

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

Local Audit Framework Consultation: Questions	PSAA views and comments
<p>Consultation is completed online – with options, and then comments</p>	<p>Do you have any comments on the question?</p> <p>Please let us know any comments you have on the proposal.</p> <p><input type="radio"/> Yes, I agree to the proposed</p> <p><input type="radio"/> I partially agree with the proposed</p> <p><input type="radio"/> No, I disagree with the proposed</p> <p><input type="radio"/> Unsure</p> <p><input checked="" type="radio"/> No comment</p>
<p>Question 1: Do you agree with the proposed functions which the system leader for local audit needs to enable a joined-up response to challenges and emerging priorities across local audit? Please let us know any comments you have on the proposal.</p>	<p>Partially agree</p> <p>As system leader ARGA will be able to set the landscape and course that will determine the success or otherwise of local audit.</p> <p>Regulation is not necessarily part of the system leader’s role. There is therefore a key choice to be made – should there be -</p> <ul style="list-style-type: none"> (i) a system leader function which includes responsibility for regulation, with the implication that the local audit system leader unit will be free to make decisions to develop a tailored regulatory approach for local audit; or (ii) a system leader function without responsibility for regulation (ie regulation would sit elsewhere in ARGAs), with the implication that the local audit system leader will be free to make representations on any regulatory issues relating to local audit. <p>Both models require a system leader function which can operate with a degree of autonomy and independence from its parent organisation.</p> <p>The challenge of having both sets of functions is significant, as there is a clear potential for conflicts to arise between regulatory and system leadership perspectives with serious consequences for the chances of the new framework being able to deliver a joined-up solution.</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

As system leader ARGA will need to express views on issues such as technical matters and provide guidance to auditors on what is expected. However, a regulator is arguably unable to do so because it may fetter its regulatory decisions.

Paragraph 27 sets out the system leader functions, including ‘the power to act’ on identified risks and issues as they emerge. It is important to clarify what is intended in practice. If ‘power’ means a power embodied in statute then it will need to be carefully constructed to ensure that the power does not conflict with other bodies’ statutory duties.

The NAO and others work together to support the local audit system. These discretionary elements include longstanding aspects such as the commissioning of the review of actuaries’ assumptions, and a review of land and property values, and working with local audit legal experts to help to work through difficult legal issues. They are important for an effective public audit system where matters of common interest can be shared for the common good.

The NAO also runs technical fora that provide a vital platform for resolving issues, which firms raise proactively. There may be some apprehension about doing so if the perception is that questions will trigger regulation-led responses. The risk is that firms try to find individual solutions rather than the pursuit of a common solution that depends on open discussion with the issuer of the Code and guidance, leading to significant inefficiencies, duplication of effort and different solutions being applied by different firms. Essentially the risk is that the priorities of a system leader to be pro-active, solution-based, current and outward-facing will conflict with the regulatory duties which are by definition applied retrospectively, designed to challenge and have the associated power to publicly criticise the auditors.

We note that the document does not clarify the role of ARGA regarding smaller authorities. Logically the system leader for local audit would have responsibility for the c.10,000 parish councils, parish meetings, inland drainage boards and other bodies (noting that Chapter 6 of the current Code of Audit Practice covers the requirements of Smaller Authorities). We note that SAAA is not included in Fig 1 (New Local Audit Framework). All Schedule 2 bodies are principal authorities unless they meet the requirements of s6.

In Fig 1 the line between MHCLG and PSAA is described as representing ‘*delegated powers*’. This is not technically correct. The audited bodies have the power to appoint their auditor and the Appointing Person opt-in regime effectively offers them the opportunity to lend those powers to PSAA for the next appointing period. PSAA is an independent limited company (a non-consolidated subsidiary of the LGA). The SoS has specified the company as the

