

SUBJECT:	LOCAL AUDIT REFORM (CONSULTATION)
REPORT BY:	CHIEF EXECUTIVE & TOWN CLERK
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1. Purpose of Report

- 1.1 To provide the Audit Committee with a summary of the recent consultation undertaken by the Ministry of Housing Communities and Local Government (MHCLG) on Local Audit Reform – A strategy for overhauling the local audit system in England.

2. Background

- 2.1 The local audit system in England has faced significant challenges, culminating in a backlog of nearly 1,000 unaudited accounts dating back to 2015/16. For the financial year 2022/23, only 1% of local bodies published audited accounts on time. This has impaired financial assurance, denied residents' transparency regarding the use of taxpayer money.
- 2.2 The Minister of State for Housing, Communities and Local Government published a written ministerial statement on 30th July 2024 regarding the backlog in the publication of audited accounts of local bodies in England.
- 2.3 In this statement, he acknowledged the Local Audit system in England as broken and advised of his intention to update on the Government's longer-term plan to fix local audit.
- 2.4 Core systemic challenges, highlighted by Government include:
- Capacity. There is a severe lack of external auditors, with a limited number of firms operating in the sector;
 - Co-ordination. Multiple organisations have a statutory role to oversee and regulate audit, across various sectors, countries (within the UK) and with responsibilities for different frameworks. There is no clear ownership of the system. This limits the ability to align incentives and establish a single vision;
 - Complexity. Financial reporting and audit requirements are disproportionately complex, beyond the system's capacity and inadvertently incentivises risk aversion. Standards are largely modelled on corporate audit rather than the needs of local bodies.
- 2.5 On 18th December 2024, the Government opened a wide-ranging consultation on Local Authority Accounts and Local Audit Reform.

2.6 The Local Audit Reform – A strategy for overhauling the Local Audit system in England, commits to a series of measures to fix the broken Local Audit system, including:

- A local audit vision with 8 core principles;
 1. Value for money. A system that provides confidence that bodies and the new LAO have arrangements in place to deliver value for money for taxpayers.
 2. Transparency of the sector's financial health and value for money arrangements.
 3. Capacity and capability. A sustainable and resilient market with access to the right expertise and with sufficient capacity to serve all eligible bodies.
 4. External scrutiny to independently identify issues, challenge and drive improvement
 5. Professionalism. Building a sector attractive to auditors to build careers and become future audit leaders.
 6. Proportionality. Local audit that is proportionate and relevant, from regulations to governance.
 7. Stronger accountability. Scrutiny and reporting of issues and high standards of financial reporting to promote public accountability.
 8. Timely. High quality accounts audited and published on time to ensure relevance and increase value to the public, including timely reporting of issues.
- The establishment of a statutory and independent Local Audit Office (LAO) with 5 strategic responsibilities;
 1. Coordinating the system – including leading the local audit system and championing auditors' statutory reporting powers;
 2. Contract management, procurement, commissioning and appointment of auditors to all eligible bodies;
 3. Setting the Code of Audit Practice;
 4. Oversight of the quality regulatory framework (inspection, enforcement and supervision) and professional bodies;
 5. Reporting, insights and guidance including the collation of reports made by auditors, national insights of local audit issues and guidance on the eligibility of auditors
- Mandating Audit Committees

- 2.7 The strategy reports to build on the recommendations set out in the “Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting” undertaken by Sir Tony Redmond in 2020, and the “Independent Review of Financial Reporting Council” conducted by Sir John Kingman in 2018.

3. Local Audit Reform Consultation

- 3.1 The proposed strategy for overhauling the Local Audit systems in England commits to establishing the LAO, to radically simplify the system, and bring as many audit functions as possible under a single organisation with a focus and expertise in local audit, as the Kingman and Redmond Reviews recommended. The proposed strategy also consults on potential additional functions for the LAO to further unify the system.
- 3.2 A LAO will form one of several steps towards resolving the sector’s most pressing challenges. Alongside the Government’s programme to clear the backlog and return to timely audit, relationships must be strengthened and capacity and capability enhanced.
- 3.3 The 6 key areas of required reform included in the consultation are summarised below:

- **The purpose of local audit** – Reforms must be guided by a vision statement with 8 core principles and be driven by user needs.

