Response to Ministry of Housing, Communities and Local Government Open Consultation – Local audit reform: A strategy for overhauling the local audit system in England

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Q1: Do you agree the LAO should become a new point of escalation for auditors with concerns?

Yes, the Local Audit Office (LAO) should become a new point of escalation for auditors with concerns in the role of system leader, as recommended by Sir Tony Redmond in his review (See Redmond, Sir T. (2020). *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting*. London: HMSO. https://assets.publishing.service.gov.uk/media/5f58b7cd8fa8f5106d15633b/Redmond_Review.pdf). Indeed, having a single body as system leader to overcome fragmentation was also raised previously (See Ferry, L. (2019). Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014. UK Parliament: Housing, Communities and Local Government Select Committee https://durham-repository.worktribe.com/output/1604988).

Q2: Do you agree relevant issues identified should be shared with auditors, government departments and inspectorates?

Yes, relevant issues identified should be shared with other auditors, relevant government departments and inspectorates to improve financial sustainability and local services in a consistent and timely manner. This should also be the case for sharing best practice. Whilst existing practice has been for auditors to discuss issues informally with the National Audit Office (NAO) and the NAO has regular discussions with the Department and the Chartered Institute of Public Finance and Accountancy (CIPFA), this needs to be formalised. In comparison, under the Audit Commission as the system leader all issues from all local auditors were consolidated, compared, and shared more comprehensively and widely. The strengthening of arrangements concerning sharing of best practice and/or concerns will assist with accountability, transparency, and financial sustainability, as has been highlighted (See Ferry, L., & Murphy, P. (2015). Financial sustainability, accountability and transparency across local public service bodies in England under austerity. Report to National Audit Office (NAO); Ferry, L., & Murphy, P. (2018). What about Financial Sustainability of Local Government! —A Critical Review of Accountability, Transparency, and Public Assurance Arrangements in England during Austerity. International Journal of Public Administration, 41(8), 619-629. https://doi.org/10.1080/01900692.2017.1292285 ; Murphy, P., Ferry, L., Glennon, R., & Greenhalgh, K. (2019). Public Service Accountability: Rekindling a debate. Palgrave Macmillan. https://doi.org/10.1007/978-3-319-93384-9). The Local Audit Office (LAO) as the new system leader should therefore perform this function.

Q3: Should the LAO also take on the appointment and contract management of auditors for smaller bodies in the longer term? If so, when should responsibilities transfer from SAAA?

Yes, the Local Audit Office (LAO) should take on the appointment and contract management of auditors for smaller bodies in the longer term. The Audit Commission carried out this function and there is no reason the LAO cannot, but only once it has the system operating effectively for local authorities.

Q4: Should the LAO oversee a scheme for enforcement cases relating to local body accounts and audit?

Yes, the Local Audit Office (LAO) should oversee a scheme for enforcement cases relating to local body accounts and audit provided it has the resources to do so. Also, this should be done on emergency footing until the local audit system recovers, when this should be reviewed and perhaps transitioned to another body. Please see our response to question 8 and concerns regarding the LAO replacing the courts outside of transitional / emergency arrangements.

Q5: How could statutory reporting and Public Interest Reports be further strengthened to improve effectiveness?

The Redmond Review found that Public Interest Reports were rarely used by auditors, perhaps due to the legal and reputational risks of using these powers. Therefore, consideration needs to be given to safeguarding legal and reputational risks. In addition, statutory reporting and Public Interest Reports could be further strengthened to improve effectiveness if they were detached from delivery of an audit, so a full audit does not have to be finalised before the completion and circulation of a Public Interest Report. Public Interest Reports should be considered by the Full Council of a local authority, not just the Audit Committee. This should be in a public meeting and trigger an action plan, which should be published. Then the Department can monitor progress, although consideration could also be given to whether this should become a role for the Local Audit Office (LAO).

Q6: Should the scope of Advisory Notices be expanded beyond unlawful expenditure, or actions likely to cause a loss or deficiency, as defined by the Local Audit and Accountability Act, to include other high-risk concerns?

