About time?

Exploring the reasons for delayed publication of audited local authority accounts

March 2023

Contents

EXECUTIVE SUMMARY

Time for change

There are some reasons for optimism that there will be an improvement in the timeliness of publication of audited accounts as foundations are being laid for the future.

The Audit, Reporting and Governance Authority (ARGA) will act as the new systems leader for local audit, with a dedicated unit with local government audit expertise. Interim arrangements are in place, including the appointment of the first Director of Local Audit (DLA) by the Financial Reporting Council (FRC). The FRC and the Department for Levelling Up, Homes and Communities (DLUHC) have published an agreed memorandum of understanding which sets out the roles and responsibilities the FRC will take on as system leader during the shadow period ahead of the intended establishment of ARGA.

Public Sector Audit Appointments Ltd (PSAA) has awarded new contracts at more sustainable fees, and new market entrants should help to secure a more competitive and resilient local audit market over time.

The current National Audit Office (NAO) Code of Audit Practice (CoAP) will apply for the next PSAA contract round, through to 2027/28, providing greater certainty on audit workloads.

Delays caused by infrastructure accounting have been largely resolved by the related Statutory Instrument and revised accounting requirements and guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). Steps are being taken to develop a longer-term approach to the accounting framework for these assets.

While these changes are positive, we do not consider that they are sufficient. The actions do not address the backlog of audits nor do they set out a sustainable future for local audit. We note the following matters that are yet to be tackled:

- **Clarity over the purpose of local audit** – there remains a lack of agreement over the role of local audit. The balance between financial statement audit and value for money audit has moved in the last 10 years towards financial statement audit. In our experience the current focus on financial statements audit is not always valued by the sector. An urgent debate is needed over the role and focus of local audit that involves the sector and key stakeholders.
- **Complexity of local government financial statements** – statutory accounts in the sector are complex due to the need to comply with both IFRS and statute (covering overrides for pensions, property, plant and equipment, school grants, financial instruments and infrastructure). Further, in recent years, more councils have become more commercial, sometimes resulting in highly complex accounting. Accounts regularly exceed 100 pages and are not easily understandable by members of the public. A consensus is needed on the right financial reporting framework for local government.
- **Focus of financial statement work** - in our view, there is no universal agreement between the sector and stakeholders over the focus of financial statement audits. This is particularly prevalent in the audit of land and buildings for example schools and other operational buildings. We note that this is the prime cause of delays in issuing audit opinions. Without consensus on this and what matters for the sector and its decision making we do not consider that there will be significant progress in returning to timely audit.
- **Finance teams** – the quality of too many financial statements and working papers are not adequate. Some councils have multiple sets of accounts open. Improvement in accounts preparation, and recruitment and investment in finance teams is essential if local government is to prepare consistently high-quality draft accounts and respond to the challenges presented by an enhanced audit regime. Greater accountability is needed from Finance Officers and Audit Committees.
- **Dealing with the backlog** – public sector audit is a specialist skill with finite resources; too much of this resource is now absorbed in resolving the backlog of audits and in dealing with poor governance and financial reporting at a small proportion of audited bodies. The local audit framework needs some temporary flexibility to deal with the serious backlog of audits. For example, by introducing reduced financial reporting requirements for late audits. Late audits create a high risk for current financial reporting governance.
- **Intervention** – there is no legislative basis for audit firms to issue modified opinions or close audits where financial reporting issues are extensive, or audits are elongated. Audits can continue indefinitely, unlike in the corporate world where companies can be struck off for failure to file accounts. Government intervention, in our view, is needed for audited bodies where there are significant failures in financial reporting and an unwillingness to take the necessary steps to produce robust financial statements.

Until these matters are resolved, we do not consider that the September deadline for audited financial statements proposed by DHLUC is achievable.

While we have made recommendations for other stakeholders in the sector, we recognise that we have our own part to play in resolving the backlog. As a firm we have a clarity of purpose – doing what is right, ahead of what is easy. We have invested heavily in recruiting and training the auditors of the future. We are committed to delivery of high-quality audits and continuous improvement. We continue to develop and deliver responsive training for our team, bespoke to the public sector audit environment; this is accompanied by assessments to test understanding. We have invested in information technology, including in data extraction tools, workflow management systems and a cloud-based audit platform.

We have also invested in central quality teams, staffed with experts in public sector audit quality and financial reporting and in a partner-led Quality Support Team. As the market leader in this sector, we will continue with our investment in this sector and with our work to resolve the matters highlighted above.

What more can be done?

All key stakeholders in the local audit system will need to continue their efforts to secure improvement and a return to high levels of compliance with timely publication of audited accounts. We explore several of the causes of delay in this report and steps which might be taken to reduce the incidence of delays. These steps relate to systems leadership, holding both authorities and auditors to account for their performance, a continued focus on the quality of accounts preparation and audit, and the effective engagement between auditors and audited bodies.

Our recommendations to improve timeliness are as follows:

For FRC, ARGA and Government

R1. To determine how to deal with the backlog of local government audits. In particular, to consider whether temporary flexibility can be introduced into the local audit framework to allow reduced scope audits to be undertaken on backlogged accounts. We consider this would be of benefit to the local government entities freeing them up for more forward-looking activities with limited detrimental impact on the users of the financial statements given some outstanding financial statements date back to 2019.

For FRC and ARGA

R2. To determine and agree with Government the purpose of local audit and the required focus on the financial statements and value for money arrangements elements respectively, particularly in relation to the audit of land and building assets.

R3. To consider whether local auditors can be represented as key stakeholders in local audit system meetings convened by the new Director of Local Audit.

R4. To consider whether the system leader's Annual reports on the state of local audit should highlight instances of poor financial reporting and longstanding delay to the publication of both unaudited and audited accounts.

For Government

R5. To require statutory officers to attest to the effectiveness of their financial reporting process, in line with Sir Donald Brydon's recommendation. This should form part of Government accounting requirements and non-compliance should result in intervention.

R6. To introduce intervention with commissioners where authorities do not afford sufficient priority to their financial reporting responsibilities.

R7. To decouple the reporting requirements for Pension Funds and Administering Authorities.

For FRAB, CIPFA/LASAAC and Government

R8. To reframe the accounting code to ensure financial statements provide the information needed by Government and elected members to manage and govern the local government sector.

This should include consideration of Whole of Government Accounts (WGA) requirements, particularly with regard to compliance with IFRS.

R9. To address Redmond's recommendation for summarised and accessible financial information to be made available to citizens, either through specifying required content within Narrative Reports or by introducing a standardised summary statement.

For local government bodies

R10. To make new investment in and keep under review the adequacy of in-house financial reporting skills, paying close attention to succession planning and professional training, and look to collaborate with other authorities or commission independent support where additional capacity or expert advice is required.

R11. To ensure auditors are engaged at an early stage where innovative, complex or significant transactions are anticipated, to allow for effective planning of the additional audit work which may be required.

R12. To ensure more consistent and robust completion of CIPFA's Disclosure Checklist and allow adequate time for robust internal quality assurance before draft accounts and working papers are presented for audit.

R13. Where significant accounting estimates are made, ensure the underlying assumptions and judgements are clearly documented and that appropriate experts are employed by the local government entity to support management on these judgements and estimates. These judgements should routinely be reported to Audit Committees.

For Audit Committees

R14. To hold management and auditors to account for preparing and monitoring delivery plans.

R15. To undertake a regular assessment of whether they have appropriate membership, training, and access to the professional support they need to effectively discharge their responsibilities.

R16. To report to full Council on an annual basis with their assessment of the account's preparation and audit process.

For auditors

R17. To focus on continuous improvement in delivering accounts audit and value for money arrangements work early and fostering effective working relationships where changes and potential complexities are identified, discussed, and planned for as soon as practicable.

R18. To consider whether to issue statutory recommendations where significant failures in financial reporting or governance are identified, delays become unacceptable or where insufficient attention is paid to timely financial reporting.

R19. To focus on making local public audit a more attractive career choice and promote the value of public sector audit and the wider societal benefits of robust and independent scrutiny.

R20. To support the local audit workforce strategy led by the Financial Reporting Council.

Introduction

There is broad consensus on the critical importance of robust and independent external audit of accounts in public sector accountability and the stewardship of public funds.

The extent of delay in publication of audited accounts across the local authority sector is severe and is therefore of widespread concern. In July 2021, the Public Accounts Committee (PAC) reported that without urgent action from government, the audit system for local authorities in England might soon reach breaking point.

By December 2022, PSAA had reported that across the sector more than 220 opinions from years prior to 2021/22 remained outstanding. Including 2021/22, audit firms still had more than 630 overdue opinions to issue as at December 2022 – by way of comparison, PSAA awarded contracts relating to 456 principal audits audits in Autumn 2022.

In this report we explore the requirements for publication of draft and audited accounts and look at some of the reasons for the decline in performance against these requirements over time. Only 12% of audited accounts for 2021/22 were published by the target date of 30 November 2022. There is no single cause for the delays in completing local authority audits, and unfortunately there is no quick solution in a complicated system involving multiple parties. We consider a variety of factors contributing to delays, note the measures which have already been taken to support the local audit system and make recommendations for further improvement.

The achievement of deadlines for 2021/22 is clearly poor. There are some reasons for cautious optimism that the system will begin to recover and there will be a gradual return to better compliance with publication targets. However, we consider that these are outweighed by a number of risk factors and that the September deadline for audited accounts set by DHLUC is not achievable in the short term and also not achievable until there is further significant change in local audit and local government.

All key stakeholders including local audited bodies, the audit firms, DLUHC, PSAA, the NAO, the FRC and its successor ARGA, CIPFA and the Institute of Chartered Accountants in England and Wales (ICAEW) will need to continue their efforts to support a coherent and sustainable system of local audit, acknowledging that it will take time to get things back on track.

Importance of audited accounts

Local authorities, police and fire bodies in England are responsible for approximately £100 billion of net revenue spending each year. These bodies are responsible for delivering many of the public services which local taxpayers rely on every day.

