

Written evidence submitted by Professor Laurence Ferry (Durham University and Rutgers University)¹ and Dr Henry Midgley (Durham University)² [FRA 018]

1. Introduction

We welcome this inquiry and the Committee's interest in this area of financial accountability.

Our key points are:

- Local authority accounts and the audit of local authorities are key supports to local democratic accountability. To do this, they need to uphold both financial conformance and operational performance (value for money – economy, efficiency, and effectiveness - and equity). This could be done through additional publication of performance information which as the Public Administration and Constitutional Affairs Committee (PACAC) (2017, 2018) suggested for central government accounting could be subject to some form of independent check (Section 2).
- Currently the standards set for local government accounting are opaque to the general public. The code is not available without a fee being paid. DLUHC should fund the code so that it can be made freely available to any citizen who wishes to see it (Section 2).
- Given the decline of other intermediaries such as the local press, we suggest that a local public accounts committee could assist in providing an assessment of the local accounts for local voters and providing a filter between the auditor and the local voter (Section 2).
- Local accounts and audit are necessarily complex, but they should be understandable and accessible. We suggest that the new systems leader for audit and the Department for Levelling Up, Housing and Communities (DLUHC) should have a role in identifying and spreading good practice in reporting (Section 3).
- Local authority accounts could be improved by providing simplified statements as suggested by Redmond (2020), which would enable comparison and discussion of value for money (linked to changes in local authority audit). Following the example of other countries, the Government and local authorities should invest in technological innovation enabling more scrutiny of the figures and more comparisons to be drawn (Section 4).
- The new systems leader for local audit could have a role in identifying flaws and strengths in the whole system, including the accounts. They should report back to this Committee about the degree to which local authority audit and accounts meet the democratic standards expected by Parliament and the public for local government (Section 4).
- Local audit needs a national system in which data is shared, published (where appropriate) and explained comparable to what happens elsewhere in the UK. The new systems leader

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should take a role in sharing best practice in audit and in identifying flaws in and improvements to the system (Section 5).

- The entire system of local accounting and audit requires adequate resourcing so that the information provided is of a good enough quality that citizens can judge their local authority and hold it to account. We believe that the responsibility for this lies with DLUHC and this includes them supporting local initiatives to improve accountability such as developing technological tools to enable more scrutiny of accounting (Section 4, Section 5).

We believe that these comments are consistent with the themes made by Ferry and Murphy (2015, 2018) which suggest that these issues are long term and are related to the structure of the local democracy post the Audit Commission's abolition. Ferry and Murphy (2018) stated,

- Transparency may not adequately replace accountability;
- Loss of formal information and interrogation capacity has not been replaced by informal arrangements;
- Austerity and cutback management will challenge governance relationships (this has become even more of a problem due to crises such as covid);
- A reduction in performance information is constraining public reporting, scrutiny and public assurance; and
- Changing the mix of accountability and transparency arrangements may involve value for money risks.

All these themes remain true, and we include them to support the points made above.

We have answered the committee's individual questions below.

2. Users and uses of local authority accounts

2.1 What is the purpose of local authority accounts

Local authority accounts have several different purposes, which are:

- They provide information about local service delivery to voters (potentially through other "intermediate" users like the local press and interested pressure groups or thinktanks).
- They provide information to local councillors about the performance of the authority.
- They provide information to local officials about the performance of the authority.
- They provide information to Central Government about the implementation of national policy priorities / elements of local services in which central government has a legitimate interest and about the financial sustainability and compliance of local authorities. They also thereby feed into central government accounting, accountability and statistics.
- Audited accounts by themselves constitute a hygiene check on local financial governance. Even if they were not being used by either local electors (or their proxies) or central government, they would be useful in demonstrating that local government financial activity is in line with its legal competencies and duties. This relies upon the auditor performing their role adequately but is an important baseline assurance for the public and Parliament.

These purposes may conflict. For example, voters might want simply presented data that is easy to read and analyse, whereas central government may desire more granular data which fits into other technical releases. Accounts need to be seen as one contribution to an entire group of documents which help provide accountability to all these users. They are distinct from other documents because they are audited and compiled to a set of standards which is generally applicable.

2.2 What role do they play in local accountability and democracy?

Local council accounts should play a role in local accountability by enhancing democratic scrutiny of local government's responsibilities, which they can do in several important ways.