Yes, the scope of Advisory Notices should be expanded beyond unlawful expenditure, or actions likely to cause a loss or deficiency, as defined by the Local Audit and Accountability Act, to include other high-risk concerns. For example, Advisory Notices could be employed for actions by a local authority that risk its financial sustainability, such as large commercial investments especially in activities that are non-core business.

Q7: Should the LAO own the register of firms qualified to conduct local audits?

Yes, the Local Audit Office (LAO) should own the register of firms qualified to conduct local audits as the new system leader. The Institute of Chartered Accountants in England and Wales (ICAEW) currently maintains the register of firms that have registered as local auditors and Key Audit Partners in England, but this register passing to the LAO would mean less fragmentation of the system. These arrangements worked well when the Audit Commission appointed local auditors.

Q8: Should the LAO hold the power to require local bodies to make changes to their accounts, so that auditors could apply to the LAO for a change to be directed instead of needing to apply to the courts?

Yes, the Local Audit Office (LAO) as the new system leader should hold the power at least on a temporary basis to require local bodies to make changes to their accounts, so that auditors could apply to the LAO for a change to be directed instead of needing to apply to the courts. This is because given the delays in the court system prevent action being taken in a timely manner, it would be a pragmatic approach, while the audit backlog is resolved. However, importantly, this would need reviewed after it was operational for a period, given the safeguards inherent in constitutional and legal issues associated with redress to the courts. In addition, the LAO should publish all the cases and its decisions, drawing lessons of general application for other auditors and authorities.

Q9: What are the barriers to progressing accounts reform?

An important barrier to progressing accounts reform is that the government needs to make clear what the purpose of local government accounts actually are, as they have done so lately for the purpose of the audit of accounts. This was a select committee recommendation (See Levelling Up, Housing and Communities Committee (HC59, 2023). Financial reporting and audit in local authorities). In addition, the Redmond Review highlighted that local authority accounts are too long, too complex, have complexities regarding statutory obligations for council tax, complications for statutory obligations regarding depreciation, and challenges concerning incorporation of pensions, among other issues. Furthermore, there are questions around whether the accounts can be trusted. These questions include :

- whether the accounts support the democratic process by providing data to inform scrutiny of value for money;
- whether users of the accounts have the necessary expertise to interrogate the accounts;
- the ongoing problem that the accounts are untested as they are currently not audited on a timely basis,
- and lastly, that the accounts are not used sufficiently to hold local government to account

(See Levelling Up, Housing and Communities Committee (2023). Financial reporting and audit in local authorities; Levelling Up, Housing and Communities Committee (2024). The Office for Local Government; Ferry, L., Fright, M., Midgley, H., Murphie, A., & Sandford, M. (2024). Are local government accounts trusted? Exploring the UK Levelling Up, Housing and Communities Committee Verdict. Public Money & Management, https://doi.org/10.1080/09540962.2024.2423370).

Q10: Are there structural or governance barriers to accounts reform that need to be addressed?

An important structural or governance barrier to accounts reform is the lack of a system leader, which makes changing the way accounts are done difficult. Currently, the form and content of the accounts are dependent on input from different bodies including the Financial Reporting Council (FRC), National Audit Office (NAO), Institute of Chartered Accountants in England

and Wales (ICAEW), Chartered Institute of Public Finance and Accountancy (CIPFA), CIPFA LASAAC etc., so the Department needs to forge a consensus to make any changes. In addition, statutory regulations, accounting standards and accepted practices have accreted over many years all of which would need unpicking. And rules differ for revenue expenditure, capital expenditure and grant funding. Furthermore, accounts reform should not be done in isolation, but needs to be tied to audit and accountability / governance reforms as otherwise there could be unintended consequences (See Ferry, L., Funnell, W., & Oldroyd, D. (2023). A genealogical and archaeological examination of the development of corporate governance and disciplinary power in English local government c.1970-2010. Accounting, Organizations and Society, 109, Article 101466. https://doi.org/10.1016/j.aos.2023.101466).

Q11: Should any action to accounts reform be prioritised ahead of the establishment of the LAO?