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

	<p>appointing person and so PSAA operates in accordance with powers contained in the Local Audit (Appointing Person) Regulations 2015. Under the transitional arrangements certain ex-Audit Commission powers have been delegated until all work under the Audit Commission contracts has been completed, but that now represents a very small element of PSAA's role. In our view it would be better to reflect the intention to have an MoU between PSAA and the Department in the figure as it will provide more detailed definition in relation to our relationship.</p>
<p>Question 2: Do you have any comments on the proposed functions that ARGA should have alongside its new system leader responsibilities?</p>	<p>The functions of ARGA as systems leader are important, but so too is its culture and outlook. The new system leader needs to address the leadership vacuum that Sir Tony Redmond and others have identified. Leadership requires ARGA to express public views on matters at the outset of issues. In contrast, as a regulator it will often be appropriate for ARGA to reserve its views initially to enable it to assess what auditors have done on their audit files up to two years after an issue has arisen.</p> <p>Para 32 notes that the NAO undertakes a number of other activities that contribute to the delivery of its statutory functions relating to local audit. It is hugely important that these activities continue as they are critical to effective operation of the system. For example, the NAO leads the Local Auditor Advisory Group (LAAG) – an important forum for auditors to share concerns and issues within a safe space, in order to allow common solutions to evolve that are designed to be the best outcome for local audit as a whole.</p> <p>It would be helpful to clarify the role of the system leader in respect of independent auditors exercising their statutory powers.</p>
<p>Question 3: Do you agree that the system leader should conduct a full post implementation review to assess whether changes to the Code of Audit Practice have led to more effective external audit consideration of financial resilience and value for money matters two years after its introduction, with an immediate technical review to be conducted by the NAO?</p>	<p>Partially agree</p> <p>The nature and timetable of the review will need to be carefully thought through. It would be helpful to link it with the start of the work in preparation for the new Code. Unless the NAO secures Parliamentary approval for a new Code (or reapproval of the current Code to extend its life), ARGA will need to kick off the review process for the next Code as soon as it comes into existence in 2023. This review would form a key part of that. However, stating that there will be a full review to follow on from the NAO first year review also runs the risk of creating unhelpful uncertainty around the new commentary for potential bidders as they assess the</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>Please let us know any comments you have on the proposal.</p>	<p>level of resource that they will need to deliver Code compliant audits. The system needs confidence and a sense of stability especially given the state of the supply market, and so clear messaging is essential on future audit scope. There is a mechanism to deal with any additional/reduced fees, but the big issue is that the review introduces uncertainty about the resource capacity that will be needed across the 5 year contract period.</p>
<p>Question 4: Do you agree with the proposals to ensure that ARGA has sufficient expertise and focus on local audit? Please let us know any comments you have on the proposals.</p>	<p>Partially agree</p> <p>It is clear from discussions with firms that they are looking for clarity about the new systems leader’s vision and what this means for regulation of local audit, and about its broad intentions for the Code. The proposed timing of the creation of the shadow unit means that our procurement is likely to be taking place without clarification of these matters which will be important for the scope of the Code audits to be delivered. Our timetable is driven by statutory requirements, and unfortunately cannot be flexed any further than the current proposals.</p> <p>We welcome the intention for ARGA to ‘<i>set up effective engagement networks with local bodies</i>’. Potentially, these networks will have an important role to play in enabling dialogue around key issues and facilitating effective communication within the system. We look forward to further details of how and when this initiative will be rolled out.</p> <p>As well as addressing the skills and knowledge required within the system leader unit, it would be helpful for ARGA to consider whether it has relevant skills and knowledge in relation to local audit at Board level. It will be important for the Board to have a good understanding of local audit and to recognise it as a significant function and responsibility of the organisation.</p>
<p>Question 5: Do you agree with the proposed role and scope of the Liaison Committee? Please let us know any comments you have on the proposal.</p>	<p>Yes</p> <p>We welcome the Liaison Committee’s creation and look forward to continuing to contribute to its work. Its success will depend on the commitment and support of all participants in tackling the current challenges. Given the scale of those challenges the Committee could develop and maintain a system risk register to support its oversight of the system, and all of the initiatives</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

