

Public Accounts Committee

Oral evidence: Timeliness of local auditor reporting, HC 995

Thursday 16 March 2023

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Members present: Dame Meg Hillier (Chair); Olivia Blake; Dan Carden; Sir Geoffrey Clifton-Brown; Peter Grant.

Gareth Davies, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, Vicky Davis, Director, NAO, and David Fairbrother, Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1 - 100

Witnesses

I: Jeremy Pocklington CB, former Permanent Secretary, Department for Levelling Up, Housing and Communities, and Permanent Secretary, Department for Energy Security and Net Zero; Sarah Healey, Permanent Secretary, DLUHC; Catherine Frances, Director General Local Government, Resilience and Communities, DLUHC; Neil Harris, Director for Local Audit, Financial Reporting Council; Tony Crawley, Chief Executive, Public Sector Audit Appointments Ltd.



Report by the Comptroller and Auditor General

Progress update: Timeliness of local auditor reporting on local government in England (HC 1026)

Examination of Witnesses

Witnesses: Jeremy Pocklington, Sarah Healey, Catherine Frances, Neil Harris and Tony Crawley.

Chair: Welcome to the Public Accounts Committee on Thursday 16 March 2023. Today, we are looking at the challenging issue of local audit, which is on a knife edge at the moment, with only 12% of local government bodies—local councils and police and fire authorities, among others—receiving their audit opinions in time to publish their 2021-22 accounts. A number of councils have had delays in audit opinions over a couple of years. This is hugely important for local taxpayers and citizens, and for the councillors who have to make decisions about how budgets are set without that audit opinion, which is, on the face of it, pretty shocking. It is something that this Committee has looked at a number of times. This also has knock-on effects on other parts of how Government work.

We want to ask our witnesses today what is happening since the Redmond review was put in place. We have now seen some of the architecture that he recommended established, and we want to ask what is being done to speed up and sort out the local audit market and make sure that local citizens are not kept in the dark about what is happening with their local council expenditure.

I would like to welcome our witnesses. A warm welcome to Sarah Healey on her first outing to us as the Permanent Secretary at the Department for Levelling Up, Housing and Communities, where she has moved to from the former DCMS.

Just for everybody to catch up, Jeremy Pocklington, who was the Permanent Secretary at the Department for Levelling Up, Housing and Communities, is now at the Department for Energy Security and Net Zero. You might tell us how to pronounce your acronym in a moment, because none of us can. He is here because, of course, of his previously held post and because he covered this with us as a Committee before. This will be his last outing in front of this Committee, we hope, as does he, as former Permanent Secretary of DLUHC.

Catherine Frances is a regular visitor to this Committee and is the director-general for local government, resilience and communities at the Department for Levelling Up, Housing and Communities. With the next change of Government machinery, maybe shorter titles would be a good recommendation.



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We are really pleased to welcome, for the first time in front of any Select Committee of the House of Commons, Neil Harris, who is the director for local audit at the Financial Reporting Council, which is an absolutely key post in the new system for making sure that public audit is delivered properly. Tony Crawley is chief executive at Public Sector Audit Appointments Ltd, which has a really key role in this as well. Thank you very much indeed.

I want to thank those who put in evidence. We have had some really interesting evidence from various bodies on the local government side and from the private audit side, as well as others. Before we go any further, I just want to ask for declarations of interest.

Peter Grant: I am a qualified member of the Chartered Institute of Public Finance and Accountancy, which has a significant role in local authority audit and elsewhere.

Sir Geoffrey Clifton-Brown: I am a fellow of the Royal Institute of Chartered Surveyors, which would have an interest in any changes to valuation of property.

Olivia Blake: I think everyone knows this one, but I am the daughter of Baroness Blake, who is currently doing some work for the Department on the Liverpool advisory panel.

Q1 **Chair:** I have nothing other than that I chair the Public Accounts Committee and have an interest in this.

Before we go any further, I want to just get the current situation. Ms Healey, how many local government bodies will publish their 2022-23 accounts on time?

Sarah Healey: To kick off with, we have done a huge amount that you have previously discussed with the Department in order to address some of the problems with local government audit. It is a complicated situation; it is a complicated set of problems in different parts of the system at one time. The Department has built up action on all of those things, and I am sure that we will talk about some of this during the course of this hearing.

Since the last time the Department appeared in front of you, a few quite significant things have happened, which we think will assist in future in the development of local audits. One in particular is the procurement of a new framework for the production of audits, but that is not going to affect those underway. One of the challenges is that we are still operating in a situation where the timeliness of current local audit is affected by the backlogs that have been built up over time. Local bodies cannot complete their current audits until their past audits have been completed. As you mentioned, for 2019-20, when the deadline originally hit, it was a very low percentage—only 9% in 2020-21 and only 12% in 2021-22—but the fact is that there has been progress with the backlog.

Q2 **Chair:** What numbers will be reporting on time?



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Sarah Healey: I am not going to predict a number for the percentage of audits this year.

Q3 **Chair:** Is it going in the right direction?

Sarah Healey: We would be disappointed if the numbers were as low as they have been in the last couple of years.

Q4 **Chair:** How many audit opinions are currently outstanding?

Sarah Healey: There are 373 currently outstanding for 2021-22.

Q5 **Chair:** Mr Pocklington, we covered this when you were Permanent Secretary, so do you want to just explain a bit more what went wrong that means that we have this backlog? It is not Covid; we need to be really clear about that. You were the Permanent Secretary during that time, but it is not really down to Covid at all, just to be absolutely clear.

Jeremy Pocklington: It is an incredibly challenging situation. It is a combination of factors. First of all, it reflects the impact of wider changes in the audit market that are well known and ultimately stem from corporate failures like Carillion. That has led to increased expectations, stronger regulation of the sector, and increasing demands on auditors.

That, in turn, led the Department to ask Sir Tony Redmond to undertake his review looking at the local government aspect of that. The changes stemming from Carillion happened at the same time as capacity was, essentially, reduced in the local government audit market, compounded by what was, in some ways, a very effective procurement exercise that was run at the time, which led to a reduction in costs and in money being taken out of the sector. Audit fees fell significantly between 2014 and 2018.

You have a combination; there are higher standards at a time when the fees have come down. Although the Department was able to make some changes to enable fees to be varied, it was still a relatively inflexible system, which meant that there was a lack of capacity in the local government audit system. It is important that the Committee and the public understand that it was compounded also by a lack of resources in local government, and a lack of expertise, as ever with local government, in some local authorities.

Q6 **Chair:** We want to look forward a lot in this session, because it is vital, and Mr Harris is leading that drive as we go forward, as we know. Going backwards, you were in the hot seat during a lot of this time. Was DLUHC asleep on the job in not seeing these problems coming and trying to make sure that they were tackled more quickly?

Jeremy Pocklington: I do not accept that. Over the last few years, the Department has been very focused on this. It is a deeply challenging systemic issue that requires not just the Department and Government, but also auditors, local government and the various regulatory bodies, to all continue to work together.



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It was not possible to foresee the changes in the audit market that came from Carillion and Patisserie Valerie, but the action that the Department has taken has focused on both the long-term strategic changes that we need, which we are now bedding in, and shorter-term changes in order to relieve bottlenecks and problems as they have arisen.

Q7 Chair: We know that there are what you could call short-term sticking plaster approaches to cover the gap, but going back, there are, exactly as you say, lots of moving parts in this, which really puts DLUHC at the centre of making sure that the system works and predicts where the problems will be. The problems were not just around Carillion and Patisserie Valerie, and some of the private sector challenges. The fees reduction and the lack of public auditors in the pipeline in the profession were not directly your line responsibility, but DLUHC had the system lead responsibility. Although Sir Tony Redmond did a great review, a lot of the discussion around that was delayed. It took some time for his report to be implemented.

Jeremy Pocklington: I do not accept that. Ultimately, pre-Carillion, there was a competitive market for local government audit. That led to commercial firms bidding for work and a very significant reduction in cost. I do not think that, at that stage, the changes in the audit market were foreseeable. Since then, the Government and my Department have acted with a great deal of energy over the last three years to address this. Covid was a factor and did delay Tony Redmond's work. Unfortunately, that happened. I do not want to overstate that, but it was a factor.

The Department took on the system leadership role in 2021 and has been working very actively to pull together all the different parts of the system, through the liaison committee but also through regular bilateral dialogue, and doing everything we can to tackle these delays. There are the long-term changes, such as establishing the FRC and, in future, ARGA as the system leader, changing the procurement, and a plan to build workforce capacity, but also shorter-term changes, such as enabling the PSAA to vary fees, putting more money into the system, and further variations on accounting standards in order to enable audits to progress.

Q8 Chair: We are going to go into some of those things in more detail. Ms Healey, you are hoping that it will go in the right direction. The audit deadline for 2022-23 has been pulled forward from November to September; the aim is to get it further forward at each stage. As you are watching and hoping, what measures are you looking for before September, so that you have an idea of what the problem is going to be?

Sarah Healey: We are keeping a close eye, via the liaison committee that Ms Frances chairs, on feedback from local authorities about what is happening within authorities on audit. We are keeping a very close tally of numbers as they change and as the backlog in audits goes down, because the backlog is, as I said earlier, materially relevant to what it is possible to do in the current circumstances.



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When we get feedback about things that are holding up the delivery of local audits, we do act on them. The statutory override that we put in place in December, for instance, was directly in response to feedback that there was an issue with the valuation of infrastructure assets, and we will always take that kind of action. We are always open to taking new action that we think will enable things to make progress.

Q9 Chair: How often have you had to use that override since you introduced it?

Sarah Healey: I am not aware of how often we have used it.

Catherine Frances: The override applies for auditors to override. They themselves can choose not to apply that valuation. They are taking it through now in the audits that they are completing.

Q10 Chair: Do you have any idea of how many times it has been or is likely to be used?

Catherine Frances: No, because that is what is coming through now as the audits are being unblocked.

Q11 Chair: You must have some intelligence.

Catherine Frances: Our soft intelligence from the sector is that we expect this to apply in lots of cases. What you do not have from the sector here—by the sector, I mean the combination of local government and audit practitioners—is a single version of the truth of what holds up each individual audit. That is for quite legitimate reasons. In some cases, it may be an issue with the council; in others, it may be an issue with valuation. We have written out to both auditors and local government and said, “Please put your heads together. Please produce a robust plan between yourselves and jointly with the FRC”.

We are already working on next steps, and we now need to ask all of our local partners to roll their sleeves up. It is a strained and difficult audit market, but it is clear that, over the next few years, some companies know that they are leaving and others that they are staying, and there are some new entrants in there too. Councils have funding certainty. The building blocks are in place, but they all need to roll up their sleeves and work out what they can do.

Sarah Healey: It is worth saying—this is precisely what Ms Frances said reflects—that the role of the system leader is absolutely vital to all of this, because it is about identifying that intelligence. It is about understanding the moving parts between local government and audit, the standards that are being applied, and all of the different players in this system, identifying early and quickly where there are problems and barriers that can be unlocked either by the Department or by others—for instance, the NAO’s very helpful signal about the use of the value for money statement to enable accounts to be signed off more quickly. That role is absolutely critical.



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You will know that we signed a memorandum of understanding with the FRC.

Chair: We got notice of that only at 6.30 last night, but well woven in, Ms Healey.

Sarah Healey: It was a really important step in handing over responsibility to the FRC on that. Neil Harris has been in place for a little while now to set up that function, but it is precisely so that we can tackle, as we go, any issues that arise and that we do not know about in the production of current audits in order to unblock those issues.

Q12 **Chair:** Being a cynic and having covered this quite a lot on this Committee, with a number of us having been in local government as well, it just feels like the system went very badly down, and that this is all just trying to play catch-up, to get it back in order.