The intended primary users of local authority accounts are citizens, as taxpayers and users of local services, and the framework for financial reporting and audit needs to protect their interests. In practice, due to their complexity, local authority accounts are primarily used by other key stakeholders, including elected members, those responsible for governance, Parliament, DLUHC, the NAO, businesses, banks and other financial institutions, auditors, regulators and the press.

The NAO have commented that proper accounting for public funds and high-quality public audit are pivotal for trust in public finance and expenditure in an accountable and democratic system. The risks from poor governance are greater in the context of funding pressures, as the stakes are higher, and the process of governance itself is more challenging. External audit is one of the key checks and balances in the system of local government.

PSAA, the body responsible for securing appointment of auditors on behalf of most local authorities, recognises audited accounts as the main way public bodies demonstrate accountability for managing public money. They consider publication of timely audited accounts, with an audit opinion, as a key element of financial management arrangements and a fundamental feature of good governance.

CIPFA LASAAC, the Board responsible for preparing the Code of Practice on Local Authority Accounting for the United Kingdom, notes UK local authority accounts should be widely recognised as an exemplar for clear reporting of the financial performance and position of public sector bodies. Users of accounts should be able to access the information they want to help them to understand the finances of an authority and to take practical and informed decisions.

The PAC, in its May 2019 report Local Government Governance and Accountability, commented that the then Ministry of Housing Communities and Local Government (MHCLG) placed great reliance on external auditors. It recognised that the importance of this work is heightened as council activities become more varied, complicated and commercial.

MHCLG was clear it viewed a robust local audit system and transparent local authority financial reporting as key to delivering Value for Money (VfM) to taxpayers, and for sustaining public confidence in our systems of local democracy. Statutory accounts are the only publicly reported information provided by local authorities that are subject to external audit. For users of the accounts to trust and rely on this information, they must both have confidence the audit process is robust and be able to understand what the financial reports are telling them.

Audit ensures transparency and, done well, encourages audited bodies to have strong governance and financial records. Effective, high-quality audit is becoming increasingly important as local authorities' accounting practices become more complex and the sector comes under financial pressure. In recent years more councils have become more commercial, sometimes becoming involved in activities they have not traditionally had the experience or expertise to operate in. This has changed the risks that councils are facing, so it is essential that the financial reporting and audit process is able to make these risks clear to the reader.

The FRC, the body responsible for the publication of auditing standards and monitoring the quality of major local audits, views high quality audit as essential to maintain stakeholder confidence by providing an independent view of a major local body's financial statements and arrangements in place to secure VfM. Poor auditing may fail to alert management, the public and other stakeholders to material misstatements, including those arising from fraud, or financial control weaknesses, not already identified or addressed by management.

The combination of management not meeting their responsibilities and poor auditing could potentially put resources, services, and jobs at risk.

There is consensus on the importance of audited accounts and it is no surprise that delays in their publication are of widespread concern. Crucial issues may not be identified in a timely manner if auditors are bogged down in prior year audits - a small number of audit opinions are now six or seven years behind schedule.

Timeliness matters and the implications of the late delivery of audit opinions are significant. Local authorities need accurate and reliable financial information to plan and manage their services and finances effectively. Accounting information and audit reports needs to reach government in a structured, timely and co-ordinated fashion. Delays to local audits cause delays for audits elsewhere in the public sector and ultimately for the Whole of Government Accounts.

In the next sections of this report we will consider the publication requirements for the accounts and performance against these targets before exploring reasons for the delays experienced in recent audit cycles.

Publication requirements and performance

Requirements

The Local Audit and Accountability Act 2014 (the Act) requires local government, police, fire and other relevant authorities to prepare annual accounts which must be audited in accordance with the provisions of the Act.

The Accounts and Audit Regulations 2015 (AAR 2015) establish the timetable for publication of unaudited accounts and the subsequent publication of the accounts, together with any certificate or opinion issued by the auditor. Where an authority is unable to publish its accounts with the auditor's opinion, it must publish a notice to that effect, including the reasons for the delay. Thus, while there is no explicit statutory deadline by which auditors must give their opinion on the financial statements, there is a clear expectation that local authorities should publish accounts with the auditor's opinion by the statutory publication date.

For financial years up to 2016/17 only a small proportion of bodies failed to meet the audited accounts publication target, and this was always to be expected, due to specific local accounting, auditing, or resourcing issues.

For audited bodies, the challenge from 2017/18 was to prepare draft accounts within two months of the year end and for auditors it was to conclude their audits two months thereafter; parity for preparers and auditors being preserved, with each having one third less time than they had for 2016/17.

In recognition of the many challenges the outbreak of the Covid-19 pandemic posed, the accounts publication timetable was extended. Preparers had until 1 September 2020 to publish draft 2019/20 accounts and until 30 November 2020 to publish accounts with any certificate or opinion issued by the auditor.

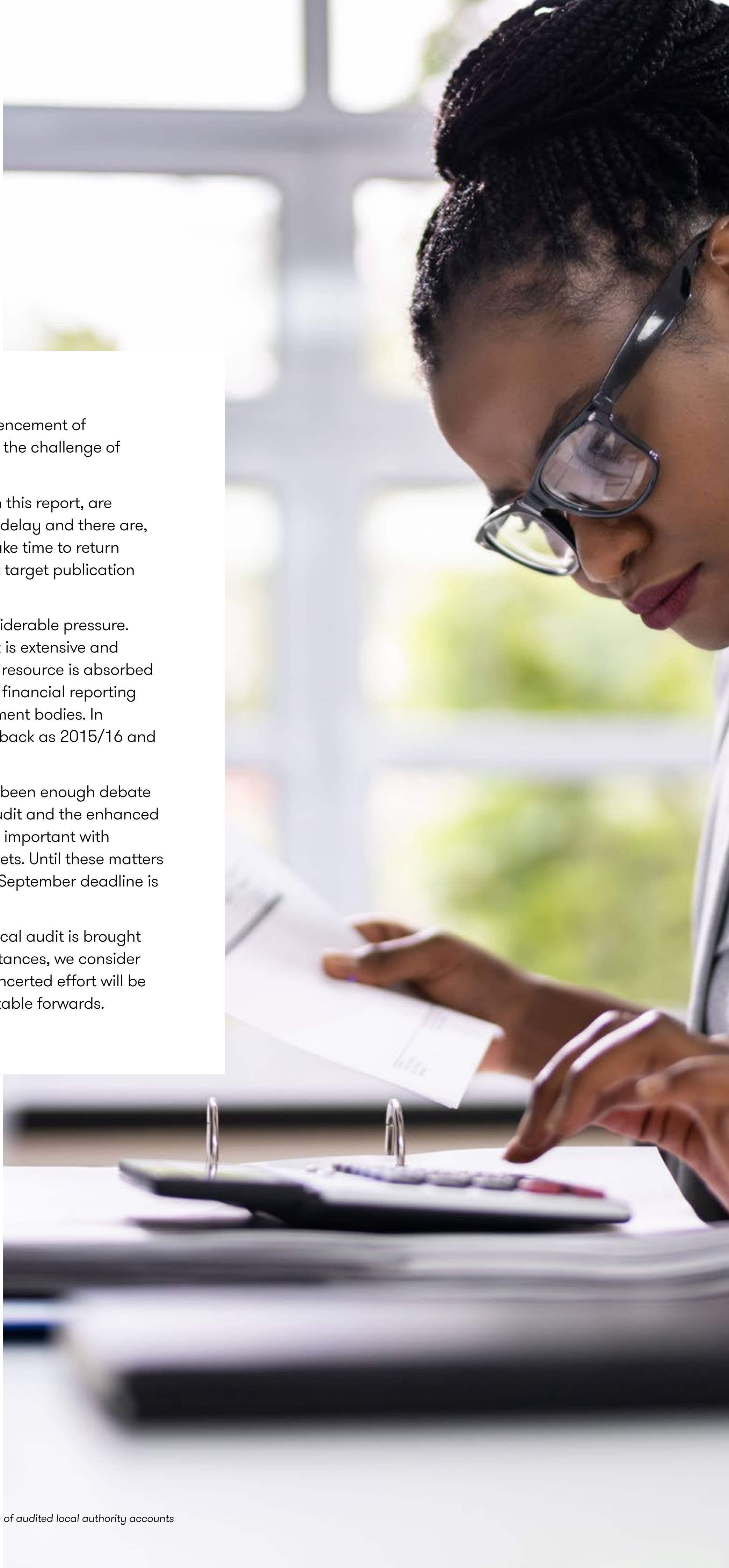
Several authorities pressed ahead, working to their original 31 May 2020 timetable, but the pressures of responding to a crisis which was unprecedented in recent times meant that many could not. Where authorities worked to their new statutory deadline, five months after the year end, auditors had just three months to conclude their work, if the target for publication of audited accounts was to be met. The uncertainties brought about by the pandemic, the consequent changes to local government finance and the restriction of lockdowns added to the challenge of delivering local audits. We explore this in more detail later in this report.

In July 2022, the Accounts and Audit (Amendment) Regulations SI 2022/708 came into force setting the target date for publication of 2022/23 to 2027/28 audited accounts as 30 September after the relevant financial year end.

Table 1 illustrates the declining performance against the target date for publication of audited accounts in recent years.

Table 1 Audited accounts published by target date over the last six years

Financial year	Deadline for publication of unaudited accounts	Target date for publication of audited accounts	% audited accounts published by target date (all firms average)	% audited accounts published by target date (Grant Thornton audits)
2016/17	30 June 2017	30 September 2017	95	97
2017/18	31 May 2018	31 July 2018	87	91
2018/19	31 May 2019	31 July 2019	58	65
2019/20	1 September 2020	30 November 2020	45	54
2020/21	1 August 2021	30 September 2021	9	12
2021/22	1 August 2022	30 November 2022	12	20



With a growing backlog of audits, commencement of subsequent audits is delayed, increasing the challenge of returning to sustainable, timely delivery.

The reasons for the delays, as explored in this report, are multi-faceted. There is no single cause of delay and there are, unfortunately, no quick solutions. It will take time to return to consistently high performance against target publication dates.

Audit resources are finite and under considerable pressure. At the time of writing, the backlog of work is extensive and greater than ever before. Too much audit resource is absorbed in dealing with longstanding and historic financial reporting issues at poorly performing local government bodies. In certain instances, audits are open as far back as 2015/16 and continue to absorb audit resource.