	<p>and actions that are designed to mitigate the risks. The register would also provide ARGA with a comprehensive picture when it assumes the chair in 2023.</p> <p>The name of the Liaison Committee illustrates that it is forum to achieve effective co-ordination across the system. The Department has a key role to play to supplement this and to help achieve alignment as it will be providing ARGA with a Remit letter and will have an MoU with PSAA.</p>
<p>Question 6: Do you agree that the responsibilities set out above will enable ARGA to act as an effective system leader for local audit? Are there any other functions you think the system leader for local audit should have?</p>	<p>Partially agree</p> <p>ARGA’s culture, communications and approach to local audit is arguably at least as important as its responsibilities if it is to be an effective system leader.</p> <p>It is widely understood that ARGA’s current primary focus is the audit of private sector entities. However, going forward local audit system leadership will need to be recognised, internally and externally, as a new and critically important activity. In order to perform its functions effectively the governance and operation of the local audit unit will need to be founded on clear objectives, proper funding and resourcing, strong, effective leadership and commitment to the sector. In our view the unit will need to be outward facing, and proactive in sharing, explaining and acting on its vision to resolve current problems and achieve a more stable and sustainable system.</p> <p>It might be helpful to set out some of the consultation arrangements that ARGA is expected to have – for example, with CIPFA/LAASAC over matters pertaining to the Accounting Code, and to work with PSAA on assessing the cost of new developments.</p>
<p>Question 7: What is your view on the proposed statutory objective for ARGA to act as system leader for local audit? Please include any comments on the proposed wording.</p>	<p>We agree that it is helpful to have a separate objective for local audit. In our view it should reference timeliness and quality, as well as the cost and efficiency of audit which were significant topics in the Redmond Review. The objective will presumably be key in the forming of the strategic priorities in MHCLG’s ‘Remit Letter’ to ARGA in respect of its local audit system leader role (paragraph 57), and so the wording has a real impact.</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