The proposal includes new emphases on the examination of an authority's financial resilience and the provision of early warnings of major governance and financial risks (including material fraud).

The most radical proposal requires auditors to give an opinion on whether an authority has actually achieved value for money (VFM), rather than purely assessing whether adequate arrangements to secure VFM are in place.

Any implementation of this proposal needs to consider that responsibility for VFM in local authorities sits with elected members. The need to maintain auditors’ independence and whether there is a risk of being drawn into challenging political decisions also need to be taken into consideration. The capacity and capability of the system to respond to an extension of auditors’ responsibilities is a further consideration requirement in this proposal

- **Local Audit Office remit** - The Government accepts the Redmond Review recommendation for a statutory and independent oversight body (the LAO), which would largely take on the roles currently performed by the FRC, PSAA and the NAO, simplifying the system and driving change. As highlighted earlier in the report. The LAO will have 5 strategic responsibilities. A point of focus within the proposal is to improve the consistency and effectiveness of the auditors' use of special powers (e.g., highlighting issues of concerns where remedial action cannot wait for the publication of the Accounts, or the concerns exceeds the scope of the audit via Advisory Notices or Public Interest Reports).

The LAO would have overall responsibility for audit inspection (although it may delegate the work to others), and consideration is being given to whether there should be a scheme for enforcement related to the financial statements that would require authorities to make changes to the accounts.

- **Financial reporting and accounts** - Reforms should consider the needs of the user and the impact of accounting requirements on the work of the account preparers, auditors and the wider audit system.

The Government acknowledges the range of views on the purposes and users of accounts. Local accounts must be fit for purpose, proportionate and relevant to account users. There is a clear need to ensure that accounts contain the correct level of information and disclosures to benefit the users and achieve the purpose of the accounts. The Government is committed to working with sector partners to review the content and format of local authority accounts to ensure that the requirements of the Accounting Code and those practices set out in legislation are appropriate and do not create any excessive or unnecessary burden. The review will consider the definition of the purpose and user of local accounts, any impact definitions may have on accounts and audit, as well as any unintended consequences.

The consultation also highlights the Government's consideration of the now MHCLG Committee's November 2023 recommendation that decoupling the Pension Fund Accounts from the main accounts, publishing them separately and subjecting them to a separate audit certificate would have numerous benefits to local government, however there is no dedicated/ specific question around this topic for response within the consultation.

The consultation document states that infrastructure asset accounting will remain unchanged in the medium term via secondary legislation to extend the current exemption.

Views are also requested for how the reform of the Code of Practice on Local Authority Accounting in the UK (the Code) could be facilitated (e.g., by making the Code an LAO responsibility). It is also proposed that the Code should be freely available.

- **Capacity and capability** – Delays and complexity disincentivise the right skills from entering the market, leading to less timely, less effective audit. The Government will work to ensure that bodies have skilled and resourced account preparers. In order to strengthen the capacity of the sector, consideration will also be given to supplementing private sector audit with public provision.

The Government is committed to ensuring that authorities have skilled and resourced account preparers and will work with the LGA and CIPFA on a programme of improvement support. The FRC's Local Audit Workforce Strategy (yet to be published) will be built upon to enable greater alignment between corporate and local audit and provide a more flexible career progression for individuals.

The eligibility criteria for Key Audit Partners will be reviewed as part of the proposal to ensure that there are no unintended barriers for partners wanting to join the profession and that the sector has the widest possible pool of qualified auditors.

The consultation also considers whether there are further ways to build public provision to supplement capacity and strengthen the sector. including consideration as to whether there should be supplemental public provision of audit.