Perhaps more importantly, there has not been enough debate with the sector on the purpose of local audit and the enhanced audit scrutiny it faces. This is particularly important with regards to the audit of local property assets. Until these matters are resolved we do not consider that the September deadline is achievable.

We think it is about time the delivery of local audit is brought back on track. Under the current circumstances, we consider that a November date is achievable. A concerted effort will be needed from all parties to move this timetable forwards.

Reports, reviews and inquiries

PAC, in its May 2019 report Local Government Governance and Accountability commented that MHCLG did not know why some local authorities were raising concerns that external audit was not meeting their needs.

However, a number of key representative organisations and councils informed PAC they had concerns about external audit. In recognition of PAC's concerns and the importance of local audit, in June 2019 MHCLG asked Sir Tony Redmond to carry out a review of the effectiveness of local audit and the transparency of local authority financial reporting. Redmond is a former local authority treasurer and chief executive, former CIPFA President, and is well-respected by the various stakeholders involved in local public audit.

Redmond's Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting, published in September 2020, followed Sir John Kingman's Independent Review into the Financial Reporting Council published in December 2018, the Competition and Markets Authority Statutory audit services market study published in April 2019 and Sir Donald Brydon's Independent Review into the quality and effectiveness of audit which was published in December 2019.

Redmond's report included a total of 23 recommendations. His recommendations included that a new body, which he suggested be named the 'Office of Local Audit and Regulation' (OLAR), be created to manage, oversee and regulate local audit. He also recommended the fee structure for local audit be revised to ensure adequate resources are deployed and that the deadline of 31 July for publication of audited accounts, which was viewed as unrealistic, be revisited with a view to extending it to 30 September.

Touchstone Renard's (TR) February 2020 report Future Procurement and Market Supply Options Review, commissioned by PSAA, noted the timing of local audits was problematic. They reported the target date of 31 July was putting extreme pressure on experienced staff and requiring more use of less experienced staff, potentially compromising quality. The target date was reported as the single most important factor, apart from fees, making the market unattractive and threatening its sustainability.

In the government's initial response to the Redmond Review, published in December 2020, MHCLG agreed with Redmond's recommendation that the timetable for publication of audited accounts be reviewed. MHCLG indicated that, subject to consultation, regulations would be amended to extend the deadline to 30 September for a period of two years, to be followed by a further consideration. In its December 2021 package of measures to improve local audit delays, MHCLG's successor DLUHC went further, committing to extend the deadline to 30 November for 2021/22 accounts and to 30 September for the following six years. This commitment was made good in June 2022, with the laying before Parliament of the Accounts and Audit (Amendment) Regulations SI 2022/708.

In its March 2021 report 'Timeliness of local auditor reporting in England', the NAO noted there were insufficient staff with the relevant qualifications, skills and experience and a net loss of qualified staff in both local finance teams and firms serving the local audit sector. Their report also noted that the pandemic had exacerbated problems which already existed within the local audit landscape.

Following on from reports from Redmond and the NAO, the PAC held an inquiry into the timeliness of local auditor reporting on local government in England in May 2021 and published its report, Local auditor reporting on local government in England, in July 2021.

PAC commented that the accountability of local authorities to stakeholders, such as residents and service users was a priority. It observed the delays in audit opinions gave MHCLG less assured information on the local government sector than usual and warned that without urgent action from government, the audit system for local authorities in England might soon reach breaking point.

PAC made a number of recommendations to MHCLG, including that PSAA's procurement exercise, which was due to commence in 2021, support a new fee regime, that work take place to support accelerated training and accreditation of auditors and that MHCLG address the need for strong system leadership ahead of the establishment of ARGA.

In the next section we consider the importance of system leadership for local public audit and how, following on from the Act, weak system leadership has contributed to delays in local audit.

EXPLORING THE CAUSES OF DELAY

System leadership

In his report, Kingman observed that following the abolition of the Audit Commission (AC) in 2015, the framework for the local audit regime was 'split, complex and fragmented'. He observed that public sector specialist expertise had been dispersed around different bodies, with no one body looking for systemic problems and no apparent co-ordination between parties to determine and act on emerging risks.

Multiple organisations currently play important roles in the complex landscape of the local audit system. DLUHC has oversight of local authorities and responsibility for maintaining a set of statutory codes and rules for local authorities. The NAO maintains a Code of Audit Practice (CoAP) for audits of local bodies and issues guidance to auditors. PSAA is the body responsible for securing appointment of auditors on behalf of local authorities opting into its services. CIPFA is responsible for publishing the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) and the ICAEW is responsible for independent monitoring of the quality of local audits outside the FRC's population and for the registration of Key Audit Partners. The FRC is responsible for the publication of auditing standards and monitoring the quality of major local audits (bodies with total income or expenditure exceeding £500m and pension funds with more than 20,000 members or gross assets over £1bn). The external audit firms are responsible for auditing the financial statements of local authorities and concluding on whether authorities have made proper arrangements for securing VfM.

Kingman noted no one body was tasked to understand and examine any tensions arising from current trends, for example between reducing audit fees and the increasing complexity of local audit given the challenging financial situation of local authorities. He noted the FRC was an expert in private sector corporate audit but its expertise and detailed understanding of issues relevant to local audit was limited.

Kingman recommended arrangements for local audit needed to be fundamentally rethought to ensure robust assessment and scrutiny of the quality of local audit work, appropriate enforcement action and the bringing together of all relevant responsibilities by a single regulatory body.

Redmond agreed. He noted the absence of a body to coordinate all stages of the audit process and made detailed proposals for a 'new organisation with the clarity of mission and purpose to act as the system leader for the local audit framework'. He noted the local audit market was very fragile. Performance against the target for publication of audited 2018/19 accounts signalled a serious weakness in the ability of auditors to comply with their contractual obligations and Redmond noted the fee structure did not enable auditors to fulfil the role in an entirely satisfactory way.

Redmond highlighted lack of co-ordination and the lack of a system leader as being widely recognised weaknesses in the local audit framework.

Therefore, Redmond recommended OLAR be created to manage, oversee and regulate local audit. It would have responsibility for the procurement and management of local audit contracts, reporting annually on the state of local audit, monitoring local audit performance and determining the CoAP.

In our evidence to the PAC inquiry, as in our submission to the Redmond Review, we strongly advocated for a systems leader, given the need for an holistic approach to the audit of a sector which is of critical interest to service users, taxpayers, central government and society at large.

Kingman had proposed a new regulator, ARGA, with a new mandate, a new clarity of mission and purpose, new leadership and new powers and that it should be accountable to Parliament and have a new Board.

Following the Kingman and Redmond reviews, government confirmed its intention that the system leader for local government should be ARGA, with PSAA continuing with the procurement of local government audit.

In its 2021 report, the PAC commented that there was a crisis in local government audit and the need for system leadership for local public audit, identified by Redmond, was pressing. PAC heard of an existential threat to the local government auditing system and it noted practical and concrete steps were needed to address urgent problems, which could not wait for ARGA. In its view, there was a pressing risk of market collapse due to over-reliance on a small number of audit firms and significant barriers to entry. Further, the commercial attractiveness to audit firms of auditing local authorities had declined. PSAA agreed that the challenges facing the market were serious and pervasive.

The government recognised the need for effective system leadership and strongly supported Redmond's recommendation for a systems leader to prepare annual reports on the state of audit in local government.

DLUHC worked closely with PSAA on their strategy for procuring auditors for the 2023/24 to 2027/28 period. The Department also reached agreement with the NAO and FRC that the CoAP 2020 will apply for the whole of the next appointment period, thus providing greater clarity over the scope of local audit in future years.

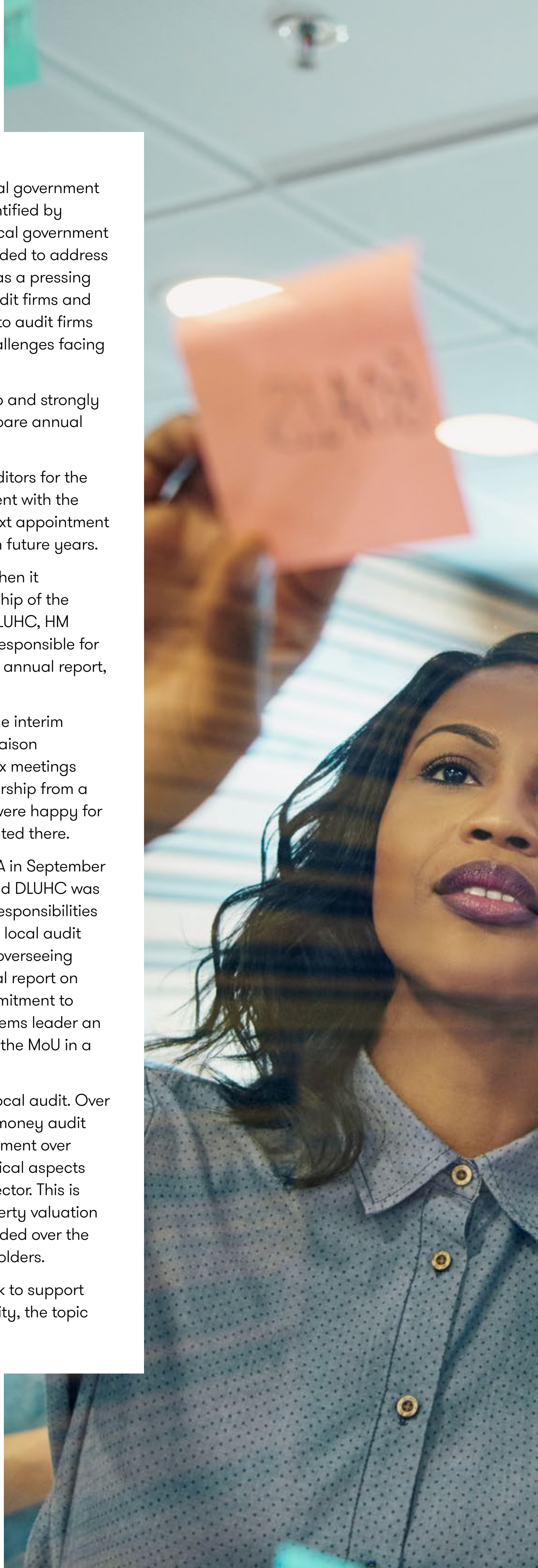
The FRC will be the convener for the local authority audit system, when it transforms to become ARGA. One of the roles will be the Chairmanship of the Liaison Committee. The intention is for key stakeholders including DLUHC, HM Treasury, CIPFA, ICAEW and PSAA to be represented. ARGA will be responsible for the CoAP, for regulating quality and performance, for producing an annual report, chairing a liaison committee and setting audit standards.