Firstly, local government accounts could be used to check a local authority's financial performance and position. A citizen of that local council could use them to assess the financial sustainability of the local council in question, the obligations it has taken on and any vulnerabilities in terms of risk (for example, the extent of its investments or liabilities). As the accounts are audited, they give a basic assurance to the citizen as well that the authority has its books in order and is able to produce accounts which can be scrutinised (so long as the financial audit is a good quality audit).

Secondly, local government accounts could be used to assess the value for money with which services are being provided at a local level.

The Public Administration and Constitutional Affairs Committee (PACAC) suggested that this was a key purpose of central government accounts in their 2017 report, *Accounting for Democracy* (PACAC, 2017, 2018). The Government recognised this in their response to the Committee's work: they agreed that financial reporting existed "to enable the public and researchers (both in civil society and Parliament) to understand and consider the value for money offered by public spending, so that they can make decisions about the effectiveness, efficiency and economy of particular policies or programmes" (Treasury, 2019, p. 11). Some progress has been made against this commitment in central government (Treasury, 2022).

Value for money has long been recognised as a key part of local authority accountability, going back well before the formation of the Audit Commission in the early 1980s (see for example, Layfield, 1976, p. 94). Much scrutiny of value for money in local government traditionally came through the auditor who published performance statistics and inspection reports for local authorities. After the abolition of the Commission, the role of accounting and audit in providing citizens with the information to scrutinise value for money was much reduced (Ferry and Murphy, 2015, 2018). As Ferry (2019) argued in a report to your predecessor committee, "Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM) – economy, efficiency and effectiveness), nor whether it has contributed towards fairness in society (equity)." This democratic purpose is even more important during times of crisis (Ferry et al., 2023).

Thirdly, accounts in local authorities provide a key resource for citizens to understand whether the authority is behaving appropriately. The Layfield Committee mentioned that accounts are there to ensure that expenditure and income were spent or raised in line with the law (Layfield, 1976, p. 94).

Currently standards for local government accounts are set by CIPFA in a document called the Code of Practice for Local Authority Accounting. Members of the public currently pay to access the code. For central government, the corresponding document - the Financial Reporting Manual - is free to read on the Treasury website. As DLUHC are responsible for the overall governance framework of the local government sector, they should provide funding to CIPFA to make the code freely available for all users of the accounts so that users could understand the detail of what local authorities are required to provide (National Audit Office (NAO), 2019).

2.3 Building on that answer, what is the purpose of local audit?

In democracies public sector audit has a constitutional role, to uphold democracy and support the rights of Parliaments and people against those of the executive (Ferry and Midgley, 2022). This

democratic role is common in local government too. A study of twenty countries across the world revealed that the role of the auditor in local government was largely determined by the constitutional arrangement of local government in that country (Ferry et al., 2022). For example, in a centralised country such as France, the audit remit is set nationally whereas in countries with a federal tradition like Germany or Austria, the audit remit varies depending on the location of the local authority concerned.

In England, the Audit Commission's remit was set in agreement with central government (Ferry et al., 2015) and since the Audit Commission's abolition, auditors have worked under a code set by the NAO. There are different arrangements in Scotland, Wales, and Northern Ireland with all three nations retaining approaches to local government audit which were "more centralised and public sector orientated" than the approach in England (Ferry and Ahrens, 2022). This has led to different approaches to audit across the UK: "the audit scope is narrowest in England" of the four nations in the UK and there are "no supply problems" of auditors in Wales or Scotland (Ferry and Ahrens, 2022; Grace and Thorogood, 2023).

The UK is typical of democratic countries in that public sector audit's primary function is democratic (Ferry, 2019; Ferry and Midgley, 2022). Audit has frequently been used to ensure that those scrutinising government, at a national and local level, have the information and skilled assistance they need to perform that role. This is the role that the NAO carries out in central government (Midgley, 2019; Ferry and Midgley, 2022). In 2011, the Communities and Local Government select committee set out principles about the ways that auditors in local government should behave, which were:

- auditors are independent of the audited body;
- the scope of auditors' work covers not only the audit of financial statements, but also 'regularity' (legality), propriety (probity) and use of resources (value for money); and
- auditors may report widely to the public, councillors and other key stakeholders (Communities and Local Government Select Committee, 2011).