Mr Harris, you now have this critical role. Having someone of your calibre come into it is particularly heartening, given that we have been worried that the role was weak. Do you have any comments on what you have just heard? How confident are you that you have the powers you need to do what you need to do?

Neil Harris: First of all, thank you very much for the invitation to my first Select Committee.

Chair: It is nice that you thank us. You do not have an option, but there you go.

Neil Harris: I am also absolutely proud to be the FRC's first director of local audit, and to be taking responsibility as we become the shadow system leader for local audit. It is a sector that I am passionate about. I have worked in it for over 20 years. As you say, Chair, I have had a deep level of expertise and knowledge of the system in my role as key audit partner and district auditor, but I have also worked very collaboratively, I like to think, across all system partners, including the local government and NHS sectors. I am very proud to be taking on this role.

I have been in place for six months. I recognise the size of the task: convening and bringing everybody together, and co-ordinating what has been—and still is, to an extent—a fragmented system. From my perspective, it is really critical now that the whole local audit system works together with purpose and speed to address the local audit challenges. I recognise a lot of what I have heard. I would say on behalf of the FRC that ARGA cannot come in quickly enough.

Q13 **Chair:** We know what these mean, but it is the Financial Reporting Council. Do you want to just spell out each acronym?

Neil Harris: ARGA is the Auditing, Reporting and Governance Authority. As far as we are concerned, ARGA cannot come in quickly enough, because we will become the shadow system leader, but we are operating only in shadow form. We are very clear, and have been in the public domain very recently on the broader corporate audit reforms, that ARGA



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needs to come in as soon as possible. We are ready to take on those statutory responsibilities. This role needs statutory underpinning, but the memorandum of understanding provides a good framework for how we will be working across the system before ARGA. When ARGA comes into place, we will be taking on responsibility for the code of audit practice.

I would make two comments about understanding whole-system risk. You need to look at the position not just in local government but in the NHS as well. Local audit, from my perspective, needs to cover both local government and the NHS. Unless you have a holistic understanding of whole-system risk, there is a risk that, if you take one measure in one direction, it has an impact somewhere else.

Q14 Chair: We on this Committee have certainly highlighted that public auditors can move from one sector to another and it does not help the whole system.

Neil Harris: We need to understand that, and it is a critical year for the NHS. Finally, the granularity of information we need in order to understand the current position on the backlog is critical. There is a responsibility on local authorities and auditors, as Ms Healey has already set out.

Q15 Sir Geoffrey Clifton-Brown: I would just like to follow up your question, Chair, on what DLUHC was doing, and come to you, Mr Pocklington. Just to remind everybody looking in on our proceedings, high-quality audit is essential for public trust in how taxpayers' money is spent. It provides transparency and accountability to both taxpayers and their local government elected representatives.

Mr Pocklington, you took over your previous role in 2020. If I could take you to figure 4 of the NAO Report, there was a clear trend well before 2020 that the number of local government audits being done on time was declining, particularly in 2018-19 compared to 2017-18.

I know that we do not want to go backwards, as the Chair has said, but it is important to learn lessons. In your answer to the Chair, you concentrated on the problems of the local government audit market, but, of course, as Catherine Frances has made clear, there are other parties to this. There is the regulator, but particularly local government has to get its audits into such a state that they can be audited. When you took over in 2020, what action did you take to look into what was already an emerging problem?

Jeremy Pocklington: I took over in March 2020. The context is that I took over just as lockdown was happening and Covid was the overwhelming focus of the Government and the country. I hope that the Committee will understand that that was the overwhelming priority at the time.

However, we had already started Sir Tony Redmond's review, so the Department had already, under my predecessor, looked at what action needed to be taken and had recognised that this needed a whole-system



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approach in order to address it, rather than it being something that the Department could fix simply acting by itself and overnight.

By that stage, although I do not particularly want a long discussion around local government finance in this hearing, we had already started to unwind some of the impact of consolidation during the coalition Government, so the Department had already recognised the need to put some more resources into local government in order to ensure that it had the capacity that it needed.

The Department was already taking action when I took over the role, and has continued to do so through the last three years, both of the long-term nature and of the short-term nature that we have discussed.

Q16 Sir Geoffrey Clifton-Brown: Thank you for that answer. Let us move on, although I want to come back to the role of local authorities.

Jeremy Pocklington: There is a role there. It is a very important role.

Sir Geoffrey Clifton-Brown: I agree with that, and thank you.

Chair: And we got good evidence on that.

Sir Geoffrey Clifton-Brown: But I will want to come back on that, because they are an important part of all of this. Perhaps turning to you, Mr Harris—and congratulations on your new job—as the incoming system leader, what are your immediate priorities?

Neil Harris: Our immediate priorities in the short term are to get a view on whole-system risk. In my previous answer, I mentioned understanding the challenges, not just in local government audit but in the NHS too. I am very keen to understand the granularity of the issues that are causing the delays in the system at the moment, so that if, working with DLUHC colleagues, we propose any additional measures to address that beyond the statutory resolution on infrastructure assets, we have confidence that that will have the impact it needs to in order to address that backlog as quickly as possible.

The Committee will be aware that there was a commitment made in the December 2021 measures to do with the workforce strategy and the capacity, capability and future sustainability of the local audit market and profession. Since I have been in post, I have taken on the momentum of the comprehensive workforce strategy, building on the work that has been undertaken to date. Those are my immediate priorities.

Shortly after we get the remit letter from DLUHC, I will be setting out the FRC's position, coming in as shadow system leader, on what we believe to be our short, medium and long-term priorities in role, how we are going to balance our role as system partner and regulator, and, in addition to that, what we see as the key recommendations for all of the system at that stage. Do look out for that shortly after we start in our role.

Q17 Sir Geoffrey Clifton-Brown: You have this new MOU and, among other



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things, it is going to facilitate the realisation of a strengthened market to launch local audit qualification, LAQ, from the spring of 2023, and a technical advisory service, TAS, in the summer of 2023. Can you tell us how preparation for both of those is getting on?

Catherine Frances: Sir Geoffrey, some of these questions are for the Department. My apologies, but it is slightly confusing between the two. Shall I answer some of them, just to be clear on accountability?

Sir Geoffrey Clifton-Brown: I do not mind who answers, as long as I get an answer.

Catherine Frances: In terms of remitting the FRC, the MOU is jointly agreed between the Department and the Financial Reporting Council, and sets out the five key objectives for the FRC. In some respects, they are quite similar to the system leadership objectives that DLUHC has had over the last couple of years, because it puts them in the driving seat. Colleagues in FRC are strongly aware—and we share this awareness—that they cannot do it alone, so they need all parties, whether that be the NAO, representatives of local government or the regulatory side of the FRC, among many others, to deliver.

When we set the objectives for the FRC, we will issue that in a remit letter, but we will also develop, between us and the FRC, some performance indicators for how the FRC is doing. We will have to be very careful about those, because some of the direct accountability sits with the system leader, while other parts, necessarily, are a result of everybody else's action. We will update the Committee in due course on that.

The first priorities for them are going to be, as my colleague Neil has said, looking at the backlog, but that needs whole-system response. If I could just pre-empt, in a sense, where we will go after we deal with this backlog, there will be a question about the underlying capability and capacity in the system. There will be a question about whether we are setting a clear direction of travel about what we want auditors to do.

We know that we need to explore some flexibilities right now with auditors, because there are so many issues facing them, some of which are about valuation. Beyond that, we all know that local audit, when it is at its best, is a partnership between the auditor and the local authority, and we do not want to see an audit market that is overly commoditised in terms of that relationship.

To come to your question about the audit qualification, that is for the Department. We have looked at this quite carefully. There is a shortage of audit practitioners who are experts in local audit, and we want to launch essentially a stopgap, filler service while the market adjusts, and while firms train up more people to be local audit specialists. This will enable senior practitioners in audit to switch to local audit practice. It is designed to fill a shortfall that would be there in the short term. Longer-



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term, we would absolutely see that the whole system needs to do it. We are on course to do next steps on it by summer 2023. It has slipped a little bit, because it is quite hard to design and to get the design just right.

Q18 Sir Geoffrey Clifton-Brown: There is a lot in that answer. Could you set out for us a timetable for when that this whole backlog of audits will be back on track and the steps to get there, so that we on this Committee, Parliament and the public will be able to judge how successful you have been?

Catherine Frances: I wish I could. I do not think it is possible, and I recognise that that is frustrating for the Committee. The reason why it is hard is that, in every individual audit decision, we have at least two players. We have the local authority, which needs to produce quality documentation, as you have said, by the deadline in advance of audit. We hear from auditors that councils are sometimes not producing quite high enough quality material on that, and we do sympathise with auditors. It is a mixed bag in councils.

Conversely, councils need their auditors to be there and ready with capacity to process their cases. As you have heard from Neil Harris, there are issues with auditors' teams, which are small, being stretched and, in a sense, operating between local councils where there is a backlog, the NHS and other bodies that ask them to audit.

I know that it is frustrating. While it is not possible to give a route straight through that in a granular way, it is the responsibility of the council to get quality documentation to the auditor, and of the auditor, because, ultimately, they did bid for these contracts, albeit they bid in an environment where the regulatory framework was somewhat different and so the demands on them have increased.

Q19 Sir Geoffrey Clifton-Brown: I am going to press you a bit. You have given us a technical explanation of what has to and what should happen, but you are not giving us an explanation of how you are going to organise this catch-up. It is really important. If we have local government audits that are delayed, taking councils like Thurrock or Slough, and there are problems in there—I want to come back to you on this in a minute, Mr Harris—it may well be that those problems were not picked up in a timely manner, because the audit was not done in a timely manner.

Catherine Frances: There is a lot in your question too, Sir Geoffrey. In terms of the sequence of how we will get from this situation, our strategy has been that, over the course of 2022, we have seen an increased focus on concerns by both auditors and councils about some issues of valuation that are slowing up some of their audit.

There are many different regulators of what is asked for in a financial statement and in an account, but, as Sarah Healey has said, we have set out a statutory instrument to try to lift the burden in terms of some valuations of infrastructure assets.



Q20 **Sir Geoffrey Clifton-Brown:** That is only temporary, is it not?

Catherine Frances: It is. We need to look at a longer-term solution with all the lead bodies. CIPFA, the financial reporting and accounting body, will also have a view on that, and that is not our lead. We start by trying to release pressure on this system, because we do agree that an audit that is spectacularly late is not very useful to anyone. Underlying that is the issue and the themes that were there in Redmond, which is that local government audit needs to be deeply relevant for local government.

There, I am afraid, some of the things that you might ask an auditor to do might add additional work. For example, the NAO's code of audit practice states something that we entirely agree with—that a value for money assessment is a valuable thing to do—but we are sequencing this. We are trying, first, to alleviate the burden and be very practical, and, secondly, to build that long-term stability about what the sector requires of it.

I can speak a little more about the risk, which is an important issue.

Sir Geoffrey Clifton-Brown: Yes, please do.

Catherine Frances: On risk, we are entirely in agreement with you that there is a real-world effect of late audit. It is a vital part of our system of operating risk and spotting it, but it is not the only element in here. Auditors can take steps, even when an audited account is not closed, to sound the alarm. We have seen some really good practice in this regard. Just to draw your attention to some, we have seen public interest reports issued in Croydon. We have seen auditors taking steps in other cases too, and they can write to senior officers. There are a couple of high-profile cases where that has happened recently.

Q21 **Chair:** Were you thinking of Bournemouth as one?

Catherine Frances: Indeed, that is another one that has been very highly publicised. In the Department, agreeing with you that it is a suboptimal context that audit is late, we are doing a set of things to additionally monitor risk. We have talked to the Committee about this before. We look at the financial risk of individual councils, and we also look at some governance indicators, which include whether audit is late.