- **Underpinning the system: relationships and audit regimes** – Existing relationships between local bodies and their auditor need to be strengthened and their respective relationship with the LAO must be clear. The collective scrutiny of audits as part of the democratic process, such as Audit Committees will be strengthened and the potential for local accounts committees for strategic authority areas in England will be considered. Audit regimes will be reviewed to ensure they are fit for purpose in the short and long term.

A key role of the LAO will be to maintain strong links between central government (in its stewardship capacity), the NAO, inspectorates of relevant bodies, and local auditors, allowing a transparent and supportive government approach when concerns are raised about particular bodies.

The strategy proposes that Audit Committees will be mandated for local authorities, with at least one independent member, and audit reports require consideration by full council. Views are also sought on whether the committee chair should be an independent member.

- **Local audit backlog** - Significant and difficult work undertaken by finance teams and auditors to clear the backlog to date is a necessary step to reform. The Government recognises that there is further work required to support the recovery process including guidance, advice and support.

The Government aspiration is that disclaimed audit opinions driven by backstop dates should be limited in unexceptional cases to the next two years (i.e., up to and including 2024/25 – backstop date of 27 February 2026).

The Government recognises that further cross system work is required to support the recovery process, and the consultation informs that the Government will work with system partners to ensure that additional guidance, advice and practical support is available. Consideration may also be given to temporary measures additional to the extended exemption from normal accounting for infrastructure assets (as noted earlier in the report) to ensure that the preparer workload and cost is proportionate (subject to the appropriate management of any risks to public funds).

4. Implications for the Council

- 4.1 At this stage the Council is in a more favourable position compared to many other authorities and has not experienced the extent of delays that others have in the publication and audit of its accounts. The Council's Statement of Account's up to

2023/24 have all received audit opinions, which means the Council is up to date and ready for the end of the current financial year when the next Statement of Account's will be prepared.

- 4.2 Once the outcome of the consultation is known and any amendments made to the requirements for the production of accounts, these will be taken into account in preparing the relevant set of financial statements and preparing for the external audit of them. Any other, wider, impacts will be reported back to the Audit Committee.

5. Strategic Priorities

- 5.1 There are no direct implications for the Council's strategic priorities. The external audit of the Council's financial statements and VFM conclusion is a statutory requirement and as such contributes towards the fitness for purpose of the Council's governance arrangements.

6. Organisational Impacts

- 6.1 Finance – There are no direct financial implications arising from this report. The external audit process provides an independent source of assurance and form a key element of the checks and balances within the local accountability framework. Part of the role of the external auditor is to provide an assessment of the arrangements that a local authority has put in place to secure economy, efficiency and effectiveness in its use.

- 6.2 Legal including Procurement Rules - The statutory framework within which local authority audits are conducted is set out in the Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015.

The Council will need to ensure it complies with any changes to the codes of practice and legislation as these arise.

- 6.3 Equality, Diversity and Human Rights

The Public Sector Equality Duty means that the Council must consider all individuals when carrying out their day-to-day work, in shaping policy, delivering services and in relation to their own employees.

It requires that public bodies have due regard to the need to:

- Eliminate discrimination
- Advance equality of opportunity
- Foster good relations between different people when carrying out their activities

Due to the nature of this report there are no direct equality, diversity or human rights implications,

7. Risk Implications

- 7.1 There are no direct risk implications arising as a result of this report.

8. Recommendation

8.1 Audit Committee are asked to note Local Audit Reform consultation.

Is this a key decision? No

Do the exempt information categories apply? No

Does Rule 15 of the Scrutiny Procedure Rules (call-in and urgency) apply? No

How many appendices does the report contain? None

List of Background Papers: Redmond Review into the Oversight of Local Audit and the transparency of local authority financial reporting – Audit Committee 23rd March 2021

DLUCH: Measures to improve local audit delays – Audit Committee 22nd March 2022

Addressing the local audit backlog in England – Audit Committee 4th June 2024

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