spent.

141. We note that while reference is made in the Call for Views in relation to CIPFA's Accounting Code of Practice, the other reviews that it has carried out, to consider how local authority accounts can be made simpler and more user-friendly are not referenced. CIPFA published *Understanding local authority financial statements* in 2016 and in June 2019, it published *Streamlining the Accounts: guidance for local authorities* which 'provides practical suggestions on how the annual statement of accounts can be 'streamlined'. The aim of streamlining is not simply to reduce the page count but equally to:

- focus on who the principal users of the accounts are and what information they need;
- improve clarity by removing unnecessary levels of detail; and
- focus on the key messages to be communicated to enable users of the accounts to better understand the authority's financial position and performance.

Authorities which have already taken steps to streamline have found that clearer and shorter accounts can be prepared to a high quality with less resource. To enable this, some review of year-end processes may be needed, and additional guidance around process is included in this document.'

142. ICAEW's view is that there is merit in considering simplification and streamlining of local authority accounts. These should be considered alongside a review of the overall financial reporting in local government which is currently wider and more complex than the financial reporting in other parts of the government. This review should be carried out by MHCLG, which sets the relevant accounts and audit regulations, and which also sets the other more complex parts of the current local government financial reporting framework currently in place.

CHAPTER 9: OTHER ISSUES

Q40. For larger authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner? If not, how should the regime be modified?

143. We do not think that the inspection and objection regime in itself needs to change. What does need to change is the financial reporting aspects (discussed in section 8 and paragraphs 13 to 20) to enable the information that local residents see, to be more useful.
144. What is not clear is whether local residents understand the extent of these powers. We discussed this in our publication Local Public Audit: expectations gap (pages 12 – 14).

Q41. Is more guidance needed to help auditors assess the impact of significant changes to common business models? If so is this guidance needed to support the financial audit, the vfm audit or both?

145. In the first instance, ICAEW believes that more guidance is needed for the local authority teams that enter into these new business models. There is a general lack of commercial skills within local government to enter into new business arrangements and local authority finance teams often look to the external auditor to provide them with advice and support on their new business models. The first step should be to increase the skills within the local authority, so that controls on these new areas can be exercised competently and continuously.
146. However, auditors are not part of the internal controls and governance structures of the organisation and thus need to remain separate and independent from decisions taken by local authorities. Local auditors cannot be involved in the development of such models as that would compromise the work that they carry out at a later stage on the independent audit of the financial statements.
147. We do, however, agree that there should be more audit work carried out where new business models have been entered into by the local authority and we would expect local auditors to discuss the additional work that would need to be carried out with both PSAA and their client, should the need arise.

Q42. Is the financial reporting and audit framework for larger category 2 authorities appropriate? If not, what additional information should be subject to audit/assurance and what would be the cost implications of this?

148. In ICAEW's view, the financial reporting and audit frameworks for larger category 2 authorities are appropriate because of the size of the bodies
149. If these authorities or other stakeholders require additional work to be carried out, they can enter into separate assurance engagements with either their own external auditors (subject to the ethical standards requirements) or with other firms of accountants, depending on the nature and scope of work, the level of testing and the form of report that they want carried out.
150. The cost of the additional work will depend on the level of assurance required, the scope of work within that level of assurance and the form of report.

Q43. For smaller authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner and is the cost of processing and responding to objections proportionate? If not, how should the regime be modified?

151. ICAEW believes that the inspection and objection regime for smaller authorities needs to remain proportionate to the size of the body.

GLOSSARY

ARGA	Audit, Reporting and Governance Authority
BEIS	Department for Business, Energy and Industrial Strategy
CCGs	Clinical Commissioning Groups
CIPFA	The Chartered Institute of Public Finance
CFO	Chief Finance Officer
CMA	Competition and Markets Authority
Code	Local Authority Accounting Code of Practice
CPD	Continuing Professional Development
DHSC	Department of Health and Social Care
FRC	Financial Reporting Council
IAASB	International Auditing and Assurance Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants of Scotland
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
ISQC1	International Standard on Quality Control
KAPs	Key Audit Partners
LAAA	Local Audit and Accountability Act 2014
MHCLG	Ministry of Housing, Communities & Local Government
NAO	National Audit Office
NHSE	NHS England
NHSI	NHS Improvement
PIE	Public Interest Entity
PIR	Public Interest Report
PSAA	Public Sector Audit Appointments
RI	Responsible Individual
RSB	Recognised Supervisory Body
RQB	Recognised Qualifying Body
TCWG	Those Charged with Governance
VFM	Value for Money arrangements

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The ICAEW's Public Sector Community comprises members working in and with government at all levels to deliver public priorities and strong public finances.

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