



Financial Reporting Council

Local audit reform: a strategy for overhauling the local audit system in England

FRC response to consultation

January 2025

Introduction and key points

1. The Financial Reporting Council (FRC) is an executive non-departmental public body sponsored by the Department for Business and Trade which serves the public interest and supports UK economic growth by upholding high standards of corporate governance, corporate reporting, audit and actuarial work.
2. The FRC has statutory responsibilities for the regulation of local audit across three areas:
 - **Standard Setting:** The FRC's Regulatory Standards Division issues the International Standards on Auditing (ISAs (UK)) which set out how auditors should undertake their work.
 - **Supervision:** The FRC's Professional Bodies Supervision (PBS) team oversees the work of both the Institute of Chartered Accountants in England and Wales (ICAEW) and the Chartered Institute of Public Finance and Accountancy (CIPFA) in their supervisory and qualification roles respectively. The FRC's Audit Quality Review (AQR) team inspects major local audits undertaken by firms and publishes an annual report on findings, and its Audit Firm Supervision (AFS) team supervises the audit firms.
 - **Enforcement:** The FRC takes enforcement action against auditors and member accountants where failures occur. This is led by its AQR team where there is evidence that an audit team has failed to comply with the Regulatory Framework for Auditing, and by its Enforcement Division in public interest cases relating to non-audit work by member accountants and firms.
3. A strong local financial reporting and audit system is a key priority for the FRC given its importance in maintaining public confidence in local democracy by providing transparency and accountability to both local residents and Parliament over public expenditure and supporting informed decision-making by bodies. We will work closely with the Government on any transition of regulatory and system leadership responsibilities to a new body following the outcome of this consultation to ensure the effective functioning of the local audit system.
4. The FRC welcomes the publication of the Government's local audit strategy for consultation which reflects the importance of addressing the structural issues which led to the emergence of timeliness issues in local authority financial reporting and audit in England. We are aligned with the Ministry of Housing, Communities and Local Government (MHCLG) that this consultation, and the further development of measures to be taken forward, must not distract system participants from continuing to play their part to ensure the measures legislated for last year to restore timeliness are successful. Neither should it detract from the necessity of bringing forward, at pace, reforms to financial reporting requirements to accompany steps which have already been taken on auditing burdens.
5. The FRC has set out our priorities to support the Government's growth agenda, including identifying and addressing unnecessary burdens on business while supporting access to audit for public and private sector organisations. We want to work with the Government to

ensure that the final proposals taken forward minimise any duplicative regulatory burdens placed on audit firms operating in the local audit market, and indeed, do not discourage audit firms from participating in the local audit market as a result.

6. We agree that the Government should develop capacity within the Local Audit Office to provide local audit services to public bodies in some circumstances. This will give the Government more flexibility on how the local audit system should operate in the future, enhance the employee offer which the Local Audit Office is able to provide in a highly competitive recruitment market, and reduce dependency on a small number of audit firms.
7. The establishment of a new public body to undertake regulation of local audit will mean audit firms which are active in more than just the local audit market will be subject to regulatory oversight and possible enforcement activity by three entities – the Local Audit Office, the FRC and the ICAEW. While all regulators will maximise collaboration, there will be a both a duplication and a divergence of processes which will increase the complexity of the regulatory regime. We are concerned that this increased complexity will lead to additional compliance costs to firms that may make operating in the market less attractive, or will be passed onto local authorities and taxpayers.
8. For example, it is essential that the inspection regime has sufficient experience and expertise to oversee and inspect the audits of local authorities who have engaged in increasingly complex commercial activity. If a local authority owned a bank or energy provider, the inspection team would need financial services or utilities experience.
9. We believe that if the Local Audit Office delegated the delivery of these regulatory activities as standard, rather than having the power to choose to do so, that would mitigate duplicative and divergent regulatory burdens and ensure sufficient experience in its regulatory activities including registration, supervision, inspection and enforcement functions. This would also reduce possible conflicts of interest if the Local Audit Office engaged in the public provision of local audit services, or acted as an auditor of last resort when a local authority cannot find an auditor.
10. We support the Government's recognition in the consultation of the importance of ISAs (UK) forming the regulatory underpinning for local audit to create regulatory alignment with corporate audit. The proposal is for the Local Audit Office to then review the 'interpretation and/or application' to local audit. The FRC supports the proportionate application of ISAs (UK) according to the entity being audited, with ISAs (UK) already containing significant public sector specific material. Care will need to be taken to avoid instances where 'interpretation' for the local public sector by the Local Audit Office leads to a non-compliant audit. Sufficient technical expertise within the new body will help mitigate against this.
11. We would support a regulatory regime which enabled auditors to move between public and private sector audits, and that this would increase overall capacity. Where the Local Audit Office chooses to diverge the application of ISAs (UK) to local audit compared to corporate audit, this may unintentionally make it more difficult to address the capacity constraints in the market. Having separate ISAs (UK) between corporate and local audits will reduce the opportunity for auditors to move between sectors and increase the complexity for firms,

which may have a detrimental impact on capacity within the system and restrict access to audit for public bodies. We would be concerned if there was less incentive for firms participating in the market to increase their number of Key Audit Partners (KAPs).

Responses to specific questions

Question 4: Should the LAO oversee a scheme for enforcement cases relating to local body accounts and audit?

12. We have set out our views on an additional regulator and its functions in paragraphs 5-9.

Question 9: What are the barriers to progressing accounts reform?

Question 10: Are there structural or governance barriers to accounts reform that need to be addressed?

Question 11: Should any action to reform be prioritised ahead of the establishment of the LAO

Question 12: Are there particularly areas of accounts which are disproportionately burdensome for the value added to the accounts?