MHCLG also committed to assuming a stronger leadership role in the interim period, before ARGA is established, and it initiated the Local Audit Liaison Committee (LALC) from July 2021. LALC has published minutes of six meetings covering the period up to October 2022. LALC has drawn its membership from a wide range of stakeholders, although whilst members agreed they were happy for audit firms to attend future meetings, no firm has yet been represented there.

The FRC, acting as shadow system convener, appointed the first DLA in September 2022. A Memorandum of Understanding (MoU) between the FRC and DLUHC was published in March 2023. Under the agreement, the FRC will have responsibilities which include leading the response to challenges arising across the local audit system, leading work to improve competition and bolster capacity, overseeing the entire quality framework for local audit and preparing an annual report on the local audit system. In the agreement, DLUHC reinforced its commitment to delivering on the Redmond Review, set out its intent to send the systems leader an annual Remit Letter covering its priorities and signalled it will review the MoU in a year's time.

A key role of the new system leader will be to determine the role of local audit. Over the last ten years there has been a movement away from value for money audit towards financial statement audit. There is currently a lack of agreement over whether this change is the right one. The current focus on the technical aspects financial statements audit is not, in our experience, valued by the sector. This is particularly the case with certain aspects of the audit such as property valuation which have no direct General Fund impact. An urgent debate is needed over the role and focus of local audit that involves the sector and key stakeholders.

We are encouraged by the appointment of the first DLA and will look to support them in their important work, given our mutual interest in audit quality, the topic we consider next.



Audit Quality

In his December 2018 report, Kingman noted the financial crisis ten years earlier reflected failings in accounting and financial reporting. Part of the genesis of his review had been concern that a more effective FRC could do more to avert major corporate collapses, such as that of Carillion plc.

Notably, for 2017/18, no firms subject to Audit Quality Reviews (AQRs) had met the FRC's stated quality target. Kingman noted the FRC's 2018 announcement of plans to enhance its monitoring of the six largest audit firms, including a 35% increase in inspections in 2018/19. His review recommended greater transparency with regards review findings and an increase in the seniority of staff conducting AQR inspections.

Kingman also recommended the arrangements for local audit needed to be fundamentally rethought, and these should include robust assessment and scrutiny of the quality of local audit work. He recommended a separate local audit regulator, with deeper expertise of local audit, a clear objective to secure quality and responsibility for appointing auditors and agreeing fees. This body should have a different, and much more focused, remit than the former AC.

Amongst Brydon's recommendations was the introduction of 'professional suspicion' into the qualities of auditing, in addition to scepticism. Such a change would clearly raise the bar and necessitate additional and more detailed audit work.

He counselled for greater transparency over what the regulator regards as good audits, rather than a majority emphasis on failures, and it is pleasing to see good practice being highlighted in the FRC's 2022 report on the quality inspections of major local audits.

Brydon noted a triangle of reviews, his own, alongside Kingman's and the Competition and Markets Authority's April 2019 Statutory Audit Services Market Study and hoped the time for major reviews was over for several years and that legislative and regulatory action would follow.

The AC had previously contracted with the FRC to undertake quality assurance reviews of local authority audits, with coverage of at least one from each firm for the 2016/17 and 2017/18 financial years. At this time, in their reviews the FRC noted concerns about the quality of audit work relating to operational and investment property and pension liability valuations. The FRC also paid particular attention to audit work relating to the occurrence and completeness of expenditure, impairment of receivables and to auditors' fraud risk assessments and responses. From 2018/19 the FRC's responsibility for AQRs of the 230 larger local authority audits was placed on a statutory footing.

Kingman had noted that the FRC found itself subject to 'tough and persistent criticism', criticisms which put it under an 'unprecedented spotlight'. This then set the scene for FRC inspections of local audits which followed.

In October 2020, the FRC published its first public report setting out the principal findings from its inspection of 2018/19 major local audits. The FRC reported that nine audits, across seven audit firms reviewed, required improvements and, as this represented 60% of the audits reviewed, this was unacceptable, with urgent action required by some firms including the need for detailed Root Cause Analysis. Yet the FRC found that the quality of VfM arrangements work remained high across all audit firms.

The FRC reported that the quality of audit work over property valuations continued to be their area of greatest concern, with auditors needing to strengthen their audit procedures and their challenge of management and valuation experts in the testing of property revalued in the year. This included ensuring sufficient work testing the completeness and accuracy of data provided to, and used by, management experts, challenging and corroborating valuation assumptions and giving consideration to properties not revalued in the year.

This additional scrutiny has, in several cases, led to management commissioning additional work from their valuers and in some cases even led to management replacing their valuers and commissioning reports from new valuation experts. Additional audit focus on property valuations has meant auditors are increasingly reliant on receiving information from expert valuers. It is therefore vital that appropriate valuers are used by local government entities to provide management with high quality information and to provide auditors with appropriate evidence to audit.

In October 2021, the FRC reported that 70% of twenty 2019/20 audits reviewed required no more than limited improvements and that, while it was too soon to identify this improvement as a trend, it was encouraging. The FRC again noted strong performance with regards the quality of VfM arrangements work.

However, the FRC once again noted room for improvement in the audit of property, plant and equipment and investment property balances.

In October 2022, the FRC's inspection of twenty audits, across the firms, found 70% were good or with limited improvements required, consistent with the prior year – although inconsistency in audit quality remained, and the importance of sufficient evaluation and challenge of assumptions in property valuations was raised once again.

As a firm we have re-affirmed our commitment to audit quality, having invested to expand our public sector audit quality and financial reporting teams and provided more bespoke training, guidance and support to our audit teams. We are pleased with our continuing improvement journey, which reflects on our significant investment in audit quality over recent years and continue to invest in audit quality to ensure that the required standards are met. The positive direction of travel over the past five years is illustrated below:

Table 2 FRC assessment of the quality of Grant Thornton financial statements audits - major local audits

Where FRC findings indicate an auditor has failed to comply with the auditing framework, its Enforcement Committee can sanction an audit firm for such breaches or may refer the conduct in question for consideration under the FRC Accountancy Scheme or the disciplinary procedures of the relevant supervisory body. In January 2022, the FRC issued its first fine to a local audit firm for non-compliance with the Regulatory Framework for Auditing.

Audit firms have acknowledged the need to improve audit quality. In response they have invested in quality improvement programs, additional testing, and are increasingly using experts to inform their audit conclusions. The additional audit work requires additional work from local finance staff. The increased work has, inevitably, increasing the time taken to conduct audits but had also improved the quality of local government financial reporting.

In short, the FRC's focus has been successful in improving both the quality of audit and the quality of financial reporting in the sector. Our firm, and other local audit firms, are not willing to compromise on audit quality. Firms will defer audit reports where it is not possible to complete work to the required standards by target dates.

This has posed a number of issues for the sector.

Local government accounts are complex and need to comply with IFRS and statute (covering overrides for pensions, property, plant and equipment, school grants, financial instruments and infrastructure). The full application of these standards and legislation has substantially increased the volume of audit work required.

The pressure on resource and the significant technical knowledge needed to undertake local government audit has reduced the attractiveness of the sector to audit firms. It is one of the factors that has seen suppliers exiting the market.

Equally, the complexity of audits, high risk commercial ventures and complex accounting arrangements has increased the amount of work needed.

These factors have made local audit a difficult area in which to recruit. There remains a limited pool of local audit talent, with many newly qualified local auditors choosing to follow alternative careers. This has exacerbated timeliness issues.

Audits are now a 'harder test' than they were five years ago. In our view, there is a lack of consensus between the sector and stakeholders over the focus of financial statement audits. This is particularly prevalent in the audit of property. Without consensus on this and what matters for the sector and its decision making, we do not consider that there will be significant progress in returning to timely audit.

Accounting for infrastructure assets is an example of this impact.

In February 2022 concerns were raised by a local government auditor that some authorities were not applying component accounting requirements appropriately to the reporting of infrastructure assets. Infrastructure is a broad class of assets which may include roads, foot and cycle ways, structures such as bridges, tunnels and coastal defenses, street lighting, street furniture and traffic management installations.

The underlying issues were found to be more prevalent than anticipated and the issue quickly became an area of focus for all local audit firms. In recognition of a complex, serious and widespread issue, with the potential to result in audit delays and qualification of audit reports, CIPFA offered to assist and established an "Urgent Task and Finish Group" in March 2022. CIPFA subsequently launched an urgent consultation on temporary proposals to update the Code.