We have also tightened the riskiest parts of this system. You will know that access to the Public Works Loan Board is now more limited than it was in the past in order to prevent the riskiest commercial behaviour, and we are taking powers through the Levelling Up and Regeneration Bill to try to ensure that, in cases where places are really heavily indebted, we have a suite of options available to us.

The last piece in this jigsaw is that councils need to step up. We and CIPFA have asked that all councils have independent scrutiny on their audit committees. Councils should be demanding more as well.



Q22 Sir Geoffrey Clifton-Brown: I will come to you, Ms Healey, if I may. The C&AG and I attended a function where we had all the top people in the room, and I sat next to one of the senior partners of Deloitte. We were talking about the difference between commercial audits and local government audits. They are very different, as we all know. What intelligence are you getting that local government auditors are training up or shifting enough people across, if they are able to, from commercial to local government to be able to fulfil this function?

Chair: What is the incentive?

Sir Geoffrey Clifton-Brown: Yes, what is the incentive?

Sarah Healey: It is worth saying, as Ms Frances has already set out, that the auditors that previously entered into contracts to complete these audits are contractually obliged to so do. We have taken some action to put more money into the system, but that is a contract that they are required to fulfil. We just need to focus on that, whatever the changes in context.

Separately—and you might want to speak to Mr Crawley about some of this later on in the hearing—the PSAA has completed a procurement, which has quite recently secured enough capacity for audits of all local bodies. This has seen a considerable increase in fees, which one might be concerned about because of the impact on local government, but both Mr Pocklington and Ms Frances have described a situation in which the requirements of local audit have increased significantly.

What has happened with the fees is now a realistic reflection of what is required to take part in local audit. It has increased very significantly from the lows. That means that it is much more financially viable to be involved in local audit than it was.

Q23 Sir Geoffrey Clifton-Brown: I accept all of that, and that is all helpful, in some senses, provided we do not go on getting these huge increases in fees. Otherwise, local government will be in difficulty. They are already complaining about the increase in fees, but we understand why it was necessary.

To try to get behind my question, it is all very well the PSAA having let all of its audits this year. What sort of intelligence do you have for future years that enough people are being trained into the profession? After all, we are still in a fairly fragile situation. You have only one extra auditing firm coming into the field.

Sarah Healey: Two, and a returner.

Q24 Sir Geoffrey Clifton-Brown: Okay, but it is still a relatively fragile situation. What intel do you have that there are enough people? You cannot just get an auditor overnight. Training takes a long time.

Sarah Healey: Indeed. Some of it is the local audit qualification, which Ms Frances has referred to, that enables that shift. We have also done



more to enable recruitment of auditors from EEA and EFTA countries, so that can fill gaps. Mr Harris referred earlier to the long-term workforce strategy that the FRC is developing as shadow system leader, and that will be absolutely critical to making sure that that pipeline works. That is the role that we have been playing in the liaison committee, and which is transferring to the FRC, of being the system leader that is monitoring that pipeline and keeping close to intelligence from auditors about capacity.

The fact that the PSAA has managed to procure enough auditors at the moment is a good, positive sign. It was not easy and it is not fixed overnight as a system, but it is moving in the right direction, where we are taking action that is needed to enable those local audits to be staffed up in the future. We absolutely acknowledge that it is a fragile system and one that needs really careful watching to make sure that the problems of the past do not come through again.

It is worth saying that some of the problems of the past were a generational shift, so we would not necessarily expect those to be repeated in quite the same way with the retirement of key audit partners who were qualified in local audit, and those who had a history and who had transferred into the private market retiring at once. There was this generational issue, which cannot repeat in quite the same way in the future.

Q25 Sir Geoffrey Clifton-Brown: Yes and no. Those senior people in local government audit had years and years of experience. Experience is one thing; training is another. New auditors coming in do not have quite that same experience. It is a good thing that people are being trained up, but that still leaves a bit of a problem.

Sarah Healey: One of the purposes of the audit qualification is precisely in order to enable people to use the experience that they have outside of local audit in order to understand the local audit context. We cannot necessarily get people who have retired back into the profession, because they have retired, but we can do everything possible to use the skills that exist in the audit market in order to provide that capacity and capability as needed.

Q26 Chair: The key thing for a public auditor is that they have to make different judgment calls to private audits. A qualification for someone who is experienced does not give you the experience to make that call, which we have seen most recently in Bournemouth. It is quite a difficult judgment to make.

Catherine Frances: It is quite a difficult judgment to make and it requires experience and joint work with the council leadership team.

Q27 Chair: There is going to be this gap. However many brilliant people you get coming through the sausage machine, it is not going to get people with the right experience for some years.



Catherine Frances: There are a remarkably small number of people in the audit profession at the moment—under 100 people at key audit partner level, so the most senior level—who are available to do this work with their supporting teams. When I have spoken to the auditors who have either entered or remained in the market, there are a few key messages from them.

The first is that they are very keen and public service-driven people who want to do that kind of deep work with local partnership, and that is why they have chosen to do this line of work rather than commercial.

The other message that they have given us, loud and clear, particularly those who are either entering or are already in the market and choosing to remain, is that it gives them certainty by which they can plan something of their pipeline of new auditors and new trainees, and bring them through the system. It is really challenging but it is a market, frustrating though that is.

Q28 **Sir Geoffrey Clifton-Brown:** That is what I want to come to Mr Harris about. Clearly, these increases in fees will enable firms to pay these auditors better. This is still a very fragile situation, with fewer than 100 senior auditors. Are you confident that, going forward, your training programme will produce sufficiently qualified people with experience to be able to do these? As we were making very clear earlier, it is not just local authorities but health bodies as well. Are you confident that you are going to be able to see enough properly qualified and trained people to do this job?

Neil Harris: I will turn to my DLUHC colleagues to answer the question specifically on the qualification, because the role of the FRC is to own an overall workforce strategy that brings all of the system together. That is looking at not just the qualification but routes into local audit, how we can increase the capacity at key audit partner level, and any barriers to entry. It is also looking at the prestige of local audit.

The work that I am overseeing at the moment with a number of partners across the system, particularly the audit firms, the professional institutes and others, is a much more comprehensive workforce strategy, which the FRC intends to publish by the autumn of this year. One part of that is the qualification. It is more appropriate, if I may, that DLUHC colleagues answer that question.

Q29 **Sir Geoffrey Clifton-Brown:** I will turn to Ms Healey on that. The real essence of the question is this. If, like Mr Grant, you were a youngster thinking about coming into the audit profession, what would encourage you to go into a local government auditing section, rather than going into the possibly higher-paid and possibly faster moving private sector?

Sarah Healey: In a sense, the answer to that question is the same one as it is for people who choose public service in all sorts of ways. It may be via a market, but, fundamentally, there is huge interest and value in audit of the public sector. It has its own particular challenges and



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rewards. There is work out there that firms have bid for. Therefore, if they want to be in the audit market for the long term, they will be encouraging some of their young recruits to go into this particular line of auditing work.

As in a lot of these cases when people are making decisions between being paid one amount in one sector and another amount in another, they sometimes choose things on the value and interest of the work that they do.

Q30 Chair: We know that there has been a big problem.

Sarah Healey: This is why the increase in fees is important: so that there is a much closer match between the fees being paid and the work that needs to be done. We are making it clear that this is a market for the long term, where there will be benefit to firms taking part in it.

Q31 Chair: As well as entries into the market, there have also been exits from the market. We could take markets such as rail or energy, for example. We have seen a number of market failures where it is a regulated market, or quasi-public but private sector. It is still not really solid, is it?

Sarah Healey: As we have already said, I do not think that we are claiming that we have absolutely fixed it all, that it is all absolutely fine and that we do not have to watch out for any issues. We absolutely, definitely are not saying that. Precisely what we are saying is that we have put the fabric and the building blocks in place to fix this for the longer term, and it needs to work.

Q32 Chair: Just before we let this go, it is a rare moment to have both of you in the room. Mr Pocklington was there for some of this, if not for all of the diminution of the availability of public audit. Is someone doing a lessons learned here? This is a systems-wide failure, and only Whitehall has a reach across the whole system to say, "These are things that could go wrong". It has not just happened here; this is a lesson that could be learned by other Departments dealing with other areas like this where you are relying on the private sector to provide a certain level of expertise in order to carry out what is critical public service. Is that something that you could think about?

Jeremy Pocklington: First of all, we are still in the middle of this.

Chair: I am not saying lessons learned right now, but at some point.

Jeremy Pocklington: The right thing is to focus on implementing the actions that we have taken following Sir Tony's external review, and setting up Mr Harris and the FRC and ARGAs to succeed in their role as system leader.

Q33 Chair: Do you not agree that there are lessons to be learned here?

Jeremy Pocklington: You are absolutely correct that this is not the only part of the economy where this has happened, but it is a complicated set of circumstances that led to it. The challenge back on this, if I may, is,



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“What are the actions that we should be taking that we are not already taking?”

Q34 **Chair:** It is about the timeliness of it. It is about seeing it coming.

Jeremy Pocklington: We have implemented the review. We have been focused on all aspects of the system. These things are not just in the Department’s control. It is not obvious to me that there are things that, without the benefit of hindsight, the Department should have been doing. That is the slight challenge back on that, if I may.

Q35 **Chair:** My challenge, then, back to you is that red flags were rising.

Jeremy Pocklington: We were taking action. What has happened then is that further problems have arisen as well—including, in the past year, the impact of a fine in the sector, as mentioned in the NAO Report. It was a perfectly legitimate regulatory decision and I am not questioning that, but that had a further chilling effect on the system over the past year, which has delayed the recovery and required us to ask CIPFA to take action. They could not then get enough agreement from other bodies, including FRAB, which is the Treasury body that oversees regulation standards. Therefore, the Department had to step in. I am trying to paint a picture of quite how complicated the action is.

Q36 **Chair:** That is exactly my point. It is complicated and there are red flags, so we could have a lessons learned about all these different moving parts, such as a fine and the knock-on and ripple effect. If you take the tragedy of Grenfell, for example, subsequent Government decisions about what might happen also had knock-on effects on, in that case, people’s ability to sell their homes—the EWS1 form—and the insurance industry. We need an understanding of how one decision in Whitewall or somewhere in the system can have a knock-on effect systemwide.

I will perhaps park that for now, because it is not really the main subject for today, but I have been on this Committee for over a decade and we see these same things come up. I am just keen to see that there is some understanding that there may be some system learning.

Jeremy Pocklington: Ultimately, it is about system learning and system leadership. That is the challenge.

Q37 **Chair:** With respect, Mr Pocklington, you were in the Department for a couple of years. Ms Healey has now taken over.

Jeremy Pocklington: I was in the Department for nearly five years.

Q38 **Chair:** We were talking about Covid, so I was thinking about the two years of Covid, which was an intense time. Forgive me; I did not mean to diminish that. The point is that we see a turnover of people. In fact, none of you were in the jobs that you are in when I took on my chairmanship of this Committee, for example, which is not that long ago, so there is a turnover.



Sarah Healey: It is worth also saying that there are clearly benefits of learning from different parts of the public sector being applied in other parts of the public sector. While I accept your point on turnover, and having been in my previous Permanent Secretary role for almost four years, which was not a short stint, you do bring with you a perspective from different experiences and different sectors, which can be extremely helpful.

Chair: I will park that there. You can sense that I just have a bit of frustration in me this morning. *Groundhog Day* comes to mind.

Q39 **Sir Geoffrey Clifton-Brown:** These are two separate questions, really. Firstly to you, Mr Harris, as the incoming system leader, what are your immediate priorities? What are the biggest risks to delivering your plans? How will you manage them? How will you keep Parliament updated?

Neil Harris: Just to recap what I said earlier, at the risk of repeating myself, it is really important that we progress as soon as possible the legislation for ARGA that gives that statutory underpinning to this role.