These principles are consistent with the academic evidence described above, with one addition. In both central and local government, in a UK Context over recent contemporary history, it is clear that the auditor themselves should not be a participant in the partisan political debate: the 1983 National Audit Act prohibits the NAO from questioning the policy objectives of departments and the most recent guidance to local authority auditors states that it is not part of the auditor's responsibility to "question the merits of policy" (NAO, 2020). There are good reasons for this: in 1983 when the exclusions were put into the National Audit Act, it was argued that excluding the auditor from discussing policy objectives enabled them to be a trusted provider of information to politicians who held varying views about what the country should do (Midgley, 2019; Ferry and Midgley, 2022). The same logic applies in local government.

2.4 Does it ensure compliance with requirements, assure the credibility of the accounts, assess the local authorities themselves through value for money work, etc.?

There are two parts to this question. Firstly, there is the question of what the current audit arrangements are designed to do and secondly there is a question about the execution of the current audit arrangements by audit firms.

In terms of the design of the audit arrangements, at the moment, the auditor's remit is limited. The NAO provides a code of practice which sets out what auditors of local authorities should focus their work on. The most recent version was published in 2020. The Code of Practice states that the

auditor should audit the financial statements of the local authority in a “risk-based and proportionate” way (NAO, 2020, p. 9) and do so in such a way that they are “complying with auditing standards currently in force in the United Kingdom” (NAO, 2020, p. 12). This means that auditors will apply a sampling approach, will attempt to find material errors (rather than all errors within the accounts) and will do so in line with the approach of professional auditors in the public and private sector. This approach to the audit should produce an audit report which is “timely” (NAO, 2020, p. 10). The auditor is also able to report in a number of other ways - for example in the public interest: in these additional cases, the auditor is expected to bear in mind whether additional reporting is in the public interest (NAO, 2020, p. 23-4).

The code makes it clear that there is an extension to these arrangements when it comes to value for money. The Code states that the auditor is required to assess the authority’s approach to value for money: the auditor should “undertake sufficient work to be able to satisfy themselves as to whether, in the auditor’s view, the audited body has put arrangements in place that support the achievement of value for money. In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period” (NAO, 2020, p. 16). The auditor is then required to report against this in a clear and understandable way. This is a limited reporting right – it is clear that the auditor is not reporting on value for money, nor are they publishing performance information, rather they are reporting on whether the authority has arrangements to manage value for money in place (Ferry, 2019).

The NAO has a role in conducting value for money studies across the entire field of local government. However, as the NAO reports to the Public Accounts Committee rather than to individual councils, its findings are applicable for local government as a whole rather than for each individual council. Ferry (2019) suggested that there were significant gaps both in value for money reporting and in the absence of comparative data for holding local authorities to account.

In terms of the execution of these arrangements, there have been three significant objections.

Firstly, on timeliness, there have been building issues around timeliness of the auditor’s report and therefore a completed audited set of accounts. This has been especially true in the pandemic: as of January 2023 there were 632 audit reports outstanding on local public bodies. 12% of local public bodies reported on time in 2021-2 (a slight rise on the 9% who did so in 2020-21), leaving 88% of accounts for 2021-2 late (NAO, 2023, p. 4). This contrasts with the last year of the Audit Commission, when the Commission reported that in 2013-14 99% of councils and 98% of “principal bodies” met the statutory timetable for their accounts publication (Audit Commission, 2014). Despite the fact that the pandemic would have caused delays in any system, a decline in timeliness was visible pre-pandemic and the pandemic should not have caused so many accounts to have been delayed (Murphie and Fright, 2023).

Secondly, there is a gap between reporting on local authorities approach to managing the risks associated with poor value for money and reporting on actual achievement of value for money. Auditors are not required to audit performance figures in the accounts - something PACAC (2017) called for in the context of central government accounts. Auditors do not, as the Audit Commission did prior to 2015, publish their own performance data. This gap around performance information makes it very difficult to hold local authorities to account for the value for money that they produce for different services (Ferry et al., 2015; Ferry and Murphy 2015, 2018; Ferry, 2019; Murphy et al., 2019; Ferry et al., 2022a).

Thirdly, the dismantling of the Audit Commission has meant that local government audit is now both conducted mainly by private sector firms and is also subject to the regulation of the private sector regulators. Given the fundamentally different remit and purpose of private sector audit (concerned with profitability and solvency) and public sector audit (concerned with democratic accountability), there are significant questions about this decision (Ferry et al., 2015; Ferry and Murphy 2015, 2018; Ferry, 2019; Murphy et al., 2019; Ferry et al., 2022a; Ferry and Midgley, 2022). The Committee might want to consider whether there are different options for regulating the local government audit profession: whether through a centralised body reporting its audit findings to each local authority but accountable to Parliament (as the ultimate constitutional guardian of democratic rights within the UK) for carrying out its functions or whether the private sector regulators should themselves report to local government and Parliament about this work.