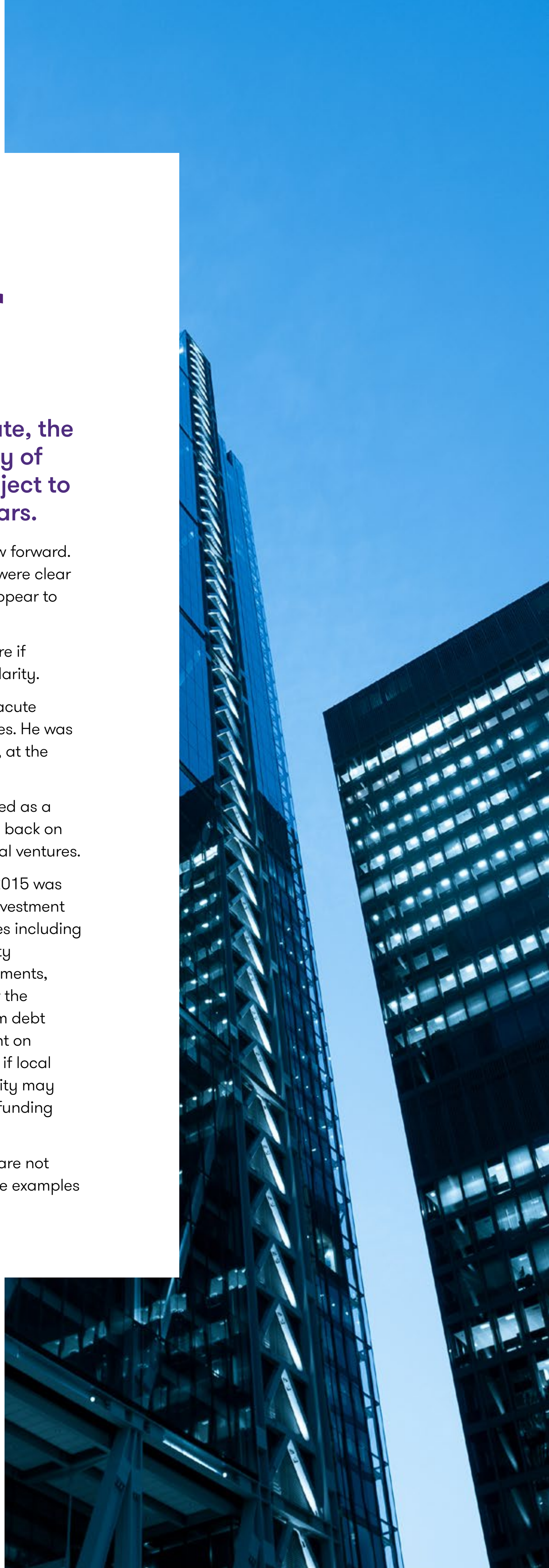
CIPFA, the NAO and the audit firms engaged with DLUHC when it became evident that resolution of the underlying issues was not possible solely through amendment of the Code. DLUHC subsequently determined that statutory regulation was necessary to unlock increasingly apparent complex technical accounting issues.

Code updates and statutory accounting regulations are unusual measures. Due process to update the Code and to introduce secondary legislation takes time. A Code update was published at the end of November 2022 and the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2022 were laid before Parliament, to become effective at the end of December 2022.

Highways authorities typically hold highly material infrastructure balances, as do some other local authorities. Pending the release of the Code update and the effective date of the regulations, many local auditors were not in a position to conclude that draft accounts presented a true and fair view.

This issue came to light at a particularly unfortunate time, further delaying some 2020/21 and many 2021/22 audits and compounding the delays considered in this report. It took nine months to put in place a temporary solution to this issue, and it will take considerably longer to put in place a permanent solution. The benefit to the sector of this focus on infrastructure assets continues to be debated.

Risks in an evolving sector



The environment in which authorities operate, the expectations upon them and the availability of central government funding have been subject to significant changes over the last fifteen years.

Brydon observed that the 2008 financial crash cast a long shadow forward. Whilst his comments were in the context of corporate audit, there were clear parallels for local audit. Trust in leaders and organisations does appear to have fallen.

Ineffective or untimely audit can contribute to organisational failure if warning signals are not communicated in time, or with sufficient clarity.

In his review, Kingman observed that local authorities were under acute financial pressure, with some engaging in risky speculative ventures. He was very concerned that the quality of scrutiny was being pared back, at the worst possible time.

The Redmond review similarly observed that audit risk has increased as a result of the impact of austerity, including local authorities cutting back on finance staff and in some cases undertaking more risky commercial ventures.

Redmond noted one of the most significant sectoral trends since 2015 was the increased commercialisation of local authorities, citing both investment in commercial property and investment in wholly owned companies including housing and energy companies. The NAO's study on Local Authority Investment in Commercial Property concluded '…as with all investments, there are risks. Income from commercial property is uncertain over the long term and authorities may be taking on high levels of long-term debt with associated debt costs or may become significantly dependent on commercial property income to support services.' Redmond noted if local authority owned companies get into difficulties, the parent authority may ultimately be responsible or may have to write off loans or equity funding and this can impact financial resilience.

Acute financial pressure and risks arising from commercialisation are not theoretical risks, they have manifested in several recent high-profile examples across the local government sector.

Section 114 notices

In February 2018, Northamptonshire County Council's s151[1] officer, issued a s114 notice[2] which referred to the Council having faced a serious financial problem for some years. The notice stated that the Council faced an overspend of over £20m for the 2017/18 financial year and a danger of ending the year in a negative General Fund position. The notice came with serious operational implications, including a prohibition on entering new agreements involving spending until after full Council met to consider the notice.

Whilst Northamptonshire's was the first s114 notice to be issued in many years, it was not the last, nor the most financially significant. The s151 officers of the London Borough of Croydon, Slough Borough Council, Nottingham City Council and Northumberland County Council have all issued such notices, and Thurrock Council became the latest to join this unenviable club in December 2022. Thurrock's notice outlined the causes of an in-year deficit approaching half a billion pounds.

Timely auditor reporting is of heightened importance where there are instances of significant governance and financial failings. Under the 2014 Act, local auditors have a range of duties and reporting powers, including raising recommendations as part of their VfM arrangements work and issuing statutory recommendations and public interest reports, which audited bodies must respond to in public. Such powers can be, and are, exercised ahead of issuing audit opinions on statutory accounts, in recognition of the importance of bringing matters to stakeholders' attention in as timely a manner as possible.

Inevitably, where there are significant and sensitive matters to consider during the course of an audit, this takes time. This can be due to a combination of factors, including the need for a more sceptical and sometimes forensic approach to the audit, delays in obtaining key pieces of evidence required for the audit, the need to involve auditor's experts such as lawyers or valuers, the need for management to commission professional accounting, legal, valuation or actuarial advice, the need for auditors to consult with senior peers on complex judgements and changes in senior personnel within audited bodies.

Particularly challenging audits can absorb a vast amounts of audit resource, sometimes running into several thousand hours; this, of course, constrains the ability to the firms to progress other more routine audits.

Challenges faced include weaknesses in councils' decision-making processes, the failure of investments and group companies, novel transactions, non-compliance with laws and regulations, serious weaknesses in accounts preparation, bribery and corruption allegations, falsification of documents and in some cases a combination of all these factors which can result in lengthy delays to local audits. The consequences of significant reductions in audit fees will have presented genuine threats to audit quality in an increasingly complex sector.

In April 2020 the NAO published the new CoAP, effective from the 2020/21 financial year. The main change to the preceding CoAP was in respect of local auditor's VfM work. The change involved a move away from a binary 'qualified' or 'unqualified' VfM conclusion to an approach where the auditor now provides detailed commentary on organisational arrangements. This, coupled with changes to the form of auditor recommendations was designed to increase the value of this aspect of local auditor's work and we welcomed and fully supported the new Code which should assist in earlier warning over governance and financial failure.

Until 2018, PSAA published, under AC powers, an annual report summarising the results of local auditors' work and including lists of bodies where the publication date for audited accounts had not been met. Given the significant deterioration in performance against publication targets, such lists would not have been particularly practical or meaningful for years after 2018/19. However, this also means that a public spotlight has been removed from the smaller number of authorities which have been unable to publish audited accounts for long periods. There is a possible opportunity to address this gap in the newly appointed DLA's annual report on the state of local audit.

We will continue to encourage our local auditors to exercise their statutory reporting powers on a timely basis, where it is appropriate they are used. We also believe thought should be given to Government intervention where authorities are not giving sufficient priority to their financial reporting responsibilities.

1. Section 151 of the Local Government Act 1972, see Appendix
2. Section 114 of the Local Government Finance Act 1988, see Appendix

Complexity of accounts and reporting requirements

Local authority accounts are inherently complex and many authorities are increasingly engaging in innovative or unusual projects, such as arrangements involving multiple layers of lease agreements, trading companies, investments in commercial property and property trusts and transactions involving complex borrowings, investments and financial instruments.

Despite this, Redmond noted at least a third of authorities do not even purchase an up-to-date version of the CIPFA Code each year.

CIPFA's Code introduced International Financial Reporting Standards (IFRS) from 2010/11, recognising the framework as a gold standard of accounting which provides better quality financial information. CIPFA notes the strong case for the use of valuation models in accounting for the use of resources. Its view is that for the proper stewardship of assets, it is not enough to simply know how much they cost and how much of that cost has still to be paid for. Information about inherent value and the rate at which this value is consumed is needed to support the continued provision of services, supporting intergenerational equity of resource use.

Since the introduction of IFRS, financial statements contain many estimates and assumptions, generally required to be set out in notes to the accounts, that are dependent on judgements about the future. The impact is particularly notable in accounting for operational and investment property, pension liability balances and financial instruments.

Following the adoption of accruals accounting and IFRS by the local authority sector, successive governments have sought to protect council taxpayers from volatility in taxation arising from accounting entries which do not have an immediate impact on the cost-of-service delivery. This has been achieved through introducing 'statutory overrides' in secondary legislation. Whilst protecting council taxpayers from short-term volatility, the overrides complicate the accounts which are first prepared on an IFRS basis and then, via the Movement in Reserves Statement, on a funding basis. Reconciling the accounting and funding basis results in the inclusion of additional notes to the accounts which can be difficult for the lay reader to understand. Local authority accounts are lengthy compared to accounts in other sectors and are arguably more complex and more challenging to understand than accounts produced by other parts of the public sector. This increases the risk of error and omission in their preparation.

The NAO has commented that the requirements of IFRS, along with increased expectations from the FRC following the high-profile corporate failures, such as Carillion, have combined to produce a significant increase in audit work, for example on asset and pension valuations.

Brydon reflected that 'annual reports and accounts are already very long' whilst Kingman in his 2018 report commented that 'the regulator should be required to promote brevity and comprehensibility in accounts and annual reports'.

Redmond noted the breadth and complexity of IFRS as one of the factors contributing to the findings of his review. In his evidence to the PAC inquiry however, he noted he did not think many simplifications could be achieved within the framework of statutory accounts and that these will remain complex.