I answered earlier in terms of my short-term priorities. We will issue a statement in response to the remit letter from DLUHC, setting out our objectives for the forthcoming 12 months. I have already signalled that we will be setting out, in due course, our diagnosis of the systemwide issues, risks and challenges, and how we propose to address that in the short, medium and long term.

I covered in my previous answer the short-term objectives on the backlog, timeliness of reporting and the workforce strategy, but there is also some long-term work to be done across the system just to build that consensus on a roadmap to sustainable reforms, with a vision and purpose of what financial reporting and audit is and what changes need to be made to get to that. That should be done in parallel with the short-term measures that we are looking at now.

In terms of the risks of taking on this role, I would put that into two parts. The first is the risk to the FRC in taking on this role. You would fully expect that, in the time that I have been in post, I have agreed at board level within the FRC a set of key risks for the FRC, one of which is that we do not deliver on the MOU.

The second is that we do not have the capacity and capability to undertake our role and to operate appropriately with our dual hats in terms of being a system partner and a regulator. The third is that any action we take as a regulator could have a detrimental effect on the market. Those are the three key risks that we have set out very clearly to the board, with a series of mitigating actions.

The second element of risk is whole-system risk. As we become the shadow system leader, we will become the chair of the liaison committee, but it is important to say that I have been working closely with DLUHC colleagues ever since I arrived to understand what the key risks are. The



first priority for us as the incoming shadow system leader is to agree among the liaison committee of all senior stakeholders what that whole-system risk is and the priorities for action. That is a very important exercise, and we will be using the liaison committee to track those higher-risk items. The meetings of the liaison committee will be published and will be available to you.

In terms of reporting to Parliament, there are a number of things to say, and DLUHC colleagues may want to come in on this. DLUHC will remain the accounting officer for local government, which is clearly a key role in terms of that overall accountability to Parliament. The remit letter is really important for this Committee to be aware of, because it sets the Department's priorities for the FRC. We will be responding to that, and those will both be public documents.

If you have had an opportunity to read the MOU, the two appendices set out governance frameworks. I will be monitoring with DLUHC on how we deliver against the MOU in a series of escalations towards our reporting to various committees and how that translates to you. That will be in things like responding to letters and inquiries from this Committee, appearing in front of you and contributing to Treasury minutes.

All of our documents that we produce as shadow system leader will also be publicly available, as will the minutes of the liaison committee. There are a number of mechanisms that ensure that you as a Committee and Parliament will be briefed on the work that we are doing as part of discharging what we have to do under the MOU.

Q40 Sir Geoffrey Clifton-Brown: Chair, I thought I had finished with my section, but that answer raises alarm bells in my head. Could you just address this issue that you raised of whole-system risk? What exactly are you thinking of there? Are you thinking that you are not going to be able to get the accounts back on track within a reasonable period or that it is going to get worse?

Neil Harris: It is far from certain as to the answer to that question. Where I am referring to whole-system risk, it is about the interdependencies with the NHS. We have had a lot of discussion today about local government. It is very important to understand the interdependencies with the NHS audit market as well, the reason being that the same pool of audit resources works across both sectors.

The NHS has gone through some structural change in the last 12 months, and there is an audit of accounts happening this year. Auditors need to balance their resource in terms of clearing this backlog, delivering against NHS timetables, and then moving on to current financial years. That is what I mean by whole-system risk. In the shadow system leader role we have to understand that risk, but it is far from certain, in answer to your question, as to whether it will get worse before it gets better.

Q41 Sir Geoffrey Clifton-Brown: Knowing that and knowing all the different bits of the system, what action are you taking to try to do your best to



make sure that this is possible? If it really started to degenerate into the health service audits, this would become a really serious matter, so what actions are you taking to mitigate the possibility of this whole-system risk?

Neil Harris: For a start, understanding the issues in each of the individual sectors, such as whether there is the potential of another infrastructure asset issue that might be happening again this year, or whether there are complexities in each of the NHS audits that may be taking more time from auditors.

I also come back to a previous answer about the responsibility of the local authorities and auditors in the local government space to flush out the current position. The backlog is so significant that it is really important to know what is holding this up and what steps need to be taken to address that in a more granular way.

I am keen that, if auditors are concerned about the quality of financial reporting capacity or capability, or that there might be other governance and financial management issues, those are raised and escalated as soon as possible, so that, from a system point of view, I have a much more granular understanding of what is happening. Bear in mind that we are operating in a shadow form without statutory underpinning, but, as a shadow, we can make policy recommendations to DLUHC and commission work from other parts of the system to support us.

It is also important to say that I am here for the whole of the FRC and that the FRC plays its part as well. There may be recommendations that I want to make to parts of the FRC as well. The whole system needs to come together. I have been undertaking a lot of activity since I have started, including engagement across the local government and NHS sectors, and the audit suppliers, and attending liaison committees.

Working with DLUHC recently, I got a cross-Department meeting together to understand the challenges across the system. That holistic working is the only way that we can get this position addressed and then put it on a sustainable footing in the future.

Q42 **Sir Geoffrey Clifton-Brown:** We will come a little later to some of the standards that you set for the valuation of assets and so on, but I just want to finish with you, Mr Crawley. You have done a great job in letting all these contracts. How confident are you that, in the next round, you will be able to have a similar level of success? What if, hearing what Mr Harris says, you cannot let all these contracts? I am not entirely sure—and perhaps you will tell us that I should be—whether you cover these health audits and whether they are within your remit.

Tony Crawley: First of all, thank you for the invite to come here in person. The last time, it was from my spare bedroom.

We do not cover the NHS. That is through statute. We have no access to the NHS, just to clarify that position.



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In terms of the procurement, it was very tough. We initially got 90% of what we needed from the first round. We then went to 96% and 99%, and got to 99.5%, which was enough, because of the local government reorganisation clarification. It is not ideal for any procurement to not get enough in the first round, because you want to be able to make a choice of what you want from the offers made to you, rather than have to go back and ask for more.

We liaised very closely with the Department. We met weekly during the procurement round. We made it very clear that the focus needs to be on what the position of the procurer is going to be next time, because what the procurer needs is a market that is vibrant. We have said that an auditor of last resort needs to be examined. We know that it is going to be difficult to do that, but we have also been working with colleagues from DLUHC and from the Cabinet Office to talk about what could be done and how the market could be developed next time.

You asked a question about the qualification. We know that there are people in firms waiting for that qualification to bring their knowledge of IFRS accounting across and using that qualification to get into the local audit market. As we know, a qualification design is being worked on. We know that that includes looking at how you work in a political environment, how you do the FM arrangements-type work, and how you look at elector queries, which is a unique feature of local government audit.

There is already a lot going on to look at the position of the procurer next time round, because work on that starts way before the contracts are let. That is very much a focus of our discussions with the Department already.

Q43 Sir Geoffrey Clifton-Brown: That was a brilliant answer, but not quite to the question that I asked. How confident are you in the next round that you are going to be able to let all these contracts first time round?

Tony Crawley: At the last appearance leading up to this, we were really concerned about getting enough. We just got there. If nothing changes, we will be in the same position.

Catherine Frances: The lot that has just been allocated is until 2027-28. Your question is a very good one, and auditors will have to finish on the old contracts that the PSAA has ably managed and move to this new contract, but there is quite a long window. Exactly as Tony Crawley says, we are thinking about the future, but we have quite a long window and we want to take exactly the strategic look that you have been quite rightly pushing us on throughout this hearing.

Sarah Healey: This is the value of the strategic work on workforce that will come through at that point. We will be staying in close touch with the market between now and then, but it is not an imminent re-procurement.

Q44 Chair: We saw two companies leave and three join, but two of them are



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quite small. Mr Crawley, was that because of active work that you were doing to encourage the market?

Tony Crawley: We specifically let lots that were designed for new entrants, because there is a cut-off point of what are called major local audits and public entities. Coming into the local audit market, with all of its differences, we wanted to give them a safer space to start off with. The hope would be that those two new ones look at their progression through the next contract period and are more confident next time about going for the standard lots.

We are also encouraged by the fact that the two that have exited the market this time round have both said that they regard it as a pause. They recognise that they are in a challenging position in terms of resources at the moment. Neither has ruled out coming back in, just as KPMG came in this time.

Q45 **Chair:** We would have hoped that BDO and Deloitte would be big enough to come back in with relative ease. At least they know the market, even if they have resource constraints. With the new ones, that is quite interesting. Is there an issue at all, if you are a small company, that you might have to take out hefty insurance against your professional views? That is just more challenging if you are dealing with some of these local audits.

Tony Crawley: Part of our contracting process is to look at the insurances and we set the expectations within that. They all have professional indemnity insurance anyway, so we check that through the process. Also, we can contract only with people who have gone through the ICAEW process to become accredited auditors.

Q46 **Olivia Blake:** I have a quick question for Ms Frances. I was interested in what you were saying about capacity and capability within local government. What should local political leaders be pushing or looking for locally to improve internally?

Catherine Frances: That is a very good question. The best councils have very good whole-council discussions, which, of course, they are required to do, of their financial plans looking forward. They have very clear statements and a good understanding of risk at the political level, as well as at the officer level. They push on that and make sure that they understand it and are happy.

Sir Tony Redmond originally recommended, which we very much agree with, and CIPFA has backed, that, on an audit committee, you would have somebody who is independent and also highly qualified. We have funded the sector specifically for that, along with some of the other changes that have been made.

Any locally elected person should feel that they are comfortable in asking those questions. In a minority of cases where things have gone wrong, one of the lessons learned that has been drawn out, both by the



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Department and by some of the auditors who have done a bit of a look around and a refresh looking at public interest reports, is that that level of open scrutiny, discussion and clarity around governance has been a source of weakness, which is something that can be solved only at the local level.

Q47 Olivia Blake: Off the back of that, do you feel that there is enough understanding of this whole issue among local leaders?

Catherine Frances: It is not my job to spend lots of time with local leaders—I hope that you will understand that—but rather with their lead officers. We see at council level in general that there is a very mixed picture. The LGA has recently done some work looking at the financial capabilities among officers, and has found that there are gaps and not a very deep pipeline of people working in this area who are comfortable and confident in all councils. The comprehension of risk is variable, and that is what has led to some of the failures.

However, people's risk appetite may be different, and that is part of a local accountability framework. It is legitimate in some contexts for local councillors, as long as they are operating within frameworks and understand the risk, to take a different approach. That is something that councils have said to us very strongly, and appetite in one part of the country may be different to that in another.

Q48 Olivia Blake: The reason I am pushing on that is that, without the buy-in of local councillors, officers might struggle, in a resource environment that has been a bit challenging, to get this as a priority for political leadership. Do you think that the Department is supporting officers in local authorities enough to get the urgency of these issues across?

Catherine Frances: I do. We have been very clear about the expectations on them in terms of scrutiny arrangements, but also audit committee arrangements. We write to councils regularly. My own Ministers have done webinars for elected people across the country to tune into, and they have had high attendance rates, where they have talked about the importance more widely of measurement of local government outcomes. We have generally reiterated this message.

If you were to ask local government about the clarity of message from the Department on the small but notable minority of councils that have made unwise and difficult decisions, and the visibility of our interventions and steps in some of the most challenged councils, where the issues are often but not always around governance and poor financial failure, that is something that the sector is very aware of.

Q49 Olivia Blake: With regard to timeliness, this is a long-running new issue. Why does the Department not already know what the issues are that are causing this and what the solutions are to it?

Catherine Frances: We do know, overarchingly, what the causes of the problems are. They go right back to the start of the hearing, when Jeremy set out issues with the audit market, the underlying regulation,



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the history of procurement and costs in local government audit, and what has happened to the capacity in the sector. They are down to something to do with local authority grip on the presentation of some of its accounts and processes. They are down to workforce shortages, then compounded by Covid and the chilling effects that Jeremy has talked about in terms of fines.