2.5 Who currently uses local authority accounts?

Evidence in general about the usage of government accounts is limited. PACAC (2017) did analysis on central government accounts, which are less complex than local authority accounts but compiled on a similar basis (using International Financial Reporting Standards) that revealed there were very few users of them either in Parliament or outside in thinktanks. Similarly, Sir Tony Redmond in his Review of local government accountability found few users of local authority accounts (Redmond, 2020).

There is more understanding amongst local councillors who scrutinise the accounts in council committees. Members of staff will help them with the accounts and councillors will be able to scrutinise expenditure. Even amongst councillors, especially backbench councillors, understanding is limited. In a CIPFA survey in 2020, 26% of councillors who responded said they did not understand or only marginally understood the local authority accounts - this rose to 41% of councillors when cabinet members were excluded and 50% of backbenchers (Peebles and Dalton, 2020). The response rate to this survey itself was 10%.

There are also issues about whether users of the accounts would exist in local government even if the accounts were more understandable and transparent. Citizens are often, in the accounting literature, assumed to perform their scrutiny through others i.e. intermediaries. In central government, there are plenty of intermediaries including dedicated thinktanks, journalists and other analysts. However, although there are thinktanks who look at local government - for example the Centre for Public Scrutiny, there are fewer of them, and they are covering more sets of accounts. Perhaps most worryingly though, the decline of local journalism (the Cairncross Review found that the circulation of local papers fell substantially between 2007 and 2017 - from sales of 63.4 million copies a week in 2007 to 31.4 million in 2017) means that there are fewer people actually seeking out and analysing the information that is produced and its harder and harder for that analysis to make it out to the general public (Cairncross, 2019, p. 24; Ferry et al., 2022a).

2.6 What do they use the accounts for?

There is evidence that local authority accounts are used for some specific purposes. For example, the Taxpayers Alliance produce a report covering the highest paid members of staff in local authorities which is based upon the remuneration report disclosures about pay (Taxpayers Alliance, 2022). Local officials are able to use the accounts similarly: for example, in the early part of the 2010s, Newcastle City Councillors used accounting data to create pictorial representations of the cuts made because (they argued) of central government cuts to funding (Ahrens and Ferry, 2015) - in this case, the accounts were being used to hold central government to account. There was more

local use of accounts by local campaign groups (Ahrens and Ferry, 2018) - but ultimately use is likely to be limited. For example, it is almost impossible to use the accounts to discuss value for money in a meaningful way because of the lack of performance information either in the accounts or in an audit report (Ferry and Murphy, 2015, 2018).

2.7 Who should be using local authority accounts?

The Redmond Review (2020) suggested that the potential users for local authority accounts are a large group of people: "Potential users extend beyond councils, government and auditors. Key stakeholders include council taxpayers/service users, the general public, academia, the media and local authority partners and contractors" (Redmond, 2020). Ultimately, local authority accounts are part of a local democratic infrastructure, reporting to the local community about the activities and decisions of their democratically elected councils. As Ferry (2019) argued in advanced liberal democracies "citizens have many things to do in their everyday life that detracts from them spending time going through local authority data" and this means that local intermediate users are important to ensure that citizens are adequately informed. Transparency can improve public services but only "if it takes account of context, is adaptive to ongoing changes, and ensures that citizens can access and understand the relevant data" (Ferry and Eckersley, 2015).

2.8 If these groups of users aren't the same, why not?

These groups of users may all use accounts, however evidence suggests that the level of engagement is low. Partly this is due to the complexity of local authority accounts, the Redmond Review concluded that accounts are only understandable to those with technical accounting skills (Redmond, 2020). The Public Accounts Committee agreed: they stated that "the accounts of local authorities are impenetrable to many stakeholders. There could be much greater transparency in the financial reporting of local authorities, such as through the inclusion of a simple standard statement, focused on the key issues of most use and relevance to stakeholders, presented in a readily understandable way" (Public Accounts Committee, 2020).