CIPFA published 'Streamlining the accounts' in 2019, emphasising the importance of a focus on who the principal users of the accounts are and what information they need, of the need to improve clarity by removing unnecessary detail and a focus on key messages to be communicated in relation to financial position and performance. The importance of appropriately using materiality to avoid key messages being obscured by excessive detail and the need to consider presentation and layout to help readers navigate through the accounts were stressed. The FRC has also published material on the subject of cutting clutter within accounts.

Another complexity of the current reporting framework has led to unnecessary delay in the conclusion of audits. Local authorities which administer local government pension funds are required to publish full Pension Fund accounts in the same document as their local authority accounts. This requirement means that the audited accounts of the host authority and related fund cannot be finalised until both audits have been completed. This co-dependency has compounded delays in the conclusion of audits and publication of audited accounts and decoupling them would support more timely publication of audited accounts.

In summary, statutory accounts in the sector are complex due to the need to comply with both IFRS and statute. Accounts are regularly over 100 pages and are not easily understandable by members of the public. A consensus is needed on the right financial reporting framework for local government.

Quality of draft accounts

The quality of draft accounts presented for audit can have a significant bearing on the time taken to complete an audit.

Whilst many sets of draft local authority accounts are prepared diligently and are free from material error, this is far from universally the case. In his review, Redmond noted that some auditors have experienced local authorities lacking accounting staff with the technical expertise necessary to complete the accounts.

Often the hallmarks of 'change' or 'complexity', for example a potential new entity within a group reporting boundary, the anticipated loss of control of a subsidiary or contemplation of significant and unusual leasing arrangements, can provide an early indication that financial reporting implications will need careful consideration and that early engagement with the auditor is advisable.

Where draft accounts are not reflective of relevant facts and circumstances, this can and will lead to auditors challenging underlying accounting treatments and in turn this can result in material and sometimes fundamental amendment of the accounts being necessary to avoid qualification. Such amendments cause duplication of effort, not least in both accounts preparers' and auditors reviewing updated versions of draft accounts. The need for amendment of accounts can delay planned timetables and result in the target for publication of audited accounts being missed.

In our experience, issues with group accounts preparation, accounting complexities arising from collaborative working arrangements, complex transactions and failure to meet disclosure requirements can, and often do, cause delays.

Following on from the 2008 financial crisis, a lengthy period of austerity and greater reliance on local sources of funding, the prevalence of new and complex arrangements in the sector has significantly increased. Unusual and complex arrangements often come with the associated risk that accounting implications are not fully understood ahead of transactions being concluded. Too often, auditors are not sighted on such transactions until receiving draft accounts for audit, by which time the opportunity for early risk assessment and engagement has passed.

Understandably, accountants may not have prior experience of similar complex, unusual or novel arrangements and the necessary technical accounting expertise may not be available in-house. Incorrect accounting may have a real impact on General Fund or Housing Revenue Account reserves. We regularly note authorities being reluctant to commission external accounting advice as part of the accounts preparation process. This appears to be in part due to the perceived cost of such advice and in part due to misplaced confidence; however, knowing when to seek advice is a strength and the cost of such advice can be insignificant when compared to the scale of the arrangement being accounted for or to the cost of delays caused by adoption of inappropriate accounting treatments. In many cases, accounting advice is eventually commissioned which, had it been available at the outset, could have saved both cost and time.

Brydon recommended a signed attestation by the Chief Executive and Chief Finance Officer that an evaluation of the effectiveness of internal controls over financial reporting had been completed and whether or not they were effective. We think consideration should be given to how such an approach might work for local authorities, to bring the importance of the preparation of high-quality accounts into sharper focus.

Proper completion of the CIPFA disclosure checklist by the finance team and thorough proof-reading and internal challenge of the draft accounts, by an individual familiar with the authority, but not directly involved in the detail of the accounts preparation process, can both make a significant difference to the quality of draft accounts and working papers submitted for audit.

Unfortunately, the quality of too many financial statements and working papers are not adequate. Some councils have multiple sets of accounts open. Others are having to rely on interim staff for accounts preparation which reduces corporate memory and impacts on succession planning. Improvement in accounts preparation, and recruitment and investment in finance teams is essential if local government is to prepare consistently high-quality draft accounts and respond to the challenges presented by an enhanced audit regime.

Responding to the audit process

Redmond's review noted some auditor concerns about local authority officers not being available to answer audit questions. He reiterated this point at the PAC inquiry.

In its evidence to the PAC inquiry, the Department noted there were some examples of very good practice in local authorities, with appropriate expertise, governance and oversight, whilst acknowledging that in some local authorities there is a lack of capacity and skills to act as a strong enough client in all situations, an issue further compounded by the pandemic.

Developments in the local authority sector and in technology have led to a significant increase in the complexity of financial systems used in the processing, recording, and reporting of transactions which feed into financial statements. The use of more complex systems increases the level of technical expertise required in their set-up and administration. In turn, it is more difficult for management to understand how their financial systems work and to exercise proper oversight over them.

Delays are often experienced in obtaining complete and accurate financial data reports from systems that reconcile to account balances and disclosures. This is generally due to reports not being designed to extract all relevant information to compile the financial statements, resulting in significant manual intervention to arrive at the values disclosed in the financial statements. Additional audit work is required to understand data sources and test manual adjustments for appropriateness, as well as undertaking planned audit procedures. Populations obtained for sampling can often consist of a large volume of transactions, including debits and credits rolled forward for a number of years. This leads to a high absolute value of transactions and increases the chance of selecting an item that does not represent a true year-end balance. Significant time can be spent in cleansing populations or selecting further items to obtain sufficient assurance.

Evidence received during audits also varies in quality. With thorough and well-explained evidence, testing can be completed quickly and efficiently, however where it is weak and lacking in detail the testing process takes much longer. For example, a good piece of evidence to support an accrual would be a working paper signposting the sampled figure with a comment on how it had been calculated and, if applicable, the subsequent invoice demonstrating its accuracy; in comparison, a poor piece of evidence would simply be a journal with no further comments. In the latter example it will take the auditor more time to understand the evidence provided and subsequently raise queries requesting further evidence which can result in a drawn-out and iterative testing process.

With increased audit focus on property valuations and pension liabilities, authorities should expect and be prepared to respond to audit queries and challenge on underlying assumptions, data inputs, the bases of valuation, clarity of instructions to management experts and compliance with CIPFA Code requirements. Rising audit quality expectations have increased auditor scrutiny and challenge of audited bodies. Similarly, auditors are now more likely to review the work of management experts, such as valuers, in much greater detail. The quality of some of underlying information made available as audit evidence by audited bodies is not sufficiently robust and this can lead to significant delays in concluding audits.

A well-documented accounts closedown process, which captures key data sources, internal and external contacts and their responsibilities and a well-organised approach to working paper preparation, review, version control and filing all help to smooth the audit process and add resilience should there be a change of finance personnel.

Clear and disciplined focus on the part of both preparers and auditors on what can be done early is also paramount. It is good practice for this to begin with an open and honest debrief at the end of each audit cycle, with a view to continuous improvement. Early work can and should take place to prepare and review accounting policies. Removing immaterial or redundant disclosures from accounts templates brought forward and entering early dialogue on areas of complexity and significant judgement can pay dividends.

In our experience, the audit process works efficiently and effectively where there is regular communication and collaborative working between the auditor and audited body.

Capacity

Local audit is a highly specialised field. To issue a safe opinion on a local government audit, thus playing an effective part in the safeguarding and reporting of public funds, auditors need a depth of knowledge and sector experience to apply judgement where the commercial focus of IFRS is not directly relevant and to understand the implications of the various specific legislative and regulatory provisions that have a bearing on the financial statements.

Local auditors also have a broader remit than their commercial counterparts, with responsibility for assessing local bodies' arrangements to secure VfM, and quasi-judicial roles on public objections to accounts and public interest reporting.

This change to the CoAP expanding the scope of the VfM arrangements work, coupled with evolving auditing standards and the increasingly demanding expectations of regulators, combined to cause a significant shift in the requirements on auditors, far beyond what could reasonably have been foreseen in PSAA's 2017 contract round. The timing of this change unfortunately coincided with the pandemic.

Local authorities have also experienced pressures in maintaining staff capacity and capability within their finance functions. The limited availability of staff with the relevant qualifications, skills and experience to deal with the complexity of work, compile working papers and financial statements of a high standard within the time available has made preparation of accounts increasingly challenging. We don't see enough attention being paid to the importance of succession planning and, in a sector with an ageing demographic, there is a growing need to recruit and train the public sector finance professionals of the future.

This increases audit risk and means it is even more important the auditor understands the accounting implications of transactions in the context of the financial and legal framework the bodies operate in and has the support of colleagues with sector experience.

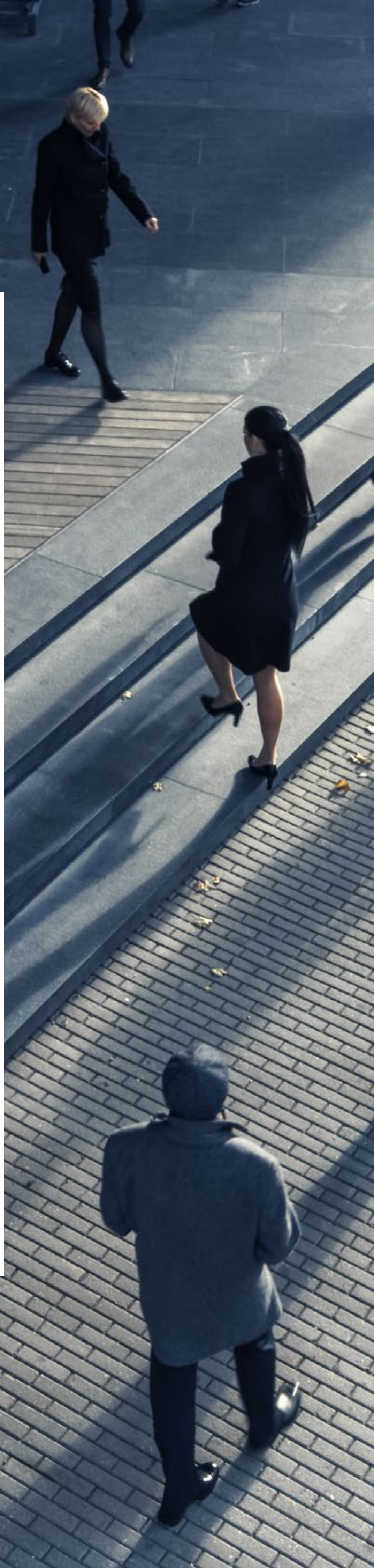
The ability of auditors to work with political bodies and challenging politicians is a vital skill which is learned over an extensive period. Coming into the sector, having never audited a local authority before, is demanding and requires extensive support and training, whatever the wider experience of the auditor.