We can describe that, absolutely fine, in macro terms. The challenge then comes that, if you ask any individual local area, "What is causing your problem?" you will get different answers depending on whether you talk to the council or the auditor. That may be valid, because it may be that one of them feels that the information they are getting is not sufficient, and another feels that their auditor is not available at quite the right time. It may be multifaceted.

For some of these audits that are late you can say, "Yes, I see what the issue is there", but there are others where it may be more contested and there may be different views between the parties, legitimately. We cannot put it neatly on one table, much though I would love to do so.

Q50 **Olivia Blake:** There is not really a prescriptive solution for this, is there?

Sarah Healey: When we identify things that are common across different situations that need to be solved systemically, that is what we do. That is the reason for the action on the statutory override, for instance. It is also the reason why the NAO made the change it did on VFM statements and financial opinion.

We know there is a capacity problem, hence the work on the qualification we talked about earlier. It is not that we do not know what some of the bigger issues are. It is just that, as Catherine is setting out, there will also be specific issues in specific areas that we cannot necessarily solve at a systemic level, which have to be solved between the auditor and the local authority.

Q51 **Olivia Blake:** Finally, Ms Frances used an interesting phrase earlier. You said you did not want the market to become over-commodified. I just wondered whether you could expand on what you meant by "over-commodified".

Catherine Frances: Yes, I was alluding to the fact that what experienced local government auditors and experienced chief executives talk about is the partnership between the two of them. That is a challenge function that is provided yearlong, with a proper conversation about where risk lies and what the challenges are.

We have a double bind here. The first is that we want to crack on and get through these audits so we can deal with the backlog. Secondly, everybody is really clear that you do not want that simply to become a numerical exercise or an exercise that looks, if I can put it this way, only at the commercial pursuits of councils. It also needs to look at the underlying service delivery, issues of efficiency and value for money.



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That is why the Comptroller and Auditor General, in the code of audit practice, sets out this double requirement on auditors in local government, looking first at the financial audit and secondly at the value for money element. With some regret, we have had to say that, in this context, auditors have been given an option to delay the value for money piece. That is a pragmatic solution. We all agree on what we want local audit to do.

Olivia Blake: That is very useful. Thank you.

Chair: It is worth noting, perhaps for those who are watching who may not appreciate this, that the National Audit Office sets the framework, but it does not do the local government audit. It has no other role in that. I do not know whether you want to add anything, Comptroller and Auditor General, to explain how that works.

Gareth Davies: That is right. Since 2020, the current code of practice has set out the framework for local audit. As Catherine Frances has said, that has been adjusted to deal with this backlog issue. Where it has been used—it has been used in quite a few cases—it has already demonstrated its value as a way of providing an early signal of emerging problems, whether that is in governance, efficiency or the other areas you have mentioned.

Chair: I just wanted to be clear on who was responsible for what. This is a market with lots of moving parts.

Q52 **Olivia Blake:** It is a little bit complicated. Mr Harris, just returning to the risks you were mentioning, how do you feel your organisation prioritises not just the system risk, but the risk you mentioned for health? What would be the priority for you—health or local government?

Neil Harris: The simple answer to that is that they are both equal, as far as I am concerned. The only way you are going to get a sustainable solution across local audit is to look holistically across local government and the NHS.

As this role progresses, there is a role for the FRC to make recommendations to Government, if more needs to be done in having a more holistic set of expectations around financial reporting and audit deadlines across a number of sectors, which might help to provide some prioritisation of audit resource. That is why I say these are equally important.

Q53 **Olivia Blake:** Do you feel there is any potential, given all that is going on and all you have said, for the FRC, and your role in particular, to be a little overwhelmed or quite challenged?

Neil Harris: Yes, for fear of repeating myself, we are doing this in shadow form. We have to be very clear about our role and responsibilities before ARGA. We will make that position very clear in response to the



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remit letter and how we are going to deliver on the memorandum of understanding.

We have made sure the risks of the FRC taking on this role on a number of fronts are visible to the board. It is also important to say we are hardwiring this work on local audit into the FRC. I have the ability to work with a number of colleagues across the FRC to support me as I need.

Q54 **Chair:** What do you mean by “hardwiring”?

Neil Harris: It is integrated. We are appointing an independent non-executive to the board with expertise in local audit, and we are currently out to recruit for a senior adviser as well to give me some independent challenge.

I want to give you the assurance that we are building capacity and capability within the FRC to deliver on our responsibilities within the MOU. My recruitment to our dedicated local audit team continues. I am pleased to say my deputy director is joining in the middle of April and is a practitioner in the local government sector. That is about trying to give me some complementary skills.

We just need to be very clear about what we can and cannot do within the FRC. As soon as an issue emerge across the system, it should not be assumed that the FRC is solely responsible for fixing it. We have a role to convene and co-ordinate the system and have that more holistic look. There may be things that the FRC, in its regulatory function, could legitimately do, but we may also be making policy recommendations to DLUHC or other parts of Government, and asking others within the system to contribute. Those would be audit suppliers, some elements of local government, the professional institutes and others.

It is really important that I hold that line. It will become overwhelming if there is a perception that we are responsible for fixing everything and that I am the great messiah who is going to fix local audit, which should not be the case.

Q55 **Olivia Blake:** It sounds like you feel your role is more as an enabler.

Neil Harris: I would say I am a head of statutory underpinning, yes. The memorandum of understanding gives us some very clear roles and responsibilities. It is a very serious task we have within the FRC to bring the whole system together. I said at the very beginning that everyone has to play their part. It needs a dedicated and concerted effort from absolutely everybody. Every part of the system has a part to play here.

Catherine Frances: We have published the MOU between us and the FRC, and Neil Harris and his team are building up, as he has said, but we have not transferred the role to them yet. I just want to make sure we are absolutely clear.

Chair: It is in shadow, yes.



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Catherine Frances: No, not even in shadow. We have published the MOU, and we are undergoing a process between us and the FRC to make sure it is absolutely ready and we are absolutely ready to hand over. We then hand over to them, trigger the remit letter and they then operate in shadow form.

At the moment—I just want to be clear on the accountabilities—Neil is building all of this capacity absolutely well and working very jointly with us before that formal handover.

Olivia Blake: It is in readiness, okay.

Q56 **Chair:** Mr Harris, you said you are not the messiah. You are like a tsar; you are an enabler. We are using all these words. In terms of your powers, when you do have this responsibility, if somebody does not play ball, you are the first person in this role, so it is pretty critical.

You talk about there being a line you cannot cross when it comes to the FRC's responsibilities, but is there a line that you would have to really hold and dig in on, if you felt a bit of the system was not doing what it should be doing? As of yet your profile is emerging because you are very new in the role, but, with your experience, can you develop the profile you need to make sure people are cajoled, frightened or persuaded, whatever it takes, to do what they need to do?

Neil Harris: Yes, I can.

Chair: You have a fierce side, do you?

Neil Harris: You have not seen it yet, but yes.

Q57 **Chair:** If you are up against a Department, if it comes to a head-to-head, and there is a discussion, maybe a political discussion, that means Ms Healey has to implement something that might be challenging politically, do you think you have that strength?

Neil Harris: I do, yes. One of the things I have got involved in already is DLUHC's accountability framework. I will be getting involved in a lot more of the stewardship meetings within DLUHC so I can impart my views about what needs to happen within the system directly into DLUHC. If I think there are policy recommendations to make and I believe they are so important, I have a mechanism to do so.

The FRC has, as part of the MOU, an ability to produce an annual report on the state of local audit, but it can report at any time. If we feel so strongly that something needs to happen, we have an ability to—

Q58 **Chair:** You are confident that you will be confident enough to do that.

Neil Harris: Yes.

Q59 **Olivia Blake:** Moving on to Mr Crawley, you mentioned the auditor of last resort. I just wondered whether you could provide a bit more information on how that might strengthen the market and what you



would like to see from that.

Tony Crawley: We have asked for an evaluation of whether it is feasible because it is not easy to set up a new entity. There are all sorts of issues about business planning and how far it would go, et cetera.

What it does give—this exists in other parts of the UK—is an ability for the procurer to know they will always be able to make an appointment. There is always somebody they can call on, if the private sector firms decide they do not want to get involved to the extent that was perhaps originally envisaged. It gives that security; it gives that backstop to the market. It would be enormously useful to any procurer to have an auditor of last resort available.

Q60 **Peter Grant:** Mr Pocklington, your remit or your Department's remit on local government extends only to England, but, although they may be worded differently, a lot of the financial reporting and audit standards are very similar across the United Kingdom. How big a problem is lateness in local authority audits in the rest of the UK?

Jeremy Pocklington: Scotland is a very different market, as you will know probably better than I do. I am not aware there is quite the same scale of issues. Ms Frances has more up-to-date information than I do.

Catherine Frances: I do, though we are not accountable for it, as you know. Audit Scotland commissions in a combination of ways from the private and public sector. My information on Scotland is that there are not the same timing issues as we are facing in the English context.

Q61 **Peter Grant:** I got somebody in my office to check yesterday. Four out of 32 Scottish local authorities have not met the deadline for last year's publication, which is within a few days of the same deadline here. Have you looked, Mr Pocklington, at the detailed differences in the way things are done in Scotland to see whether there is quite an easy fix for the problems you have?

I will maybe come back to you in a minute about the audit market, but, if your next-door neighbour has a level of compliance seven times as high as yours, that would seem an obvious place to look to improve the performance in England. I do not know; maybe Wales and Northern Ireland are even better.

Could you just explain what you mean when you say that the audit market is different? I am particularly keen to tease out whether it is different because of factors that are within the control of Government and local government, or because of factors outwith the control of anybody in this room.

Jeremy Pocklington: Scotland runs a model based on Audit Scotland, as I understand it. There is a combination of both direct provision of audit functions by Audit Scotland and some market procurement of private sector audit to audit local government as well. There is a very different model to that operating in England.



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The background in England is that the audit model in England was fundamentally changed under the 2014 legislation. That is the historic background. We abolished the Audit Commission and moved to a fully market-led model, which was a policy decision taken by the Government at the time. The scale is very different in England. The Government do not have any plans to move back to the approach that currently operates in Scotland.

It is devolved so it is a matter for the Scottish Government. There is no reason why we cannot make market systems work effectively to deliver the outcomes we want, but we have talked about the challenges that have arisen in England, as Sir Tony found and as the Chair alluded to earlier. The fragmentation of the system has been the cause of the challenge in England.

Q62 Peter Grant: To be clear, the major differences in the way local authority audit works in Scotland, which on the evidence seems to be much more effective, are things that are within the gift of the UK Government to change, leading to a similar model in England.

Jeremy Pocklington: Fundamentally, these are policy decisions that the Government of the day need to take. That is a truism.

Q63 Peter Grant: When the Government take a decision, for example, to allocate new ring-fenced funding to local authorities, which is always brings with it an additional burden of accountability and auditing—more so than it would if they said to local government, “There is money; you decide how to spend it”—what assessment do you make of the additional burdens this puts on local authority management, local authority finance teams and eventually on auditors?

For example, the pothole money that was announced yesterday will no doubt be welcome, but, in every council that gets the money, somebody is going to have to spend time proving it was spent on potholes and not on something else. What assessment do you make of the demands you are putting on an already failing system of accounts preparation and audit?

Jeremy Pocklington: I am afraid I do not know the details of what was announced yesterday. I will bring in Ms Frances on that. I am no longer in the Department.

Q64 Peter Grant: As a general point—this is not the first time there has been a big announcement of money for councils to spend on a particular thing—is it part of the assessment process to look at the capacity of receiving organisations to ensure they can deal with the accountability requirements that are put on them?

Catherine Frances: As a general rule, under the best value framework, if any Government Department takes a step to put a new burden on local government, it is obliged to fund it.