The issue though goes beyond accounts. The accounts have to be examined in the context of a wider accountability regime. Redmond (2020) suggested for example that the accounts might be supplemented with simpler material which enabled citizens to scrutinise local authority performance. Ferry et al. (2022a) argued that the accountability system as a whole, including both audit and the accounts was failing to establish place based accountability because of a lack of clear information for the public to use, a lack of capacity to make decisions at the local level, the financial opacity of some of the financing arrangements entered into by local authorities and the lack of a place based forum for accountability to take place in (given the dependence of local authorities on other bodies to achieve their outcomes). One solution suggested by Ferry et al. (2022a) following Hammond (2018) was that local Public Accounts Committees could be convened to scrutinise on behalf of the electorate all the relevant bodies and produce reports which would explain and discuss what local bodies had done.

2.9 What information do citizens need in order to hold their local authorities to account?

CIPFA (2008) set out in a vision of what they thought individuals needed to know about their local authorities. They said reporting should meet the following purposes:

- provides a sense of place that is individual to the organisation and is delivered through a vibrant document.

- is accessible and is produced for the whole authority/community, not just those with a financial background.
- helps to close the gap between low public perception and local government's overall improving performance.
- enables the authority to be held to account for performance and looks forward as well as backwards.
- addresses accountability and stewardship in a way that is meaningful.
- tackles over prescription by central government.
- addresses issues that matter locally such as sustainability / inclusion / community cohesion / leadership and is owned by the leaders of the organisation and other community leaders.
- would be a standard for UK local government reporting & could potentially be a standard for other UK and international public sector reporting.
- underpins all external reporting, including that which is primarily financial in nature and that which is not.

CIPFA's suggestions encompass the concepts of "regularity' (legality), propriety (probity) and use of resources (value for money)" that the Communities and Local Government Committee (2011) described as the core information that the public required to hold their local authority to account.

2.10 Is this information available in the local authority accounts as they stand?

Currently local authorities do publish an immense amount of financial data in their accounts. Lots of this is useful to understanding the financial performance and position of the local authority. For example, the accounts report back on the basic outturn and give some breakdown of those figures. Some councils also publish a large amount of performance information - for example indices of Key Performance Indicators for services but this information is published separately to the accounts itself (e.g. Wandsworth Council, 2022a).

We have listed some examples of useful data published by local authorities below in their accounts:

- Wandsworth published a summary of the impact of the COVID-19 pandemic on their accounts (Wandsworth Council, 2022);
- Durham County Council produced a useful section at the front of their accounts setting out the circumstances of Durham as an area including population data, employment data and demographic data (Durham County Council, 2022); and
- Essex County Council provide a narrative in the front of their accounts which breaks down individual service lines, explains surpluses and how they will be spent and explains the future budget and its link to the accounts (Essex County Council, 2022).

Some of this reporting is discretionary, other elements are compulsory. Sir Tony Redmond commented in his Review that "the coverage of the financial and VfM audits is far narrower than many stakeholders expect" (Redmond, 2020, p. 38).

The major gap in the accounts is the performance data. In central government, the idea that the annual report and accounts should provide performance data is now accepted by the Treasury (Treasury, 2014; Treasury 2019). PACAC in 2017 recommended that the government should publish more performance information about central government to support the value for money objective of the accounts and suggested that this information should be subjected to an independent check.

CIPFA have also acknowledged that accounts should contain performance information (CIPFA, 2008). In local authorities, traditionally the Audit Commission and CIPFA would publish performance data.

Centralised performance data was scrapped by the coalition government in 2010-15. Authorities still do publish a vast amount of performance data: ranging from publications about KPIs and their achievement to entire websites devoted to local authority performance (Leicester Council, 2023; Wandsworth Council, 2022a), but generally this information does not form part of the accounts. The Local Government Association have attempted to fill this gap of providing benchmarking data, but their service is not as extensive as the Audit Commission's benchmarking data was in the past as they do not have the same resources and some of the data is behind a paywall so inaccessible to ordinary citizens (Local Government Association, 2023).

The Committee should seek to restore this as part of the overall accountability settlement. They could do this through suggesting local authorities provide an annual report (comparable to the annual report that central government departments provide with the same requirements for audit as recommended by PACAC (2017)) or they could return to the auditor and other bodies publishing this performance information more extensive arrangements as used in local government in the past. For example, the committee could examine the case for different models of performance area which report on service (Best Value Performance Reviews), authority / organisation (Comprehensive Performance Assessment) or place (Comprehensive Area Assessment). The key principle is that performance data and financial data should be published so that the two can be linked together and value for money can be assessed by the citizen or intermediary (Ferry et al., 2015; Ferry and Murphy, 2015, 2018; PACAC, 2017, 2018). Ideally, they should be published in the same place so that citizens and intermediaries can easily access the information and compare them.