	<p>Our suggested wording for the objective is:</p> <p><i>to ensure the local audit system operates economically, efficiently and effectively securing the timely delivery of audits of appropriate quality for all relevant bodies.</i></p> <p>It may be helpful to define what is meant by ‘the local audit system’ by referencing the LAAA 2014 (including VFM arrangements), but also in the context of ARGA’s position as regards the NHS.</p>
<p>Question 8: Do you agree with the proposal that ARGA will have a responsibility to give regard to the value for money considerations set out in the Local Audit and Accountability Act 2014? Please include any comments on the proposed wording.</p>	<p>Yes</p> <p>Auditors’ duties in respect of value for money arrangements are contained in the LAAA 2014, and the work required is set out in the Code of Audit Practice and related guidance notes. It is generally accepted that an audit approach that integrates the financial and non-financial elements is more efficient and beneficial for both auditor and auditee. It makes sense for the oversight of both elements to be in the same body to ensure that the guidance is similarly co-ordinated and the opportunities for efficiency are highlighted, and so we support ARGA having the value for money role, and do not see that there is any realistic alternative. A key thrust of the Redmond Review recommendations was to reduce the fragmentation of the local audit system, and we do not think that decoupling responsibility for VFM arrangements from ARGAs role as system leader would be appropriate.</p> <p>We would be keen to explore ways to work with ARGAs in relation to identifying the potential fee impact of any proposed Code or other changes to ensure that the cost and benefit is assessed at as early a stage as possible.</p>
<p>Question 9: Do you agree that the proposals outlined above will provide an appropriate governance mechanism to ensure that the new system leader has appropriate regard to the government’s overarching policy aims without compromising its operational and</p>	<p>Partially agree</p> <p>MHCLG’s Remit letter provides a solid mechanism to set the strategic priorities for the local audit system leader. However, we think that ARGAs response (para 57) should be in its role as system leader rather than regulator. As noted elsewhere, we think that it is important to recognise the two distinct roles, regulator and system leader, and to make arrangements for both to be performed with an appropriate degree of autonomy and independence. Conflicts</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>regulatory independence? Please let us know any comments you have on the proposal.</p>	<p>between the two perspectives are likely to arise from time to time and appropriate arrangements will need to be developed to enable their effective management.</p> <p>We agree that it is vital that the need for system leader to have appropriate regard to the government’s overarching policy aims does not compromise its operational independence. In addition, it should not limit its leadership role and public-facing accountability to explain decisions and strategy to the system including local bodies.</p> <p>The local audit system includes bodies within the remit of the Home Office, DfT and DeFRA. There are other stakeholders such as the LGA, CIPFA and other Liaison Committee members who will have views on the operation of the local audit system. It would be helpful to have an arrangement whereby the views of relevant departments and stakeholders could be collected to help inform the content of Remit letters.</p>
<p>Question 10: Do you agree that ARGA’s annual reporting should include detail both on the state of the local audit market, and ARGA’s related activities, but also summarising the results of audits? Please include any views on other things you think this should include.</p>	<p>Yes</p> <p>It may be better to have two separate reports relating to local audit as they cover different matters, and this assists with timeliness as they can be published when each subject matter is ready. ARGA’s ‘<i>state of the local audit market</i>’ report might usefully explain how it is fulfilling its system leadership role and its intentions for the following year, referencing its objectives and responsibilities.</p> <p>ARGA’s overall annual report covering all of its activity will presumably include its local audit activity and reporting.</p> <p>PSAA would be keen to help where possible with appropriate data in relation to the position in relation to opted-in bodies.</p>
<p>Question 11: Do you agree with the proposal outlined above relating to board responsibility for local audit? Please let us</p>	<p>Partially agree</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>know any comments you have on the proposal.</p>	<p>The Board as a whole will be responsible ARGA's work as the system leader for local audit. The appointment of a nominated member to take a special interest in this specific area of work may well be helpful but it does not diminish the responsibilities of the Board as a whole.</p> <p>Local audit does have some unusual features including the unique aspects of the auditor's responsibilities. Given the importance of the systems leader role care will need to be taken to ensure that the ARGA Board has a good understanding of it.</p>
<p>Question 12: Do you agree that ARGA's local audit functions and responsibilities should be funded directly by MHCLG rather than a statutory levy?</p>	<p>Yes</p> <p>This is the simplest solution, noting that there are other Departments' bodies within the boundaries of local government audit.</p> <p>It will be helpful to clarify whether the arrangement will cover the cost of individual audit inspections which are currently levied on firms which in turn recover anticipated regulatory costs through higher audit fees. Firms will be keen to know ahead of making their bids to the next procurement.</p>
<p>Question 13: Do you agree that ARGA should also take on system leader responsibilities for health audit? Please let us know any comments you have on the proposal.</p>	<p>Yes</p> <p>There are strong connections between the sectors and a common Code of Audit Practice written by one body makes sense. Not doing so would create confusing fragmentation and inefficiency, for example:</p> <ul style="list-style-type: none"> • maintaining a separate function within the NAO to produce a separate NHS Code of Audit Practice; • ARGA would be operating as a system leader and regulator for some aspects of local audit and solely as regulator for others; and • firms and other stakeholders would have to deal with two frameworks when working through audit assurance arrangements for local audit.

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>Question 14: If you agree that ARGA should assume system leader responsibilities for health audit, do you think any further measures are required to ensure that there is alignment across the broader system?</p>	<p>Yes</p> <p>The logic of having two very different auditor appointment systems drawing on the same pool of registered audit firms is unclear. The introduction of Integrated Care Systems heightens the potential benefits of having a common auditor within an area. We do note that implementing any non-essential change in the NHS audit framework needs to be timed carefully taking into account the current level of pressure on management and Boards.</p> <p>There are some legislation differences that should be reviewed to assess if inconsistencies are still valid. For example, the audit framework for NHS Foundation Trusts is different to other NHS bodies as they are subject to different monitoring regimes, and KAP status is not needed to sign off a Foundation Trust.</p>
<p>Question 15: Do you agree with the government's proposals for maintaining the existing appointing person and opt-in arrangements for principal bodies but with strengthened governance across the system, including with the new system leader? Please let us know any comments you have on the proposal.</p>	<p>Yes</p> <p>We look forward to discussions with the system leader to enable PSAA to work and interact with it as effectively as possible.</p> <p>We assume that Local Audit & Accountability Act will be amended to enable ARGA to take on the systems leader role. If a wider review of the legislation is envisaged, Government may wish to consider other possible amendments including;</p> <ul style="list-style-type: none">(i) Making opting in the default option (as is the case of smaller authorities); this would not change the choices available to local bodies but it would improve administrative efficiency; and(ii) Permitting local bodies to delegate the decision to opt-in to an appropriate committee. At present Section 19 of the Local Audit (Appointing Person) Regulations 2015 requires eligible bodies to take the opt in decision to the full Council meeting or equivalent (except for the likes of PCCs). This is causing significant difficulties as full council meetings are held less frequently than in previous years. We are having to allow 25 weeks for the current opt in period whereas the statutory minimum is only eight weeks.