The issue you are describing—I am sorry; I am not an expert on the individual cases—is one of the balance of funding that goes from central Government to local government. The question is how far we try to put funding through undifferentiated routes, routes that are identified for a particular but very broad use or routes where there is a very high degree of specificity. In truth, there is always a judgment to be made there.

From the departmental perspective, in general, we try to encourage all our colleagues across Whitehall to streamline wherever it is possible and to remove ring-fences. For example, if you look at the local government finance settlement this year, it had the undifferentiated grant—the revenue support grant, which has been there for a long time—and it additionally had a lot of extra money for social care. That went into a grant that could be spent only on social care, but children’s and adult’s in the round. We will be working with all our colleagues on the balance of other bits of funding.

In a sense, it is our pursuit to look at the funding going out from Government and, wherever possible, to remove ring-fences and restrictions, so that, where restrictions remain, it is for good reason. It is because the Government have taken a policy decision that, yes, they want this to be spent on a particular piece of work.

The feedback from councils is that ring-fencing, although it is not always popular with them, is not a particular issue. The feedback from councils recently has been around competition. That is something we take very seriously indeed. We have tried to streamline the number of competitions that are being run. That is the immediate feedback from councils.

Sarah Healey: You will also be aware that the Department retains a commitment to publishing a funding simplification plan for local government. In addition to that, just to build on what Catherine said about the key issues for audit, those tend to be less about ring-fencing. Where we have been able to lift burdens or hold back from adding new requirements on local authorities, we have done so precisely because of the difficulties in the system at the present time.

Q65 Sir Geoffrey Clifton-Brown: Ms Frances, I want to come back and build on Ms Blake’s very important question about risk. It is this. What is the danger of these delayed audits in detecting a real systemic risk to a council? Perhaps allied to that question, how effective are these risk statements?

When we hear of a recent publicised case where Liverpool discovered it had £200 million of outstanding debt, it seems like, instead of waiting for a full audit, these risk statements need to be issued quicker. That is also a problem for the auditors who are doing it. There are relatively young people going in to do the audit in the first instance. They might not necessarily be aware of the systemic risk they are seeing.



Catherine Frances: On an individual council level, audited accounts not being on time adds risk. There is no doubt about that. I am not going to comment in depth on the individual case you raise, if that is okay.

Returning to one of the points I made earlier, we are seeing—I am really encouraged by this—auditors issuing strong statements. They can either issue public interest reports, which they can do under statute, or very noticeable interventions, letters of intervention to lead officers and so on and so forth, in advance of accounts being completed and audited.

That has been very effective in a number of cases. There was the high-profile case in Slough, for instance, where auditors raised concerns. Croydon was also notable. The Chair talked earlier about Bournemouth. There are these instances, and they have a real impact. That risk hits at a council level.

At a macro level, across the whole system, we are looking very closely indeed and we are trying to tighten the main areas of risk for individual councils. You may know we have issued a couple of consultations on how they should account for their debt repayments, for example. A third consultation on that is pending. It is quite technical area, but one where some councils have got into problems so we are trying to shut down that avenue of risk.

Similarly, restrictions have now come in around borrowing for commercial yield. A council cannot do that and still borrow from the PWLB. All those things are systemwide and designed to support the work going on in councils to spot and minimise risk as far as possible. I cannot pretend to this Committee that having late audits is not a proper additional risk factor for individual councils. It is.

Q66 **Sir Geoffrey Clifton-Brown:** I am very grateful. I have been pressing the risks with PWLB on this Committee. The changes did stop my local council making an unwise investment so I am grateful for that.

Ms Healey, as I understand it, there is no sanction on any local authority if it does not prepare its audit properly and on time. Given that this is one of the real spinning wheels as part of this whole problem of delayed audits, is there something else that needs to be done here to give local authorities a real incentive to get their accounts done on time?

Sarah Healey: There is a statutory deadline for the production of accounts, just like there are all sorts of statutory responsibilities local authorities have.

Sir Geoffrey Clifton-Brown: But there is no sanction.

Sarah Healey: Ms Frances has already laid out that we have written to local authorities to emphasise the significance of this issue and to underline their responsibilities to get audits completed on time and, indeed, in particular to deal with the backlog that is holding up the relevance of those accounts.



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You are correct that there is no specific sanction against local authorities, but we are clear that they are accountable for making this happen and we expect to see action on it.

Q67 **Sir Geoffrey Clifton-Brown:** I accept that, but this is not a new problem. It has been going on for a number of years. This is the beginning of the cycle of decline. If the local authority does not do its accounts on time, the poor auditor cannot possibly do their audit on time. How confident are you that the action Ms Frances has taken is going to make sure the laggards do their accounts to the statutory deadline?

Sarah Healey: As we have explained throughout this hearing, there are lots of different players that have responsibilities.

Sir Geoffrey Clifton-Brown: The local authority is at the beginning of the chain.

Sarah Healey: The local authority is absolutely critical to it, and both Mr Pocklington and Ms Frances have emphasised the significance of the role of the local authority in this. We have given them extra funding to enable them to build their capacity to respond alongside the broader increase in spending power that they have received.

We have also done everything we can to try to help with the capacity they can draw on from audit firms in completing this. We have set our expectations and, with the improvements in the overall system, we expect to see them stepping up.

Q68 **Sir Geoffrey Clifton-Brown:** Will you be able to keep the Committee in the loop as to how well that process is going?

Sarah Healey: Yes, of course.

Sir Geoffrey Clifton-Brown: It seems to me to be fairly critical to the whole process.

Sarah Healey: We are very happy to write and give you an update regularly on how that is proceeding and what we are seeing taking place.

Sir Geoffrey Clifton-Brown: That would be very helpful. Thank you.

Q69 **Chair:** On the issue about quality in local authorities, the audit deadline is being pulled forward. We are all trying to get that to happen across central Government and local government. We have had evidence saying that there are quite big gaps and some difficulty in recruiting the right financial expertise into local government. Will drawing that deadline forward, though we all want to see it happen, mean a risk in the quality of accounts? I suppose I am looking at Ms Frances on this.

Catherine Frances: As you know, we have adjusted the timelines here at multiple points in the past. We will just keep it under review. We have not made any plans to change what we have committed to so far. In this



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context, we are trying to keep a proper focus on how everybody has to get to something that feels realistic.

If I can be frank, some auditors have told councils they are not available to start work on certain accounts, even if the council lays the material on time, because of the constraints within their own companies, which we understand and recognise. Similarly, auditors have said that some councils are not providing them with the material they need in order for it to be of a high enough quality. You can see, then, a system properly under strain from both sides.

Coming back to the point about penalising one partner or another in this, that is the difficulty. You have the whole system under strain, and we need them to properly get together and, as Sarah Healey has said, understand the granularity of that as it unfolds.

Chair: We know there are still many, many problems in the system.

Q70 **Sir Geoffrey Clifton-Brown:** Ms Healey, I would just like to come on to a different subject. We have already heard about the systemic risk to health audits. I would like to just examine other systemic risks to other parts of Government auditing. Pensions is one of those key ones that would delay individual departmental accounts. DCMS, your old Ministry, is one of the Departments at risk from its next steps agencies. How can you tighten up this area so we do not begin to get a risk to the auditing process right across Government?

Sarah Healey: I do not have an easy answer to that question. When I left DCMS we were in discussions with the NAO about how to ensure this did not end up endlessly delaying the closure of the departmental accounts. It is also an issue for some other parts of Government. For instance, the Ministry of Justice set a significantly larger number in those accounts than in the DCMS accounts.

We are really seeking a sensible settlement where we took account of the risk of not having full local government information in determining when it was reasonable to close those departmental accounts, which only partly drew on that local government information.

Neither the Committee, the NAO, the Department, the Department's audit committee nor anyone else would be happy to do that unless we were all satisfied the settlement that was reached was fair, reasonable and balanced and was not taking too much risk simply for the sake of closing things earlier. I am not sure where those conversations have got to, but, insofar as I can assist with them in my new role, I am very happy to take part in them.

Q71 **Sir Geoffrey Clifton-Brown:** The other risk is to whole-of-Government accounts. If the departmental accounts are not closed, the whole-of-Government accounts will be published later. The later they are published, the less value they are to everybody who is trying to make use



of them.

Sarah Healey: That is absolutely true. We have sensibly taken the decision to change the threshold for local bodies' accounts to be included in whole-of-Government accounts. That has been pragmatically raised in order to ensure there are fewer bodies and therefore less contagion risk to the whole-of-Government accounts from that.

We are conscious of the impact local bodies have due to their breadth and the contribution they make to all of these different Departments. That is the nature of local government: it is involved in all sorts of other parts of what the Government do locally and nationally. That is one of the reasons we are so keen to see this improve, despite the challenges of making it happen.

Q72 **Sir Geoffrey Clifton-Brown:** Can I move to you, Mr Crawley? On Ms Frances's point, say a local authority gets its audit done on time, by the statutory date, but the auditor says, "We are not available to do it for the next month". Should they not be ready as part of their contractual obligation? If the local authority does it by the statutory date, the auditor should be ready to take over from there on it and not cause any delays.

Tony Crawley: We do not have the power to direct auditors. That is part of the independence framework of this system. Once appointed, auditors are independent of us, by design. We obviously want the audit to be done on time. There is no statutory date for the auditor to give the opinion. That is another part of the framework that creates a challenge for the contract.

The reality is that there is a shortage of audit resources, as has been mentioned, with the knowledge to do local audit. The firms want to get through the audits as quickly as possible. Those who are exiting want to release their staff to work on other work. The ones who have new contracts want to get to the new contracts as quickly as possible, but they have to deliver the required standard of audit. They have been very clear in their public statements that they are not prepared to compromise on audit quality at all.

There is something that has struck me as part of this debate. I will quote from the ICAEW. "There is insufficient capacity in the local audit market, while auditors, finance teams and regulators are not aligned in their view of audit risks". For me, this is a really important point. If we can broker a position where there is clarity that scarce audit resource is aimed at the areas that are really important, which enables scarce finance resource to provide the information that is important, that is the way we tackle the backlog.

At the moment, the size of the audits is very substantial. The auditors are in a position where they are cautious in terms of regulatory risk. We need to broker a way forward so that there is congruence between the preparers, the auditors and the regulators about what really matters for



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local audit and what the audit should be concentrating on. At the moment, we have a position where the volume of work the auditors are required to do with no statutory deadline to give their opinion means the backlog is building.

For me, that is an absolutely crucial point. Grant Thornton's recent report at the time talked about the importance of addressing the issue around property, plant and equipment, and getting congruence between what the regulators are expecting the auditors to do and the information the auditors are expecting from the bodies. The auditors are caught in the middle in terms of the expectation of what is required around certain areas of work. No one is doing anything wrong, but it is a matter of bringing that together. For me, that is a really important point, which both ICAEW and Grant Thornton have mentioned.

Chair: This is the evidence from Grant Thornton.

Q73 Sir Geoffrey Clifton-Brown: Grant Thornton asked whether the FRC would consider introducing temporary flexibility into the local audit framework to allow reduced-scope audits to be undertaken on backlog accounts. That is a slightly different point, Mr Harris, but would that be a possibility?

Chair: It would be quite risky.

Neil Harris: The first thing to say is that, as you would expect from a representative of the FRC, we cannot compromise on having high standards of financial reporting, governance and audit in the public interest and holding to account those who are responsible for doing so.

Notwithstanding that, clearly we recognise, as one part of the system, that we need to get to a consensual view on what a proportionate risk-based audit is. It will be my responsibility, when I come in shortly as the shadow system leader, to convene and bring all of the partners together on a common understanding of what that is that does not undermine professional accounting and auditing standards.

I am not going to comment on individual account balances. It is not appropriate for me to do so. It is also important to say that we do not set the financial reporting framework. If we think there is a consensual view that does not compromise the high standards we would expect, within the system we would all want to work towards achieving that.