The Chartered Institute of Public Finance and Accountancy (CIPFA) could review the basis of accounts with the aim of updating the Accounting Code, but as the Redmond Review highlighted this would not be easy due to time to design and implement a new framework and the risk of such a step, which would entail moving away from International Financial Reporting Standards (IFRS). The UK public sector is arguably held up as a gold standard of accounting primarily because it is one of the few countries to apply IFRS fully. For accounts reform to work, external users of the accounts need to have confidence in the figures in the accounts and consequently, those accounts require audit. Even if, as the select committee recommended and we have argued above, accounts require reform, this reform needs to come after the auditing system is reformed so that a reformed set of accounts don't just become another set of data that no one trusts.

On balance, it is therefore unlikely that any significant action towards accounts reform could be prioritised ahead of the establishment of the Local Audit Office (LAO).

Q12: Are there particular areas of accounts which are disproportionately burdensome for the value added to the accounts?

In the interim, nothing should be done to de-prioritize the backstop and resolving the audit backlog.

There are areas of the audit that are more time consuming and so consideration maybe given to how these could be managed in the shorter term to get the audit backlog sorted and stability returned to the sector. For example, the Redmond Review highlighted the extent and nature of asset valuations as an issue, especially relating to property and pension valuations that take considerable time and effort, increase the audit cost, and can delay completion. However, this raises the question of whether International Financial Reporting Standards (IFRS) should underpin local authority statutory accounts that could have implications for the Whole of Government Accounts (WGA).

Importantly, beyond the transitional period to sort out the backlog and get stability back into the sector, as a principle the credibility of the accounts should not be undermined by dumbing down.

The question becomes then are the accounts burdensome or is it that auditors now have less knowledge of local government? Indeed, a related concern rightly highlighted by the Redmond

Review, although not universally shared, is that the complexity of local authority accounting arrangements was less of an issue previously under the District Audit Service, but the depletion in the number of auditors with the appropriate technical skills has impacted on the capacity of the external auditor to test and validate technically intricate accounting treatments without the previous familiarity with local authority finance and accounting.

The answer seems to be to identify what can be streamlined without undermining WGA/IFRS, but also improving auditor capacity and capability. There needs to be for example, training in specific public sector audit that the Chartered Institute of Public Finance and Accountancy (CIPFA) used to provide, and the District Audit Service utilised, to increase the pool of qualified staff with the necessary knowledge and expertise.

Q13: Do you agree that the current exemption to the usual accounting treatment of local authority infrastructure assets should be extended and if so, when should it expire?

Yes, the current exemption to the usual accounting treatment of local authority infrastructure assets should be extended. This should be on the clear understanding that it is only until the audit backlog is cleared and the system is operationally feasible again. The timing should be therefore determined on the best estimate of when this can be accomplished.

Q14a: Should the LAO adopt responsibility for CIPFA's Code of Practice on Local Authority Accounting?

In principle as the system leader there is an argument for the Local Audit Office (LAO) adopting responsibility for the Code of Practice on Local Authority Accounting, but equally as Chartered Institute of Public Finance and Accountancy (CIPFA) is the professional accounting body for this area then there are strong arguments for it to remain with them. On balance, in practice it would seem unlikely that the LAO would be able to build up the technical accounting skills to operate the Code at this juncture given the other challenges they would have to address and so it should remain with CIPFA who already have the staff and local government networks. Of course, it is also possible to review this arrangement say in 5 years when the new system has had an opportunity to mature.

Q14b: Are there other options relating to responsibility of CIPFA's Code of Practice?

The most feasible option is to leave responsibility for the Code of Practice with the Chartered Institute of Public Finance and Accountancy (CIPFA).

Q15: Should the Accounting Code be freely available if it is not transferred to the LAO?

Yes, the Accounting Code should be freely available. This should be true regardless of whether the code is transferred to the Local Audit Office (LAO) or not. If the Code remains with the Chartered Institute of Public Finance and Accountancy (CIPFA), CIPFA would need to be compensated for the financial cost of not charging for it. This was recommended in the Select Committee report (See Levelling Up, Housing and Communities Committee (HC59, 2023). Financial reporting and audit in local authorities).

Q16: What additional support should be provided to finance teams, audit committees and elected members to develop and strengthen financial governance?