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>Question 16: Do you agree with the proposal for strengthened audit committee guidance? Please let us know any comments you have on the proposal.</p>	<p>Yes</p> <p>The recently published FRC paper on culture highlighted that the audit committee has a key role to play in driving audit quality. An engaged and informed audit committee asks tough questions and sets the tone for a company's financial reporting and for the company's relationship with the auditor. It is crucial that auditors can effectively challenge during an audit, especially with areas of judgement and estimates and the audit committee should support that challenge. This should be the ambition for local audits, noting that there are additional sector-specific challenges to achieving that goal.</p> <p>Independent members can make a very positive contribution, but are not a panacea. It takes time and considerable work to identify and appoint the right person with the appropriate skills. Independent members as well as other Committee members need to be provided with the necessary support, including appropriate induction and training.</p> <p>Special briefing arrangements may be required to ensure that independent members are well informed about developments within the local body including significant policy initiatives, personnel changes, etc.</p> <p>Independent members should participate in an annual appraisal process to enable any concerns or barriers to effective performance of the role to be addressed.</p>
<p>Question 17: Do you have any views on whether reliance on auditors to comment and recommend improvement in audit committee arrangements is sufficient, or do you think the Department should take further steps towards making the committee a statutory requirement?</p>	<p>It is a very important to recognise the principle that the auditor's remit is to comply with the requirements of the Code Audit Practice. This does not include a responsibility to provide assurance to the Department, and great care needs to be taken not to use the auditors as a proxy for assurance on a matter when their work is not designed for that purpose.</p> <p>Compelling local bodies by statute to establish an audit committee with specific responsibilities should be a last resort. In our view the emphasis should be on encouraging local bodies to recognise the benefits which a highly effective audit committee will bring to the organisation. Compulsion risks encouraging a compliance response rather than the continuous improvement focus which is required.</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>Question 18: Do you agree with the proposals that auditors should be required to present an annual report to Full Council, and that the Audit Committee should also report its responses to the Auditor’s report? Please let us know any comments you have on the proposal.</p>	<p>Yes</p> <p>We expect this to raise the profile of both audit and the audit committee.</p> <p>We also note that the 2020 Code of Audit Practice requires that where the auditor is unable to publish their ‘annual report’ then the audit letter which is issued explaining the delay should be reported to Full Council (or equivalent).</p>
<p>Question 19: Do you have any comments on the proposals for amending Key Audit Partner guidance or addressing concerns raised about skills and training?</p>	<p>The options of providing alternative routes and allowing discretion in the KAP process are both helpful, noting that it is critical that the expected standards of knowledge and experience must reflect the critical nature of the local auditor’s role including its quasi-judicial functions. This should be principles rather than rules-based. We are aware of the ICAEW’s efforts to ensure that the current KAP application process runs smoothly which is also welcome.</p> <p>The additional KAP routes need to have commenced by January 2022 if firms are to be able to evidence their application in order to express an interest to participate in our next procurement for audit services. We note Paragraph 117 ‘<i>Any changes made to the guidance would need to be consulted on and pass through the FRC governance procedures</i>’, and clearly this could be an important factor.</p> <p>The role of ARGAs in offering a technical advisory service needs to be clarified in terms of the regulator role – firms would want to be assured that, if they followed the advice, it would be acceptable to the quality reviewer. Similarly, if bodies were able to access the advisory service then they would want assurance that their auditor would accept the proposed solution. In practice it is difficult to see how either expectation could be fully assured.</p>
<p>Question 20: Are there other changes that might be needed to the Local Audit (Auditor Qualifications and Major Local Audit) Regulations 2014 alongside</p>	<p>No comment</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