Question 13: Do you agree that the current exemption to the usual accounting treatment of local authority infrastructure assets should be extended and if so, when should it expire?

13. The timeliness issues which we have seen emerge in recent years have been partly driven by weaknesses in local government financial reporting, financial management and governance, partly driven by a lack of clarity on the purpose of the accounts and who the primary users are. In the case of infrastructure assets, many of the problems are not related to financial reporting, but because some local authorities have failed to maintain basic accounting records to allow them to report. The Government's consultation includes a welcome commitment to consider the purpose of local body accounts and their primary users, this work should be prioritised to guide wider reform.
14. Local bodies spend significant amounts of taxpayers' money and hold substantial public assets. It is important that they are therefore held to as high a standard as public interest entities and central government bodies, following International Financial Reporting Standards (IFRS), to support their consolidation into the Whole of Government Accounts (WGA). We believe however that there are opportunities to reduce burdens on the sector by removing the additional non-IFRS elements (statutory overrides) from local government accounts, increasing alignment with other sectors.
15. This should be accompanied by longer-term reforms to financial reporting requirements for operational property, pensions valuation and infrastructure assets to ensure they better meet the needs of users and do not create disproportionate burdens on preparers and auditors.

Question 17: How should KAP eligibility be extended further, should some categories of local audit be signed off by suitability experienced RIs (and if so, which)?

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16. We do not consider local audit to be significantly different from corporate audit, with similar skills required to do both. There is therefore merit in considering ways to remove sector-specific complexity where this is contributing to challenges around auditor capacity, which the FRC are happy to support MHCLG's work on. The requirement for local audits to be signed by a KAP restricts capacity in local audit, and we agree there are areas of local audit which could be signed off by RIs with relevant experience, as well as KAPs.
 17. We believe there are three specific areas which the Government should explore allowing suitably experienced Responsible Individuals to sign audit opinions:
 - a) Local Government Pension Scheme accounts, the audits of which have minimal sector-specific nuances and are more akin to other pension fund audits such as those in the corporate sector.
 - b) NHS Trusts and Integrated Care Boards, mirroring the requirement for NHS Foundation Trusts. These bodies' financial statements are inherently less complex than other types of local audit, and this move would be supported by the existing wider eligibility for signing the audit opinions for other types of public body such as NHS Foundation Trusts, academy schools and housing associations.
 - c) Other types of local bodies subject to the Local Audit and Accountability Act with far less complexity than local authorities, such as national park or fire and rescue authorities.

Question 18: Should the market include an element of public provision?

Question 19: If yes, should public provision be a function of the LAO?

18. We agree that there is merit in the Government developing a function at the Local Audit Office for the delivery of audit services in some circumstances. This will provide the Government with additional options for operation of the local audit system and reduce dependency on a small number of private sector audit firms for the delivery of these services, including as an auditor of last resort where these firms are unable to take on contracts. This will also build an additional employee offer for the Local Audit Office in a sector where there is competition for talent.
19. Irrespective of the delivery model and whether there is an element of public provision, a shift in the delivery model would not in of itself address the structural issues which have led to capacity and capability challenges within the system given there is no latent capacity, or additional capacity created. The establishment of a public provision function within the new Local Audit Office with the infrastructure to deliver in the public interest will be a long-term investment and will take time to develop. Any move towards introducing public provision should seek to mitigate against a reduction in capacity in the short-term due to private sector audit firms making strategic and commercial decision to reduce investment in the recruitment and retention of local auditors.
20. If the Government decides for the Local Audit Office to engage in the public provision of audit services, this may introduce conflicts of interest for the organisation as it would have responsibilities for both the delivery and inspection of local audits. We believe this can be

mitigated against by the Local Audit Office having a default position of delegating the delivery of regulatory functions in line with current arrangements, as set out in Paragraph 9.

Question 26: Do you agree that the MLA threshold should be increased?

21. We consider it timely for the Government to consider the current MLA threshold of £500 million which has not been uplifted since 2014 to reflect inflation. The English Devolution White Paper published in December 2024 commences a programme of local government reorganisation for two-tier areas with the intention to establish new unitary authorities. We would expect the increased size of these local authorities to mean they would be likely to be considered MLAs under the current thresholds.
22. Alongside the level of the monetary threshold, the Government could consider further measures to improve the operation of the threshold for example requiring a public body to be above the threshold for three consecutive years before it is considered an MLA. This would mitigate against the risk of local bodies 'bouncing' in and out of the threshold.
23. The Government's consultation rightly emphasises the importance of having a level of assurance for local bodies based on the relative risk. Some bodies which have been identified as having significant financial management issues in recent years are already below the MLA threshold. Further increasing the threshold introduces a risk of further bodies of heightened risk being subject to an audit regime not subject to oversight by the regulator. The Government may want to consider mitigations to ensure that the regulator can examine audits of high-risk bodies where appropriate.

Question 27: Do you agree that some local bodies should be declared exempt from the regulatory focus on an MLA? For example, should Integrated Care Boards be exempt?

24. We received feedback from stakeholders as part of our NHS audit market study that ICBs should be excluded from the definition of an MLA. We are further exploring this suggestion as part of the latest phase of the market study and will be producing a final report in Spring 2025, we will share the findings with the Government.

Question 28: Do you agree that smaller authorities' thresholds should be increased?

25. We agree that the threshold for smaller authority audits (SAA) should be increased to ensure that drainage boards and town councils remain within the SAA threshold exemption and are not subject to a full audit which would place additional strain on the local audit system. The Government may wish to consider aligning the SAA threshold with the audit exemption threshold in the Companies Act 2006.



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