Significant numbers of experienced audit staff have left the audit profession entirely in recent years, moving into non-audit roles within firms providing audit services and into the public and wider private sector. A combination of long working hours, the compression of deadlines, pay constraint and also a vastly increased focus on auditing the valuations of operational property, which have no impact on General Fund balances, has proven unattractive for new and experienced auditors alike. High staff turnover presents difficulties in terms of the continuity of audit teams and the demand placed on experienced colleagues in recruiting, orienting and training new employees and consequently there has been an impact on the timeliness of some audits.

It is hardly surprising, but nevertheless of real concern, that Redmond noted many local authorities had a negative opinion of the overall knowledge and expertise of their audit teams. He highlighted the difficulty in attracting and retaining quality junior staff and the challenge of retaining more experienced staff.

He also noted some evidence that reduction in audit fees had led to a decline in the number of auditors with the appropriate skills, knowledge and expertise. He commented that a fundamental review of the fee structure was necessary as, following successive Audit Commission and PSAA procurement exercises, no assessment of the amount it would cost to audit each local authority, based on their level of audit risk, had been made in the previous ten years whilst, over the same period, there had been changes to the powers and duties of local authorities and to the environment in which they operate.

Kingman noted a serious concern that arrangements for central procurement of local auditors were, in practice, prioritising a reduction in the cost of audits at the expense of audit quality.



From 2014 onwards, PSAA took on the responsibility of managing the framework contracts let by the Audit Commission in 2012 and 2014. In 2017 PSAA itself let new contracts, covering financial years from 2018/19 to 2022/23. Five lots comprising between 5% and 40% of the total market were let with scale fees reducing by 23%, following an assessment which was weighted 50:50 between price and quality. By way of comparison, the final procurement managed by the AC used a price-quality ratio of 60:40.

Redmond observed that not only had audit fees declined in cash terms, they had also dropped by approximately 20% when compared to net current expenditure of local authorities. In his evidence to PAC, Redmond noted the balance between price and quality in the procurement process was a big area of concern.

Taking inflation into account, the position is starker still. In real terms, 2018/19 audit fees stood at 43% of their level in 2011/12. This is despite the fact, over the same period, fees had increased in other sectors. Towards the end of PSAA's first contracting period, in late 2022, in real terms audit fees were just 35% of the level they had been a decade earlier.

In our view, each of the procurement exercises between 2011 and 2017 placed too much weighting on price at the expense of audit quality. This drove down prices at the same time that accounts became more complex. Following the collapse of Carillion in January 2018, the Kingman review of December 2018 and the Brydon review of December 2019, the audit landscape changed in a way that could not have been foreseen in letting the 2017 contracts.

Brydon commented that 'the profession of auditor must become more attractive. Breaking the negative spiral into which the profession seems to have fallen is necessary. The profession itself is primarily responsible for providing an attractive environment for potential new auditors, and must address such crucial factors as work pressure, work-life balance and culture'. We also need to make public sector audit a more attractive career choice, to retain a higher proportion of staff post-qualification. This has also been recognised by the new DLA who has commented that the local audit system has a very bad press at present and that he is keen to see the importance of the role in safeguarding public funds elavated so that more people want a career in local audit.

In its March 2021 report, the NAO noted there were insufficient staff with the relevant qualifications, skills and experience in both local finance teams and firms serving the local audit sector and a net loss of qualified staff from both. The NAO also observed that delays in completion of audits affects the planning and progress of auditors' annual work programmes, with delays in local authority audits affecting the delivery of NHS audits and delaying the planning of subsequent local authority audits.

The ICAEW told the PAC that the difficulty in finding sufficient qualified and experienced individuals to deliver local authority audits could in part be due to low margins on the audits, limiting the ability to offer higher pay, and in part due to less attractive career paths. Pressure on audit staff to work intensely over a short period of time exacerbated staffing issues. In our own evidence to the PAC inquiry, we recognised the need for more audit suppliers in the market.

DLUHC proposes to work with the new system leader and the audit firms to develop an industry-led workforce strategy to consider the future supply of local auditors. We are keen to work with the new DLA and the FRC on the development of a workforce strategy.

As a firm, we have increased the number of staff working on our local audits since early 2021 by engaging with partner Grant Thornton International firms in India and the Philippines. This initiative has seen over 70 new colleagues support the delivery of our audits; it is improving our resilience and sustainability and offers a promising pipeline for the future.

The PAC, in its July 2021 report, recommended that MHCLG should ensure PSAA's next procurement exercise supported a new fee regime for local government audit, appropriately funded with fees in line with costs of the work.

In its response to the PAC report, the government recognised the need for a more competitive market, new entrants and a stronger pipeline. MHCLG also provided an additional £15m to local bodies to help with the costs of audit and new initiatives and committed to provide greater flexibility to PSAA to agree additional audit costs.

One measure proposed is for firms to enter the market while carrying out relatively small packages of audit work, recognising the investment required in entering a new market. It is pleasing to note that PSAA has had some success with this initiative, although in the short-term there is a real risk that firms will compete amongst themselves for a relatively small pool of experienced local auditors, with resultant recruitment, orientation processes and rotation of audit personnel draining capacity within the system overall.

In October 2022, PSAA announced the outcome of its procurement of audit services for the 470 local government, police and fire bodies that opted into its national scheme for the next appointing period spanning the audits from 2023/24 to 2027/28.

The procurement took place against the challenging backcloth of a troubled audit profession, a turbulent market and a local audit system that is facing unprecedented difficulties including large volumes of delayed audit opinions. PSAA note only nine audit suppliers are currently registered to undertake local audits in England, three of which opted not to take part in the procurement.

PSAA offered contracts to six suppliers following a competitive process, with the scale of the contracts varying widely depending upon the capacity each supplier is able to provide. PSAA will retain the services of three existing suppliers, Grant Thornton, Mazars and Ernst & Young, welcome former supplier KPMG back to the market, and will enter into contracts with two new suppliers, Bishop Fleming and Azets Audit Services.

This will help to support sustainability and competitiveness in the local audit market, although this is a slow burn process as the two new market entrants will serve just 7% of the market through to 2027/28.

PSAA also advised bodies to anticipate a major re-set of total fees for 2023/24, involving an increase in the order of 150% on the total fees for 2022/23.

This level of increase, which goes a considerable way towards reversing a decade long series of fee reductions, should give audit firms the confidence to invest for the future. It will help to ensure audit quality as well as increasing capacity and making it easier to retain experienced and talented auditors within the market. Experienced auditors can also do more to promote the value of a career in public sector audit and the recent change to the CoAP, expanding the scope of VfM work, will assist with this.

Scale fee increases will also reduce the prevalence of audit fee variations arising simply from the time lag between increases in audit work due to changes in regulatory requirements and the setting of fee scales. Redmond noted that the audit firms considered the fee variation process to be unsatisfactory and we agree that administering large volumes of fee variations, for sector-wide reasons, is not the best use of auditors', authorities or PSAA's time.

Recovering to stable and sustainable publication of audited accounts will be a challenge for finance and audit teams alike, given capacity limitations and the need not just to deliver new audits, but also to clear the backlog of prior audits.

Governance

On a day-to-day basis, local government is generally a well-governed sector. There are of course exceptions and it is healthy to reflect on and, where appropriate, challenge the status quo.

CIPFA has been clear that audit committees are a key component of governance, noting their purpose is to provide an independent and high-level focus on the adequacy of governance, risk and control arrangements. They play an important role in supporting leadership teams, elected representatives, police and crime commissioners and chief constables.

Leadership, behaviour, culture and appropriate financial management are all important, so having the right members on an audit committee, with an appropriate remit and appropriate training for those involved is key.

CIPFA has prepared separate guidance resources for audit committee members in authorities, members of police audit committees, and a supplement for those responsible for guiding the committee. Most recently refreshed in October 2022, this incorporates legislative changes and new expectations following the Redmond Review and guidance includes suggested terms of reference, a knowledge and skills framework and tools to help improve effectiveness.

Redmond reported there was merit in authorities examining the composition of audit committees in order to ensure that the required knowledge and expertise are always present when considering reports. He noted 56% of audit committees in councils had no independent members and recommended consideration be given to the appointment of at least one independent and suitably qualified member.

In his evidence to the PAC inquiry, Redmond commented on the capacity of audit committee chairs and members to absorb and understand the complex nature of many reports appearing before them. He urged for the forging of closer links with the s151 Officer, Chief Executive and Monitoring Officer to ensure the membership of the committee feels confident enough to challenge and manage issues presented to them.

Redmond noted partnership governance as an area receiving minimal or no specific coverage by Audit Committees and we have also commented on this in PIRs we have issued.

We agree with Redmond's recommendations in relation to governance and where applicable we encourage audit committees to thoroughly understand the reasons for delays in publication of audited accounts. Whilst recognising that delays can and do occur, audit committees should hold management and auditors to account for preparing and monitoring delivery plans.

Appendix - Management and audit committee checklists

Based on our experience as local authority auditors, best practice would be for management and audit committees to consider and address the points below. We recommend DLUHC, CIPFA or the FRC set out expectations for the system as a whole.