<p>changes to the FRC’s guidance on Key Audit Partners?</p>	
<p>Question 21: Are there other changes that we should consider that could help with improving the future pipeline of local auditor supply?</p>	<p>At present the local audit workforce planning model is to rely wholly on the market and for the firms to provide the pipeline. However, the current pipeline appears to be insufficient to meet future needs and the indications are that the audit resource pressures are intensifying. There is a shortage of KAPs and other experienced staff, and this impacting NHS as well as local government audits. There are many reasons for this that are well-aided, including the value placed on the auditor’s work and on the financial statements compared to other sectors, the regulatory pressures that are focused on areas that the bodies do not regard as priorities, the size, format and complexity of the accounts, the challenging expected timetable, the opinions backlog, and the relentless workload peak.</p>
<p>Question 22: Do you have any comments on the proposal to require smaller bodies to publish their budget statements and variance explanations alongside the Annual Governance and Accountability Return to aid transparency for local service users?</p>	<p>No comment</p>
<p>Question 23: is the current threshold of £6.5 million still right? If you think a different threshold would be more appropriate, please provide evidence to support this.</p>	<p>In the current framework whatever audit threshold is set, there is significant additional work when moving from the small authority regime to a full Code of Practice audit including VFM arrangements. The financial statements move from being based on a self-determined FRS basis to the IFRS-based CIPFA Code, supplemented by a large volume of guidance. The first audit year needs to encompass all of the comparative information and opening balances (effectively 3 balance sheet audits) as assurance is needed that the figures are materially accurate on the new accounting basis.</p> <p>One option is to have reduced accounts expectations for bodies that exceed a set threshold, but are below a second threshold, a version of the New Zealand style tiered solution. Note that IFRS compliant accounts are required by the Treasury for WGA, but WGA returns are</p>

MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

	<p>only required for bodies exceeding £20m in certain aspects, and so there may be some room for flexibility.</p>												
<p>Question 24: Do you have any comments on the proposal for a requirement for smaller bodies to transfer to the Category 1 authority audit regime only once the threshold has been breached for 3 years in succession?</p>	<p>We think that the consultation paper does not capture the current position. Every organisation is a principal authority unless they meet the smaller authority threshold. Our reading of s6 LAAA 2014 is that it already operates in the way envisaged in the question.</p> <p><i>Section 6 - For the purposes of section 5, a relevant authority is a “smaller authority” for a financial year if —</i></p> <p><i>(a) where that year is the year in which the authority was established, the qualifying condition is met for that year,</i></p> <p><i>(b) where that year is the year following that in which the authority was established, the qualifying condition is met for that year or the previous year, and</i></p> <p><i>(c) where that year is the second or any subsequent year following that in which the authority was established, the qualifying condition is met for that year or either of the two previous years.</i></p> <p>We think that this results in the following position -</p> <table border="1" data-bbox="788 1018 1509 1410"> <thead> <tr> <th>Category sequence in years</th> <th>Audit Category</th> </tr> </thead> <tbody> <tr> <td>2</td> <td>2</td> </tr> <tr> <td>2, 1</td> <td>2</td> </tr> <tr> <td>2,1,1</td> <td>2</td> </tr> <tr> <td>2,1,2</td> <td>2</td> </tr> <tr> <td>2,1,1,2</td> <td>2</td> </tr> </tbody> </table>	Category sequence in years	Audit Category	2	2	2, 1	2	2,1,1	2	2,1,2	2	2,1,1,2	2
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MHCLG (now DLUHC) Local Audit Framework: Technical Consultation – PSAA response

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