While financial pressures where acknowledged as a challenge to all local authorities, in an interview, Lord Morse the then chairman of the Office for Local Government's (Oflog) told *The Times* that: "All of the failures that we've seen so far; all of the authorities that are in special measures are not primarily attributable to a shortage of money — they're to do with failures in management or failures in governance" (See Poor governance to blame for financial failure, not lack of funding, Oflog chair claims, Local Government Lawyer, January 2, 2024, https://www.localgovernmentlawyer.co.uk/governance/396-governance-news/56019-poor-governance-to-blame-for-financial-failure-not-lack-of-funding-oflog-chair-claims).

Support has been provided via guidance and training produced by the Centre for Governance and Scrutiny (CfGS), Local Government Association (LGA) and Chartered Institute of Public Finance and Accountancy (CIPFA) among others, so partly the question is how readily such guidance is being utilised given budget cuts to training and time pressures for doing the day job due to workforce reductions.

Nevertheless, additional support should be provided to finance teams, audit committees and elected members to develop and strengthen financial governance. Support could include sharing guidance, best practice, and training through the CfGS and LGA. The Department should also provide clear guidance on scrutiny. In addition, there should be better professional training for accountants, finance staff and non-finance staff that need financial skills to build capacity and capability, on a sectoral basis. Finally, measures including training needs to be instituted to increase the financial skill level for elected representatives as this would be beneficial to overall governance and democratic accountablity.

The caveat here though is that additional support will most likely require additional resources and time, for it to be most effective.

Q17: How should KAP eligibility be extended further, should some categories of local audit be signed off by suitably experienced RIs (and if so, which)?

Key Audit Partner (KAP) eligibility should not be extended further as the criteria should not be weakened, but instead the Local Audit Office (LAO) as the new system leader should work with the firms to increase the number of KAPs.

Q18: Should the market include an element of public provision?

Yes, the market should include an element of public provision. This has been a critical missing factor in being able to respond to the current challenges. The Audit Commission initially had 100% of public provision through the District Audit Service. This became 70:30 as they tendered to the private sector to get mutual learning and innovation (See Ferry, L. (2019). Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014. UK Parliament: Housing, Communities and Local Government Select Committee). In general, the Audit Commission worked effectively through its many different forms during its existence (Campbell-Smith, D. (2009). Follow the money: The Audit Commission, Public Money, and the Management of Public Services. London: Penguin), although latterly the Audit Commission was subject to criticism for its eventual size and expanded role particularly concerning inspection and service improvement that some argued went too far (Ferry, L. (2019). Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014. UK Parliament: Housing, Communities and Local Government Select Committee). Nevertheless, these capacities and capabilities of both the Audit Commission and District Auditor were important (Murphy, P., Ferry, L., Glennon, R., & Greenhalgh, K. (2019). Public Service Accountability: Rekindling a debate. Palgrave Macmillan. https://doi.org/10.1007/978-3-319-93384-9). Therefore, the closure of the Audit Commission and especially loss of the District Auditor function that pre-dated the Audit Commission (set up in 1840 in fact) has been described as throwing the baby out with the bathwater by Rob Whiteman, the then CIPFA CEO giving evidence to the Select Committee (Housing, Communities and Local Government Committee (2021) Local authority financial sustainability and the section 114 regime. Question 17 - https://committees.parliament.uk/oralevidence/1688/pdf/).

Nationally, other countries in the UK have mostly public audit provision (See Ferry, L., & Ahrens, T. (2022). The future of the regulatory space in local government audit: A comparative study of the four countries of the United Kingdom. Financial Accountability and Management, 38(3), 376-393. https://doi.org/10.1111/faam.12291). Public sector audit also works well in central government financial and performance audit in the UK (See H. Midgley, L. Ferry, A. Murphie (2024). Holding the Government to account: Democracy and the National Audit Office. Routledge).

Internationally, many countries also have public provision with very few relying solely on private provision (See Ferry, L., & Ruggiero, P. (Eds.). (2022). Auditing Practices in Local Governments: An International Comparison. Emerald, and Ferry, L., Midgley, H., & Ruggiero, P. (2022). Regulatory space in local government audit: An international comparative study of 20 countries. Public Money & Management, 43(3), 233-241. https://doi.org/10.1080/09540962.2022.2129559).