3. Understandability and accessibility of local authority accounts and audit

3.1 Do the accounts provide a clear picture of the financial sustainability and resilience of a local authority?

They do provide this picture – but, as our answers below suggest, the difficulty is whether users of the accounts can actually access and understand the information.

3.2 How well do users understand the financial position and performance of a local authority from its accounts?

The Redmond Review (2020) states that “When asked whether local authority accounts allow the user to understand an authority's financial performance and its financial resilience, 93% of respondents said no.” To a specialist, local authority accounts may be able to give this clear picture, but from Redmond's analysis it is clear this is not true for many users. This is part of the gap that either the accounts, the audit or another mechanism should be able to fill.

3.3 Do the accounts provide a clear picture of the level of reserves within a local authority, and how these might be used?

The level of reserves is disclosed in the accounts. Some authorities will also disclose how the reserves can be used in narrative sections attached to the accounts (see for example Bolton's unaudited 2021-2 accounts (Bolton, 2022)). However, users of the accounts may not understand how these reserves work, which reserves are available for which services and which reserves are earmarked for a specific purpose (e.g. the Housing Revenue Account).

3.4 How easy do users find it to locate key information they are looking for in accounts?

The Redmond Review (2020) states that “When asked whether local authority accounts allow the user to understand an authority’s financial performance and its financial resilience, 93% of respondents said no.”

3.5 Electors have a statutory right to inspect and object to pre-audited accounts. How widespread is this, and how does the current format of local accounts affect it?

The NAO sets out the rights of local citizens to inspect accounts in a document that they maintain (NAO, 2022). Whilst we do not believe that the accounts are frequently inspected by citizens, it is important that this right is protected. The lack of use of this right both relates to the fact that (as discussed above) citizens are busy with other matters and the technical complexity of the accounts themselves. More assistance could be provided to citizens to inspect the accounts. In general, however, transparency cannot replace accountability (Ferry et al., 2015). The army of armchair auditors that was supposed to replace the Audit Commission has failed to materialise (Ferry and Murphy, 2018).

3.6 How well do users understand published audit findings and reports?

As Redmond (2020) noted (referenced above) there is an expectations gap surrounding local audit. This means that audit reports currently do not deliver what citizens expect to find out from them.

3.7 Are some outputs more understandable and accessible than others?

Accounts published by local authorities do vary in their presentation. For example, Leicester published visualisations of what has happened in their income, expenditure, pension deficit and other areas of the accounts (Leicester City Council, 2022). Other authorities do not publish these kinds of visualisations.

One benefit of a systems leader could be the identification and spread of good practice amongst local authorities. DLUHC should also take a role in spreading best practice in reporting as part of its overall duty to maintain the governance and accountability system for Local Government as a whole (NAO, 2019).

4. Making local authority accounts meet the needs of users better

4.1 Are local accounting requirements proportionate?

The Redmond Review said that “Local government practitioners argue that the extent and nature of asset valuations, very relevant in a commercial setting, undertaken by auditors, have limited significance in local government where assets are more often than not critical to service delivery and “market value” is not a consideration” (Redmond, 2020, p. 60). However, as the Redmond Review acknowledged moving away from an accruals basis would lead to issues: both for the Whole of Government Accounts and due to the increased leverage local authorities have recently taken on (Redmond, 2020).

4.2 Are the bespoke reporting requirements for local government accounts (as opposed to central government accounts or non-government accounts) beneficial?

It is important that there are bespoke requirements for local government accounts as opposed to central government and charity accounts. This is for several reasons.

Unlike charities, or companies, local councils are democratically elected organisations. They are not accountable to donors or to investors but to their local population. This means that the decisions

made using local government accounts are of a different nature and made by different people than the decisions made using charity or corporate accounts.

Local government accounts are also distinct from central government accounts. There are a number of different legal requirements upon them (mentioned elsewhere in this evidence).