Management

- Has a timetable been agreed with the auditor, including dates for draft accounts, working papers, and availability of key members of staff?
- Is the s151 Officer satisfied that arrangements are in place for robust completion of CIPFA's Disclosure Checklist and that appropriate time has been allowed for robust internal quality assurance before audit?
- Is the finance team clear on the information needs of users of the accounts, on their view of accounts preparation materiality and has the clarity of presentation of the accounts been reviewed?
- Does the finance team have sufficient capacity to prepare high-quality draft accounts on time? Should support or expertise be sought from outside the organisation?
- Has the need for significant accounting judgements and estimates been thoroughly assessed, especially in light of any organisational changes or significant new transactions? Have assumptions underlying judgements and estimates been properly documented and has the finance team assured themselves over the accuracy and completeness of data inputs to estimation processes?
- How has management assured itself over the competency of external valuation, accounting, actuarial or other expertise? Has management fully and appropriately briefed their experts?
- Has the finance team held a debrief meeting with the external audit team on the previous audit? What changes are needed for the following cycle?
- Is the finance team clear on the core working papers the audit team will require?
- Have the audit and finance teams discussed what work can be done early, outside the peak of post-statements audit fieldwork?

Audit Committee

- Does the Audit Committee consider it has the appropriate membership, training and access to professional support to effectively discharge its responsibilities?
- Is the Audit Committee assured on the effectiveness of internal control over the preparation of draft accounts?
- Has management clearly identified the significant judgements underpinning the financial statements? Does the Committee agree with them?
- Has management clearly identified the need for significant estimates in the accounts? How have the estimates been formed? What alternatives have been considered and have experts been involved where appropriate?
- Has the authority entered into any significant and complex new transactions in the year? If so, what has management done to assure the Committee these will be accounted for appropriately?
- Does the Committee understand the causes of any significant delays to the audit process? Is there a timetable, with clear accountabilities, in place for resolving delays?

Appendix - Timeline

Date	Event
October 2009	Approval of 2010/11 Code of Practice on Local Authority Accounting, the first based on International Financial Reporting Standards.
August 2010	Government announces intended abolition of the Audit Commission.
November 2012	Local auditors TUPE'd to audit firms following award of five-year audit contracts by the Audit Commission, covering financial years 2012/13 to 2016/17. Local audit fees for 2012/13 on average 40% lower than for 2011/12.
January 2014	Local Audit and Accountability Act enacted.
April 2015	All contracts awarded by the Audit Commission transferred to PSAA.
April 2015	The Accounts and Audit Regulations 2015 come into force. Target date for publication of audited local government accounts accelerated to 31 July, from 30 September, effective from 2017/18 financial year.
October 2015	Secretary of State extends transitional arrangements to cover local audits for 2017/18.
July 2016	PSAA specified as appointing person under LAAA 2014.
December 2017	PSAA award five-year audit contracts covering financial years from 2018/19 to 2022/23. Local audit fees for 2018/19 on average 23% lower than for 2017/18.
January 2018	Carillion PLC enters compulsory liquidation, largest ever trading liquidation in the UK.
February 2018	Northamptonshire County Council CFO issues s114 notice.
December 2018	Sir John Kingman publishes his *Independent Review of the Financial Reporting Council.*
June 2019	CIPFA publishes *Streamlining the accounts.*
December 2019	Sir Donald Brydon publishes his *Independent Review into the quality and effectiveness of audit.*
February 2020	PSAA publishes Touchstone Renard's report *Future Procurement and Market Supply Options Review.*
March 2020	UK enters its first Covid-19 lockdown.
April 2020	NAO Code of Audit Practice 2020 comes into force, introducing important changes to scope of local value for money audit.
September 2020	Sir Tony Redmond publishes his *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting.*
October 2020	Financial Reporting Council publishes its first public report Audit Quality Inspections of Major Local Audits covering 2018/19 audits.
December 2020	DLUHC publishes initial response to Redmond Review.
February 2021	PSAA Audit Quality Monitoring Report 2020 notes 42% of 2018/19 local government opinions delayed beyond 31 July 2019 publishing date.
March 2021	NAO releases report *Timeliness of local auditor reporting on local government in England.*
July 2021	First meeting of the Local Audit Liaison Committee.
September 2021	PSAA launches local audit procurement strategy.

Date	Event
October 2021	FRC publishes second public report Audit Quality Inspections of Major Local Audits covering 2019/20 audits.
December 2021	DLUHC announces measures to improve local audit delays.
January 2022	FRC announces Regulatory Penalty of £250,000 against Mazars following an inspection of a local audit.
February 2022	Concerns emerge relating to the accounting for infrastructure assets in the local government sector.
February 2022	PSAA local audit contract notice for financial years 2023/24 to 2027/28.
March 2022	PSAA Audit Quality Monitoring Report 2021 notes only 45% of 2019/20 local government opinions published by 30 November 2020.
April 2022	CIPFA announces decision to defer implementation of IFRS 16 until April 2024, following an emergency consultation.
July 2022	Accounts and Audit (Amendment) Regulations SI 2022 /708 come into force, target for publication of 2022/23 to 2027/28 audited accounts set as 30 September.
October 2022	PSAA announces appointment of contracts for local audits to 2027/28, indicating an 'unavoidable major re-set of fees' of around 150% of 2022/23 fees
October 2022	FRC publishes third public report Audit Quality Inspections of Major Local Audits covering 2019/20 and 2020/21 audits.
October 2022	FRC announces commencement of tenure of first Director of Local Audit.
October 2022	CIPFA refreshes its guidance for Audit Committees.
November 2022	CIPFA publishes an Update to the Code for Infrastructure Assets and DLUHC lays Capital Accounting and Finance Amendment Regulations before Parliament.
December 2022	Thurrock Council issues s114 notice.
March 2023	Memorandum of Understanding between the FRC and DLUHC published.

Appendix - Bibliography

CIPFA LASAAC Local Authority Code Board | CIPFA

Eric Pickles to disband Audit Commission in new era of town hall transparency - GOV.UK (www.gov.uk)

Local audit contract winners revealed | Public Finance

Local Audit and Accountability Act 2014 (legislation.gov.uk)

Functions up to 2017/18 – PSAA

The Accounts and Audit Regulations 2015 (legislation.gov.uk)

Transitional arrangements | Local Government Association

About us – PSAA

Procurement outcome 2017 – PSAA

Carillion collapse: what went wrong? (parliament.uk)

Section 114 notice.pdf (northamptonshire.gov.uk)

Independent Review of the Financial Reporting Council (publishing.service.gov.uk)

Streamlining the Accounts | CIPFA

The quality and effectiveness of audit: independent review - GOV.UK (www.gov.uk)

News item: independent review of the sustainability of the local government audit market – PSAA

Prime Minister's statement on coronavirus (COVID-19): 23 March 2020 - GOV.UK (www.gov.uk)

Code of Audit Practice - National Audit Office (NAO)

Local authority financial reporting and external audit: independent review - GOV.UK (www.gov.uk)

News I Financial Reporting Council (frc.org.uk)

Local authority financial reporting and external audit: government response to the Redmond review - GOV.UK (www.gov.uk)

2020-AQMR-published-final.pdf (psaa.co.uk)

Timeliness of local auditor reporting on local government in England, 2020 - National Audit Office (NAO) report

Procurement strategy 2022 – PSAA

News I Financial Reporting Council (frc.org.uk)

Measures to improve local audit delays - GOV.UK (www.gov.uk)

Auditors I Audit Quality Review I Auditor Regulatory Sanctions Procedure I Financial Reporting Council (frc.org.uk)

https://www.cipfa.org/-/media/files/policy-and-guidance/urgent-task-and-finish-group/note-on-infrastructure-assets.pdf

Market Engagement – PSAA

Audit Quality Monitoring Report 2019/20 – PSAA

Updated statement on the deferral of IFRS 16 leases | CIPFA

Details - SI 2022/708 - Statutory Instruments - UK Parliament

Procurement outcome 2022 – PSAA

News I Financial Reporting Council (frc.org.uk)

News I Financial Reporting Council (frc.org.uk)

Audit Committee Guidance: 2022 update | CIPFA

https://www.cipfa.org/-/media/files/policy-and-guidance/cipfa-lasaac/ifrs-based-code-update-infrastructure-assets.pdf and The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2022 (legislation.gov.uk)

Thurrock Council issues S114 notice of financial distress - BBC News

https://www.frc.org.uk/about-the-frc/procedures-and-policies/memorandum-of-understanding

Glossary

AAR	Accounts and Audit Regulations 2015 (as amended)
AC	Audit Commission
Act	Local Audit and Accountability Act 2014
AQR	Audit Quality Reviews as conducted by the FRC
ARGA	Audit, Reporting and Governance Authority
CIPFA	Chartered Institute of Public Finance and Accountancy
CoAP	NAO Code of Audit Practice
Code	CIPFA Code of Practice on Local Authority Accounting in the UK
DLA	FRC Director of Local Audit
DLUHC	Department for Levelling Up, Housing and Communities
FRC	Financial Reporting Council
GF	General Fund
HRA	Housing Revenue Account
ICAEW	Institute of Chartered Accountants in England and Wales
LALC	Local Audit Liaison Committee
LGPS	Local Government Pension Scheme
MHCLG	Ministry of Housing, Communities and Local Government
NAO	National Audit Office
OLAR	Office of Local Audit and Regulation (body proposed by Sir Tony Redmond)
PAC	Public Accounts Committee
PIR	Public Interest Report
PSAA	Public Sector Audit Appointments Ltd
s114	Section 114* of Local Government and Finance Act 1998
s151	Section 151** of Local Government Act 1972
TR	Touchstone Renard
VfM	Value for Money

***S114 Local Government Finance Act 1988 114 Functions of responsible officer as regards reports.**

2 Subject to subsection (2A), the chief finance officer of a relevant authority shall make a report under this section if it appears to him that the authority, a committee of the authority, a person holding any office or employment under the authority, a member of the relevant police force, or a joint committee on which the authority is represented—

3(a) has made or is about to make a decision which involves or would involve the authority incurring expenditure which is unlawful,

4(b) has taken or is about to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency on the part of the authority, or

5(c) is about to enter an item of account the entry of which is unlawful.

****S151 of Local Government Act 1972**

every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs

Contact us

Mark Stocks
Head of Public Sector Assurance
T +44 (0)121 232 5437
E mark.c.stocks@uk.gt.com

John Farrar
Director and
Head of Financial Reporting, PSA, Audit
T +44 (0)151 224 0869
E john.farrar@uk.gt.com

Grant Thornton

grantthornton.co.uk

DS4155