Q19: If yes, should public provision be a function of the LAO?

Yes, public provision should be a function of the Local Audit Office (LAO). The LAO should operate its system leader functions and separately operate a public provision audit service. Indeed, such arrangements were in place under the Audit Commission.

Also, there is the principle of auditor independence, whereby it would be more conducive to the public good that authorities should not be allowed to appoint their own auditor (See Ferry, L. (2019). Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014. UK Parliament: Housing, Communities and Local Government Select Committee).

Having public provision alongside private provision overseen by the system leader is more likely to engender greater capacity in the audit market and address auditor independence challenges, although in practice most local authorities use Public Sector Audit Appointments (PSAA) to appoint their auditors under current arrangements.

Q20: What should the initial aim be in relation to proportion of public and private provision?

The initial aim for public and private provision should be 25:75 by 3 years, with a stretch target of 33:67 by 5 years. This is practical given recruitment, retention, and training considerations. In the longer term, say 8 years, at least a 50:50 split would seem sensible to provide a core service should there be challenges in the private audit market in providing sufficient capacity and capability.

Q21: Should the Secretary of State, in consultation with the LAO and for defined periods, set an envelope within which the body could determine the appropriate proportion of public provision for the market?

There needs to be consideration of the constitutional and independent safeguards to protect the remit and funding of the new Local Audit Office (LAO), in much the same way that the National Audit Office's (NAO) remit and funding is protected through the Public Accounts Commission (TPAC). TPAC prevents Government interference in the funding and work of the NAO (See Midgley, H. C., Ferry, L., & Murphie, A. D. (2024). Holding Government to Account: Democracy and the National Audit Office. Routledge).

The Department making these decisions alone would not achieve that level of safeguard. Whilst the reports of the LAO should not go to Parliament, as they are reports for local authority taxpayers, Parliament as the ultimate steward of democratic accountability in the UK could hold the LAO to account for its spending and governance, in a similar way to the way TPAC examines the NAO i.e. leaving the LAO as an independent organisation but ensuring that the governance of it is independent of the Government.

Q22: Do you think that the Chair of an audit committee should be an independent member?

Yes, the Chair of an audit committee should be an independent member from the body so the audit committee can undertake its duties, and be perceived to undertake its duties, without fear or favour. Having said this, getting properly experienced and qualified independent members and a Chair for audit committees is not necessarily easy. As a result, some individuals may sit on multiple committees including in dispersed parts of the country, questioning the time that can be afforded to each committee, and efficacy of such committees. The point is that committees need to be, and not just seen to be, both independent and effective with a Chair and Members that are proactive and not spread too thinly.

Q23: Do you have views on the need for a local public accounts committees or similar model, to be introduced in strategic authority areas across England?

There has been from an accountability and transparency perspective, a gap in the understanding of the achievement of value for money by local government since the closure of the Audit Commission and scrapping of the previous performance management regimes. Indeed, concerns have been raised that accountability arrangements have focussed much more on managing spend rather than what has been got for the spend (Ferry, L., Eckersley, P., & Zakaria, Z. (2015). Accountability and transparency in English local government: Moving from 'matching parts' to 'awkward couple'?. Financial Accountability and Management, 31(3), 345-361. https://doi.org/10.1111/faam.12060).

More specifically, there is a concern with the scope of the audit of value for money arrangements for local government: for a local authority, the audit only considers whether they have appropriate arrangements in place to secure value for money rather than whether value for money is being achieved. Some structured follow up of value for money within the audit scope is missing in local authority audit (See Ferry, L. (2019). Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014. UK Parliament: Housing, Communities and Local Government Select Committee).

Local public accounts committees are a potential way of filling part of the gap around value for money, with an arguably strong and growing need for local public accounts committees, or a similar model, to be introduced in strategic authority areas across England, especially if devolution continues and grows (See Ferry, L., Midgley, H., Murphie, A., & Sandford, M. (2023). Auditing governable space - A Study of Place-Based Accountability in England. Financial Accountability and Management, 39(4), 772-789. https://doi.org/10.1111/faam.12321).