There are also two key conceptual differences between the documents. Central government accounts report to Parliament and therefore have a number of features which are required due to the parliamentary cycle of approval and accountability. Local Government does not report to Parliament and its accountability reporting therefore should be different. In addition, central government raises its own funding through general taxation and debt and has the discretion to change taxation levels or borrow more whenever it wishes to (within the constraints of the Government's view of the economic and fiscal risks created by changing taxation levels or issuing more debt). Local Government's funding is much more constrained: a portion of local government funding is given to it by central government. Furthermore, local councils cannot raise tax or issue debt when or if they deem it necessary. If they choose to raise council tax locally by an "excessive" amount, they have to go through a referendum (the precise amount can either be a cash amount or a percentage and details of how it has been set since 2012/13 are set out by the House of Commons Library (2023)). Local Councils can borrow but generally they use this money to finance capital expenditure (expenditure on assets such as buildings or machinery) rather than revenue expenditure (expenditure on services) and again there are limits on how much they can borrow (NAO, 2018; House of Commons Library, 2023). Authorities must set a balanced budget and are not therefore normally permitted to run deficits, including deficits on some specific accounts (though there are specific circumstances where central government have relaxed these rules (DFE, 2023)). Local government accountability therefore is different from central government accountability.

4.3 Do local authority finance teams have sufficient expertise and capacity?

Capacity within local authority finance teams will vary between authority with some having more finance staff and more skilled finance staff. There are wider issues within local authorities with shortages of staff to run key services (LGA, 2023). Within that context, the NAO reported in 2020 that "Local authorities reported increasing pressures, especially in maintaining staff capacity and capability within their finance functions" (NAO, 2021). In their view, this affected both the capacity of local authorities to produce accounts and the capacity of the audit firms to actually audit them (NAO, 2021). The increased importance of financial information within the way that services are run in local authorities makes the lack of this information even more important (Ahrens et al., 2018). These problems in local authority finance teams had been exacerbated by the pandemic (NAO, 2023).

The accounts staff at the local authority though are only one group required to get a set of audited accounts published. Audit teams also need to be appropriately skilled and capable of performing the work. English local authorities rely on private sector firms to conduct these audits and as the C&AG has recently said this means that "The supply of local public auditors in England is therefore entirely dependent on the attractiveness of the work to commercial organizations with the freedom to focus on other markets once their contractual responsibilities are discharged." (Davies, 2023). This problem is growing worse as "the inherited expertise from the Audit Commission is disappearing" (Murphie and Fright, 2023).

4.4 Could changes be made to local authority accounts that would both simplify their production and improve understandability for users?

There are important limitations on the changes that can be made without legislation. For example, section 74 of the 1989 Local Government and Housing Act mandates that “A local housing authority shall keep, in accordance with proper practices, an account, called the “Housing Revenue Account” and sets out what that account should cover. Without amending that act, that particular provision in the accounts cannot be changed and there are other similar areas which are limited by law.

Furthermore, there are important complexities which are introduced into local government accounts so that local government’s financial situation is appropriately described. For example, as discussed above, different reserves can be used for different purposes: some cannot be used by law to fund general expenditure but are earmarked for specific areas of spending.

4.5 How could local authority annual report and accounts be more accessible?

We think there are a number of suggestions here:

Firstly, as Sir Tony Redmond (2020) suggested in his report the authority could provide a simplified summary for local residents (and other interested parties) of what the accounts said.

Secondly, there are authorities who purely present figures rather than making those figures clear to the reader. For example, Wandsworth council’s accounts for 2021-2 do not include any graphical representations of the numbers which makes it harder to understand or see the numbers develop.

Thirdly, there are authorities whose accounts are purely published as PDF documents. Again, Wandsworth Council did this in 2021-2. Authorities could be encouraged to publish the PDF documents but also to use alternative electronic formats which allow users of the accounts to extract the data that they want. Local Authorities already publish performance information in electronically innovative ways (Leicester Council, 2023). PACAC (2017) suggested that central government accounts should make more use of technology to enable users to dig into the numbers and there is evidence from other countries such as the Netherlands and Canada of central government doing this. There is no particular reason that local government could not do this - especially if systems were set up by DLUHC to resource it and share best practice.

Fourthly, as Ferry (2019) argues there is a general lack after the Audit Commission was abolished of comparative data. One of the strengths of local authority accountability compared to central government is comparability. In principle you can compare local authorities who are all asked to do similar things and then make choices within their common remit about how to do it. Comparability therefore should be a powerful tool for local government, central government, researchers, journalists and in principle citizens to evaluate local authorities. There is a large gap though where comparative data especially performance data is concerned. In the future, a local audit sector lead could help fill this gap by publishing more comparative data about local authority finances and performance and benchmark for service improvement.