Chair: It could be quite worrying, if you have a council with more than one year's backlog and then there is a drop in quality. That could have a knock-on effect in the long term. They raise an interesting point, but it is fraught with risk.

Q74 Sir Geoffrey Clifton-Brown: The Chair is absolutely right. I just want to press you slightly on this point about the timeliness of audits, Mr Crawley. I understand that auditors, quite rightly, have to be totally independent, that they do not have a deadline on when they have to



complete it and that their quality is regulated by Mr Harris. It is their responsibility.

Timeliness is a different matter. Are you monitoring, within the contracts system, whether they start their audits on time? Could you not make it some form of condition that, if they want to get a contract in the next round, their record in this round will be looked at?

Tony Crawley: Under the procurement laws, you do need to look forward. As you have mentioned previously, we are not in a strong enough position to dictate to the market because we need to get whatever we can from the market in terms of capacity. In this current contracting round, working with the FRC, Neil's colleagues, we looked at the question around capacity. We asked the firms to give a very clear indication of their maximum capacity, taking into account what they expected to deliver.

As was mentioned earlier, what happened last time was that the level of work they expected to do when they bid in 2017 exploded during this contract round. This time we asked them—hopefully there will not be at a similar expansion during the next contract round—to be very clear about realistically bidding for a volume of work that they know they can deliver. You saw some of the suppliers reduce their capacity bid in that context.

Q75 **Sir Geoffrey Clifton-Brown:** My council and no doubt every local authority in the country will be very interested to know what your view on fees is. Will fees increase beyond the anticipated 150%?

Tony Crawley: We commission a rate, so the level of fees will depend on the volume of work needed. If new standards are brought in, typically new standards increase work. The next one is ISA 315, which will increase the amount of work they need to do around risk. The auditors have to deliver what is required by the financial reporting framework. They have to deliver what is required under the code.

If there are reductions in the amount of work, that will mean the fee is lower than it is now. If the amount of work increases, the fees will go up by more than that. It is dependent on that. There has effectively been a correction in the rate at which they are paid. The actual fees will be determined by the volume of work they need to do.

Q76 **Olivia Blake:** To follow up on that thread, is auditors' inability to be timely in this space a consequence of market failure?

Tony Crawley: We have seen a shift. There used to be equal weighting in the way the auditors approached audits in terms of quality and timeliness. There was a balance. The post-Carillion, post-Kingman focus of regulation has been very strongly on audit quality. The auditors have been very publicly saying, "We will sign when we are ready. We will not compromise on quality". If you are a provider, you listen very carefully to your regulator and you respond to that.



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In the absence of a statutory deadline to provide the opinion, the auditors are then saying, "Well, we need to make sure we are delivering what is needed". It is a consequence of a number of the factors that have been talked about this morning. The focus has moved from a balance between quality and timeliness to being focused very strongly on audit quality.

That is due to the Government's drive for much better audit quality. Local audit has been caught up in the extra circumstances of not having a deadline and the specialist skills needed to deliver local audits. It is a combination of factors, as has been mentioned a number of times this morning.

Q77 Olivia Blake: Could procurement, in and of itself, help alleviate some of that tension?

Tony Crawley: Although it has been mentioned, the fee increases for local authorities have come at an unfortunate time. The reality is that this should make it a more attractive market. We know there are firms looking at the local audit market. Part of the benefit of getting the backlog sorted would be that firms would look on coming in more favourably. It is an interesting market. It is a different way of doing things; it has extra responsibilities; it is in public. Nevertheless there are firms looking at it.

At the moment, the reality in the wider audit market is that audit firms generally have what we call channel choice. I mentioned it last time I was here, virtually. They are able to decide which markets they want to go into. They have a limited amount of capacity. Because the larger firms are reducing their presence in certain other markets, which those firms are already in, it is easier for them to expand in markets they are already in. It becomes quite complicated. Nevertheless, there are firms interested in coming in, if it can get sorted.

Q78 Olivia Blake: Moving to competitiveness, given what you have just outlined, do you feel there are enough partners in the audit market at the moment? What would an ideal number of audit partners be?

Chair: Senior experienced auditors, yes.

Tony Crawley: Key audit partner is a qualification that is needed to do either health or local government, with the exception of foundation trusts, which are slightly different. The number is below 100 at the moment. Some of those names are people who will never do an audit again. The number is worryingly low.

The local audit qualification is a really important step forward. It sends the message that you can come into this from a private sector background with the appropriate training and work through it. You would not take on a massive audit straightaway. You would get to know the sector and build on that.



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The number of key audit partners and their age profile, on which the Committee has commented before, is a concern. It is about building that back up. Neil has mentioned the workforce strategy. We have emphasised to the local audit liaison committee that we think the workforce strategy is an absolutely crucial development. It is about looking at that pipeline. How do we encourage people to come into the market?

Q79 Olivia Blake: Is this an opportunity? Looking across Government at other areas where there are skills shortages, they are poaching retirees and trying to encourage people back into work to help. Would that be a worthwhile experience? I recognise that in audit there is perhaps a bit of difficulty with that.

Tony Crawley: One thing to bear in mind is that audit has moved very significantly in the last few years in terms of the depth of challenge. We look at every firm's files every year, and we can see the expansion in the amount of work they need to do and the technicalities of it. We would need to make sure that anyone who gets accreditation has full up-to-date knowledge of what is needed to be a key audit partner and to be able to sign off public money.

Every avenue should be explored, but that would be the overriding issue for me, making sure we do not fill up numbers for the sake of it. It has to be the right people with the right up-to-date knowledge.

Q80 Olivia Blake: With new companies and auditors coming into the sector to pick up some of this work, what is your feeling about how to manage the risk of staff from other auditors moving across to them? They might, for example, have higher pay offers and things like that, which you sometimes see with emerging players.

Tony Crawley: It is a fact that people move across firms all the time in all sorts of areas. It is inevitable that some will move across. They will see new opportunities; they will see promotions that are not available in their current firm.

There is a dynamic audit market. As auditors with local audit knowledge are in short supply, some no doubt will take advantage of that and either talk to the current employers about getting more pay or move firm in order to find new opportunities. That is an inevitable consequence of the market. It has always happened and it always will.

Q81 Olivia Blake: Mr Crawley and Mr Harris, is there anything either of you could be doing to help manage that risk and to avoid audits not being completed because people are leaving the firms?

Tony Crawley: It is an indicative position—there was some coverage of the BCP case—that one person moving could cause a delay. It shows you how scarce a resource an experienced person is. That is the issue that needs to be sorted. There will always be movement between firms, but it is about building that resilience.



I would go back to my point about the volume of work. If you have the same amount of people but less work, you create headroom. I cannot emphasise enough how important it is to look at the size of the work that is done in each individual audit, even relatively straightforward audits. That is another issue that would help the workforce strategy. Ultimately, the workforce strategy has to be designed to deliver what is needed. If what is needed is less, the workforce strategy is under less stress.

Neil Harris: To add to Mr Crawley's answer from an FRC perspective, we have an important role in our supervision division. We have supervisory responsibilities over all the key audit suppliers. If we see a persistent concern around resourcing and resilience, we have an ability within our supervision role to pursue that with senior leaders within the firm. We have that ability to do it across all the sectors that are audited and within the scope of our role.

Can I just make one observation on the exchange you have had with Mr Crawley? I completely understand the point on workload. The only other thing I would mention from my engagement to date would be around risk. A small number of local authorities are perhaps taking a disproportionate amount of audit resource time, due to the significant level of complexity associated with their arrangements, the quality of their financial statements or concerns about their capacity, systems and capability to produce good-quality accounts. That can have a disproportionate impact on the level of resource required in addition to the workload points Mr Crawley has mentioned.

My view on this audit market failure is that it is important to level up across the whole system. We need higher standards and higher expectations of local authorities and auditors. That would be a way through this.

Q82 **Olivia Blake:** I just want to touch on workforce. I know we have covered quite a bit on that, but I just want to ask whether the new qualification will be attractive to people in the private sector part of auditing.

Neil Harris: Is that a question to me?

Chair: You have been in the sector. What made you want to jump?

Neil Harris: I think it would, but it needs to be put together, as Mr Crawley said, with a broader package of measures on workforce. I am really keen to understand routes into local audit. You have to start when the individuals are at university or college. How do you get individuals there to capture that social purpose?

What better time to be doing public sector audit? It needs championing, but that needs to be done at the very early stages and moving through. The qualification itself is one aspect of it, but prestige and championing the importance of the work that is done on local audit is extremely important.



Chair: It was not that long ago—well, it was quite a long time ago—that we had local auditors who were famous for the work they had done in calling out very bad practice in some local authorities. We do not have the same or equivalent visibility now.

Q83 **Olivia Blake:** I just want to pick up on the filler service that was mentioned earlier. Are you confident that will help bolster—

Catherine Frances: Apologies if I was unclear. It is the same thing. I was alluding to a qualification being in place to allow people to switch over while the market adjusts and, in exactly the way Neil Harris was talking about, brings people through. It is one and the same thing.

That is also building on work the FRC did last year to change the key audit practitioner guidance, which was already in place by the FRC to enable people to switch over. First of all, the FRC did that to facilitate that movement. Then we are proposing the local audit qualification. The third string to that bow is the piece Neil is talking about, the sector itself generating further recruits and developing their skills.

Olivia Blake: That is useful. I had not heard that phrase. I just wanted to clarify that.

Chair: It will take quite a long time, though. First, what will make someone jump to do that qualification? It will also take a very long time, as Mr Harris has hinted at, to get people coming through to be senior auditors. Realistically, Mr Harris, we are looking at a decade or so to get the right qualified people in the right place, are we not?

Neil Harris: It will take time. Yes, it is a long-term plan.

Chair: The price of failure is very high.

Neil Harris: As part of that, we also need to look at what the options are in the short term.

Olivia Blake: I will move on to ARGA.

Chair: Can we spell it out, please?

Olivia Blake: Now you are testing me.

Chair: No, okay.

Q84 **Olivia Blake:** When will ARGA be established, Neil?

Sarah Healey: That question is probably more for us. Mr Harris has made clear his eagerness to see that take place. Obviously, it requires legislation to change the Financial Reporting Council into ARGA. Clearly, we are keen, as ever, to see that happen, but it is very much dependent on legislative time being available for that legislation. We continue discussions, as is normal in Government, to secure that legislative time.



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It is not our legislation. It is legislation from the new Department for Business and Trade that will establish ARGA.

Chair: It is in a new Department. That sends a chill down my spine.

Q85 **Olivia Blake:** Will that impact timeframes?

Sarah Healey: The establishment of the new Department will not impact timeframes at all. The section of the previous Department for Business, Energy and Industrial Strategy, which was a very large Department, moved over to combine with international trade. There is no reason to suspect the people working on that or the priority given to it in the new Department will change at all.

Chair: You sound very confident.

Sarah Healey: The change in the machinery of Government is not the thing that will have an impact here. The challenge is legislative time, and that is common across Government.

Chair: It is outside your hands.

Sarah Healey: Indeed.

Q86 **Olivia Blake:** Back to Mr Harris, given the departure of the FRC's chief executive, is there a risk that there will be more delays from your side?

Neil Harris: There is no risk whatsoever. We have already put in place very good transition arrangements where Sarah Rapson, who is the executive director of supervision, is acting as the deputy chief executive. Sarah has been heavily involved in the work associated with local audit and the shadow system leadership. We expect that Sarah will be chairing the liaison committee of senior stakeholders as and when we take on our shadow system leader responsibilities.

We have a number of workstreams within the FRC to be ready and match fit for ARGAs. That work continues. In fact, we are in a really good position, hence why, as Ms Healey says, we are pressing for ARGAs as soon as possible. We think we are ready, and we want that statutory underpinning.

Sir Jon Thompson has done a terrific job at the FRC around transformation and will be sorely missed, but we are very much prepared to continue on our journey to ARGAs with the future arrangements we have put in place and a new chief executive.