However, it would need to be ascertained what a 'strategic authority area' actually is in England, in terms of powers, responsibilities and geography. In addition, local public accounts committees for these strategic authority areas would need to be properly resourced and statutorily backed. Furthermore, this may need some form of local audit office capability and capacity throughout the country to support the local public accounts committees, in much the same way that the National Audit Office (NAO) supports the Public Accounts Committee (PAC) at Parliament. So, it would not be a quick, nor cost neutral, fix.

Q24: Would such a model generate more oversight of spending public money locally?

Yes, such a model would generate more oversight of spending public money locally.

Q25: How would the creation of such a model impact the local audit system and the work of local auditors?

The creation of such a model would impact both the local audit system and work of local auditors because the local auditors would be a main source of information to local public accounts committees and so there would need to be clear governance, reporting, and communication. Also, there would be time and cost considerations with implications for capacity and capability within the audit market.

Q26: Do you agree that the MLA threshold should be increased?

No, at present, the Major Local Audits (MLA) threshold should not be increased as seems an appropriate amount. Obviously, this could and should be subject to review in the future.

Q27: Do you agree that some local bodies should be declared exempt from the regulatory focus of an MLA? For example, should Integrated Care Boards be exempt?

Local bodies such as Integrated Care Boards should not be declared exempt from the regulatory focus of a Major Local Audit (MLA), as they involve sizable funds that should be open to proper accountability and transparency arrangements in the same way.

Q28: Do you agree that smaller authorities' thresholds should be increased?

Yes, smaller authorities' thresholds should be increased.

Q29: Do you agree that the lower audit threshold of £25,000 should be increased broadly in line with inflation?

Yes, the lower audit threshold of £25,000 should be increased broadly in line with inflation. It may however also be worth considering if £25,000 is now a suitable base starting point given the impact of inflation over recent years.

Q30: Are there other changes that would improve the accounting and limited assurance regime for smaller authorities?

Less work has been done on this area, but changes that could improve the accounting and limited assurance regime for smaller authorities may include looking at auditing thresholds (as this consultation is doing), the objection regime and details around transparency and accountability of financial statements (See Lakoma, K., Murphy, P. and Toothill, A. (2024). External auditing arrangements of smaller authorities in England. *International Journal of Auditing*, 28 (4), pp. 792-805. ISSN 1090-6738). Also, there could be some standardised guidance and training, which could be online.

Q31: What additional support, guidance or advice do local bodies and/or auditors need for future statutory deadlines (including backstop dates) for the publication of audited accounts?

Additional support, guidance, and advice for local bodies and/or auditors has been put in place for future statutory deadlines (including backstop dates) for the publication of audited accounts. This includes the Government tabling legislation and a revised Code of Audit Practice, reset measures, support for auditors through the Local Audit Reset and Recovery Implementation Guidance (LARRIG) notes to support auditors meet the revised Code of Audit Practice from the National Audit Office (NAO) that were endorsed by the Financial Reporting Council (FRC), Department for Levelling Up, Housing and Communities (DLUHC) consultation on the Accounts and Audit Regulations 2015, NAO consultation on changes to the Code of Audit Practice, Chartered Institute of Public Finance and Accountancy (CIPFA) consultation on temporary changes to the Code of Practice on Local Authority Accounting for 2023/24 and 2024/25, Government legislation bringing into effect backstop dates for authorities in England, bulletin on local audit backlogs from CIPFA to assist practitioners with advice on reporting codes, Audit Committee updates on the local audit backstop from CIPFA, as well as an Auditor Guidance Note 6 on Local Government Audit Planning from the NAO among other things. Given the significant levels of support, it is now the case that those in the audit system need to make the system work.

Q32: Do you think that financial reporting and/or auditing requirements should be amended for a limited period after the backlog has been cleared and as assurance is being rebuilt, to ensure workload and cost are proportionate?

Yes, financial reporting and/or auditing requirements should be amended for a limited period after the backlog has been cleared and as assurance is being rebuilt, to ensure workload and cost are proportionate. However, it is imperative that it is clear this is for a very limited period and the intention is overwhelmingly to get back to and then operate as normal as quickly as possible. Also, in amending them, consideration will need to be given to how local authorities transition back to whatever the department decides is the eventual long-term state of local government accounting and audit.