4.6 What is the role of the new local audit system leader in improving local authority accounts?

The memorandum of understanding between DLUHC and the Financial Reporting Council (FRC) states that “DLUHC will remain responsible for local government reporting requirements, the local government accountability framework, adherence to the Best Value duty, stewardship and policy decisions” (DLUHC, 2023). The new systems leader is tasked to act as an “advocate” for local authority audit. It is unclear how either the FRC who has just taken on the role, or in the future the new regulator, the Audit Reporting and Governance Authority (ARGA) will interpret this guidance.

Potentially, the system leader could in addition to their responsibilities for the audit market perform some kind of role in reporting to the Committee about whether its instructions related to accounts and overall accountability are being fulfilled after this inquiry is completed. They could also bring together some of the comparative information that, since the Audit Commission, has not been published in a systematic way. There may be capacity issues for them in doing this - given that ARGA and the FRC both have extensive other important responsibilities - for example assuring stakeholders of the viability of private sector audit after the widely publicised issues in companies like Carillion.

5. Addressing findings in audits and sharing best practice

5.1 To what extent can local authority audits identify issues prior to the most significant difficulties being known?

The primary purpose of audit is to assist in providing democratic accountability from the local council to the councillors and then the electorate. Therefore, in this current context, it is important that audit does not become involved in making decisions for local government: if auditors do become too involved in management there is a risk that they begin to review their own decisions and consequently have a conflict of interest when it comes to fairly reporting on the aftermath of the decision they advised about. This is a key point about audit - in the UK system it is not a form of consultancy but a support to accountability - often after the fact.

There are several issues regarding audit which may impede auditors from identifying issues early:

1. There have been repeated concerns about the resourcing and skills of local authority audit. Most recently, the NAO (2023) reported that these issues remained within the system following on from such concerns highlighted by Redmond (2020) and Ferry (2019).
2. The auditors remit has been increasingly limited in local government to financial conformance - although as our submission makes clear there is some limited assessment of an authority's approach to value for money. Ferry (2019) suggests that this limited form of audit has meant that auditors have flagged up issues later than they would have otherwise, which is a systemic risk.
3. Ferry and Eckersley (2022) say that since the abolition of the Audit Commission and due to the fact that "what gets measured gets done", "Many councils are now overwhelmingly concerned with financial sustainability and conformance with the statutory requirement to deliver balanced annual revenue budgets, potentially at the expense of service sustainability and operational performance". This relates to the shrinking remit of audit identified in point 2. This has been a concern raised for many years (Ferry et al., 2015; Ferry and Murphy, 2015, 2018; Murphy et al., 2019; Ferry, 2019; Redmond, 2020; Ferry et al., 2022a).

5.2 Is there a sufficient advance warning mechanism when issues are identified to ensure action is taken?

The system is becoming more prone to systematic failure due to late accounts and late audits. As the NAO noted in 2021 "for local authorities to plan and manage their services and finances effectively, they need accurate and reliable financial information. A key element of the financial planning and budgeting process is the assurance which the audit process provides" (NAO, 2021, p. 22). In particular, they said that a delay in the production of the audited accounts has a direct effect on budgeting "as most local authorities commence their annual budget planning during the autumn of the preceding year" (NAO, 2021, p. 22).

Beyond the local authority itself, late arriving accounts and audits mean that errors, debts and investments are not properly understood either by councillors or by members of the local community. This is particularly true given the encouragement by recent governments of diverse delivery models which are more complicated to account for. Furthermore, the financial resilience of particular local authorities may be misunderstood due to the lack of audited information about the financial position of the authority in question. This could have an impact on other local services which are dependent on local authority services. A local public accounts committee would be able to identify these impacts across organisational divisions and help ensure that local councillors and other officials are held to account for them (Ferry et al., 2022a).

5.3 To what extent is there a framework for auditors in local government to work together and to share best practice? Should such a framework be formalised?

A framework to share best practice between auditors existed prior to the abolition of the Audit Commission through the Commission itself. Since the abolition of the Commission, there has not been enough sharing of good practice between auditors. We believe that this should be the responsibility of the systems leader.

5.4 To what extent has a recent absence of multi-year funding settlements hindered budgeting and forecasting?

The absence of multi-year funding settlements has hindered budgeting and forecasting. The Government previously used spending reviews as a tool to manage the introduction both of spending rises (pre-2010) and austerity (after 2010) (Ferry and Eckersley, 2011, 2012, 2015a, 2022). Not having spending reviews increases the risk (Ferry and Eckersley, 2022). Uncertainty is no excuse for this as adjustments can be made as necessary for real time crises such as Covid-19 (Ahrens and Ferry, 2020; Ahrens and Ferry, 2021).

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