Q87 **Olivia Blake:** There is lots of confidence around ARGAs. How will we know it is working, if it is working, once it has been established?

Chair: What does success look like, Mr Harris?

Neil Harris: There are some success measures we can put in place before ARGAs, working with the Department, as to what we want to see



from a successful system. Increasing the capacity of key audit partners and reducing the backlog of audit would be key measures.

For me, one of the important things is whether the system as a whole knows what is going on in terms of risk. If the system, pre and post ARGA, knows about the risks associated with financial reporting, financial sustainability and governance at an earlier stage, it is to the benefit of the whole system, allowing for earlier intervention to arrest problems before they get any worse. That is not a criticism of any part of the system, but a well-functioning system needs to get to that point. I see that as a critical success measure.

Catherine Frances: The critical change within local government audit regulation, which legislation would enable ARGA to take on, is removing the setting of the code of practice from the NAO. That is the only specific power that is of relevance, notwithstanding the wider issue about ARGA's formation, on which Neil Harris is entirely clear.

I just wanted to make that clear because the NAO has committed to lay the code of practice for the next period, covering all of the procurement period, so auditors have confidence and so the system is working very well. In practical terms, although the legislation is very important, we are getting on with it. We are just working to join it all up.

Q88 Sir Geoffrey Clifton-Brown: Mr Harris, given the delays in setting up ARGA, which we have just been discussing, would it have been better to have set up a separate new system leader for local government audit, as Redmond originally recommended?

Neil Harris: I am not going to comment on the particular proposal Sir Tony Redmond made at the time. It has been addressed since that the FRC is seen as the appropriate system leader ahead of ARGA, and we are delighted to take on that role now through the memorandum of understanding. We will deal with the same systemic challenges Tony Redmond raised in his report.

Sarah Healey: It is worth me saying, as well, that new bodies need legislation. The thing that is holding up the creation of ARGA is legislative time.

Q89 Sir Geoffrey Clifton-Brown: I get that. Do you have any information for us as to when that slot might be available?

Sarah Healey: As the Chair made clear, it is not up to me. The timetable for legislation is not within my purview, sadly. That is a balance of decisions across Government. I am just saying that setting up a different new organisation would not necessarily have been faster.

Q90 Sir Geoffrey Clifton-Brown: No, I understand that. Thank you, Ms Healey. Can I stick with you? What prevents the simplification of audit requirements and how can it be overcome? You have already mentioned the derogation you have on valuing assets. Is there any further



simplification you could do?

Sarah Healey: There is a whole range of players in the audit sector that establish standards. We have talked about almost all of them today. There were other simplifications that we have not mentioned yet. For instance, CIPFA is not requiring IFRS 16 to be implemented in order to enable some of the backlog and timeliness issues in local audit to be tackled before we add extra requirements.

You will be aware that Tony Redmond recommended a simplified statement to be put on top of local audits. It has been decided not to press forward with that right now, even though it is itself intended to enable understanding of what is being said in a local audit. At the moment, it is simply an extra thing local auditors would have to do. That is why we are holding that back for a time when the timeliness and backlog issues in the system have been dealt with.

As Mr Harris said, the aim is to have timely and high-quality accounts. He agreed that we would not want to see quality drop simply in order to drive timeliness. The broader question is always about keeping under review whether there is anything we can do to make local audits more useful to those who depend on them for information, transparency and accountability. That is something we are always open to considering.

Q91 Sir Geoffrey Clifton-Brown: I saw you nodding your head, Mr Harris. I am going to come back to you and give you a chance to talk about this. You will be aware that this Committee has commented on the impenetrability. Unless you are a local government auditor—say you are an ordinary councillor—it is almost impossible to understand these accounts.

Is not there a danger of the perfect getting in the way of the good? You tighten and tighten the audit standards to try to deal with the systemic risk, but then you make the whole system not work any better. The two things are in contrast here. Clearly, we want the best possible standards, but, if it does not make the whole system better, we are not achieving anything.

Neil Harris: The first thing to say is that the FSC is not responsible for setting the financial reporting framework. However, I do recognise the point. There has been a consensus across the system, since I have started in my post, about resetting the purpose of local audit and financial reporting. That is why I made the point about having a roadmap to sustainable long-term reforms.

There is work to do through the liaison committee to commission lots of people, particularly professional institutes, to set out what simplification and a set of accounts that is valuable to the users of the accounts would look like. That is work that would take a long time to implement. In the short term, as Mr Crawley mentioned, we have to work within the existing framework to see where there are opportunities to be more



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proportionate about risk and where the focus is put in terms of financial statement disclosures and then audit.

Sir Geoffrey Clifton-Brown: Ms Healey was alluding, I think, to this new IFRS 16.

Sarah Healey: It is IFRS 16 on the treatment of leases.

Q92 **Sir Geoffrey Clifton-Brown:** This is the one that deals with valuing leases. At a time when the whole system is in arrears anyway, why on earth would we want to be putting a whole new layer of complexity into local government audit?

Sarah Healey: That is why CIPFA has said we are going to hold off on the implementation of that for local audit.

Q93 **Sir Geoffrey Clifton-Brown:** Is the proposal still in train or has it been delayed indefinitely?

Catherine Frances: CIPFA has proposed to delay its introduction. CIPFA is responsible for the accounting framework locally, but is bound by the financial regulation accounting standards at national level alongside all the international standards.

Absolutely in line with your point, Sir Geoffrey, given that we are so mindful of timeliness, we and CIPFA have talked about the right sequence for the various new pieces of work coming in. CIPFA took the decision to delay IFRS implementation in this area in order to allow additional capacity to come into the system. We thought that was very sensible. Similarly, it has delayed the stuff about having an overarching statement on top of the accounts for exactly the same reason.

There are so many parties here because this is about financial standards. DLUHC does not govern financial standards.

Chair: Yes, we understand that.

Q94 **Sir Geoffrey Clifton-Brown:** On that same subject, that question was dealing with future standards, but what about present standards? I understand you and Ms Healey were talking about the derogation of valuing assets, but some people think the existing system of valuing assets does not make any sense. If you have a school or a road, the value is largely going to be the same as it was the year before, plus possible additions. Why do you have to revalue it each year?

Catherine Frances: It is important that assets are valued correctly. That is important to say. It is for precisely the reason you talk about that local councils have said, "I have a road. I have a coastal defence. I have something like that. It is not of immediate pertinent use to me to revalue that item. Given the enormous delay in my audit, that is not where the focus should be".



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It was precisely to lift that requirement off the auditor and the council that we laid our statutory override in December, so as to allow people not to do that. Before we laid that statutory override, other professional bodies also looked at that. CIPFA looked at that, as did FRAB, the technical body that looks at financial accounting. For various reasons, they were unable to reach a solution that was entirely valid from their perspectives, and so we took the decision to legislate in order to lift that burden off people.

I totally recognise the description you are talking about. In the long term, in the future, we need to find a solution.

Sir Geoffrey Clifton-Brown: I entirely accept that. That is a really helpful answer. Is this override going to be linked to getting these accounts up to a timely level? Will it exist so long as there is a significant backlog in the system?

Catherine Frances: We have said it is temporary for the time being. We do not have any long-term plans about it, but, clearly, it is part of the toolbox for us to work out, first, how we get the backlog cleared—that is the critical part of that—and, secondly, as we have all talked about, longer term, how we get the whole system shaped right and measuring the right things. That is not only for us in DLUHC. We have to make a lot of partners comfortable with this.

Chair: Thank you very much. It has been an interesting session. We have not really gone into what local councillors need in terms of their toolkit to do this.

Sir Geoffrey Clifton-Brown: Could I just come back on Ms Healey's answer?

Chair: Yes, but just let me finish my sentence. The Redmond review also proposes a discussion at council of annual accounts, which, as a Committee, we would agree would be a welcome step.

Q95 **Sir Geoffrey Clifton-Brown:** On your answer, Ms Healey, about deciding not to proceed with the simplified statement, presumably there were two reasons for that. First, the statement itself would need to be audited; secondly, it would impose additional work.

Sarah Healey: Yes. Right now, let us not change things that we do not absolutely need to change. Let us get the timeliness of current accounts and the backlogs dealt with before we start making changes that will inevitably cause burdens and questions for local auditors, however helpful we think those things might be to the system in future.

Q96 **Sir Geoffrey Clifton-Brown:** It is not ruled out forever.

Sarah Healey: No, absolutely not.

Sir Geoffrey Clifton-Brown: It is just until you get the backlog sorted



out.

Q97 **Chair:** Thank you very much indeed. I just wanted to touch on one other point. I will start with you, Ms Healey. We understand that there have been delays in the audit of some local government pension arrangements, which is having an impact on a number of Government Departments. Therefore, there is an impact on the National Audit Office and its work. There has been some concern in Whitehall that this Committee, among others, would take a dim view if the accounts were delayed because of this. Do you want to say anything about that? Do you have any thoughts about that?

Sarah Healey: I addressed this earlier. This was an issue in my previous Department; it is an issue for other Departments. It has been discussed with the National Audit Office and in departmental audit committees. I am keen to do anything that I can do from a DLUHC perspective in order to assist with finding a resolution that is proportionate and reasonable, and manages the risk of not having those valuations in full when signing off other Departments' accounts.

Q98 **Chair:** You use the words "proportionate" and "reasonable". This Committee's view is very much that, if it was proportional and reasonable, and done in conjunction with the National Audit Office, we would not be critical of a Department that, in order to finalise its departmental accounts, made an arrangement to have a derogation or qualification relating to the pension element, as long as it was exceptional and did not become a routine matter.

I do not know whether the Comptroller and Auditor General wanted to add anything here.

Gareth Davies: That is very helpful. If the only outstanding issue, as it has been in some arm's length bodies of the Departments you have mentioned, is assurance from the local government pension scheme, we can give a clean opinion except for a limitation of scope on that one issue. It would be very clear from the audit reporting that that was the issue it related to. That is the key to avoiding unnecessary delays to quite a string of arm's length bodies and two big Departments. It is in active discussion.

As you say, that is not to say we would want to see this becoming a permanent feature of those opinions. Otherwise, we are just sitting there, waiting for audits to be completed at a local level and putting an unnecessary delay on national accountability.

Sarah Healey: Indeed, and that seems like an unsatisfactory situation. I am very happy to discuss with colleagues how we address that.

Q99 **Chair:** Hopefully by saying it here the Committee's position is clear. We would not be hauling you across the coals for coming in with a qualification on that basis as long as it was agreed reasonably and we did not see it becoming a regular thing. It is not a free-for-all, but this



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Committee is reasonable in its approach.

Sarah Healey: That is very helpful.

Chair: We understand that there are sometimes practical issues. We would not cause any challenges for a Permanent Secretary or an accounting officer, if this was agreed in advance with the National Audit Office.

Sarah Healey: My successor at DCMS will be very grateful for that.

Chair: It is not just there.

Sarah Healey: It is also the Ministry of Justice; there is a whole range.

Q100 **Chair:** For those who are watching and wondering what we are talking about, a lot of people were taken into arm's length bodies and put into the local government pension scheme. We are often talking about very tiny elements that do not have a material impact on the accounts and the audit of a Government Department, but nevertheless prevent a full picture. We can progress on that basis and, if necessary, we can have an exchange of letters.

Sarah Healey: Of course, thank you.

Chair: That will presumably be with you, Ms Healey, but let us know. We will work it out.

Sarah Healey: We will work out exactly who should be written to, to give them the assurance they need.

Chair: Yes, and we will keep the Treasury Officer of Accounts, as ever, in the loop.

Thank you very much indeed for your time, everyone. The transcript of this session will be available on the website uncorrected in the next couple of days. Given the timetable, we will not be producing a report until some point after the Easter recess. Thank you very much.