

Levelling Up, Housing and Communities Committee

Oral evidence: Financial Reporting and Audit in Local Authorities, HC 1196

Monday 15 May 2023

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[Watch the meeting](#)

Members present: Mr Clive Betts (Chair); Bob Blackman; Ian Byrne; Mrs Natalie Elphicke; Ben Everitt; Kate Hollern; Andrew Lewer; Mary Robinson.

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Witnesses

[I](#): Sir Tony Redmond, Author of the Redmond Review; Neil Harris, Director of Local Audit, Financial Reporting Council; and Sarah Rapson, Deputy CEO, Executive Director of Supervision, and future Chair of the Liaison Committee, Financial Reporting Council.

[II](#): Ed Hammond, Interim Chief Executive, Centre for Governance and Scrutiny; Dr Henry Midgley, Assistant Professor in Accounting, Durham University; and Professor David Heald, Emeritus Professor, University of Glasgow.

Examination of witnesses

Witnesses: Sir Tony Redmond, Neil Harris and Sarah Rapson.

Q1 **Chair:** Welcome, everyone, to this afternoon's session of the Levelling Up, Housing and Communities Select Committee. This afternoon we have our first evidence session in an inquiry into financial reporting and audit in local authorities. It is a subject that sometimes appears a bit dry, sometimes is very complicated, but is extremely important for the people we represent and the services they receive at local level. We have before us this afternoon two panels to give evidence to us. I will come over to the first panel in just a minute, but first of all I ask members to put on record any interests they may have that may be directly relevant to this inquiry. I am a vice-president of the Local Government Association.

Kate Hollern: I employ a councillor in my office.

Bob Blackman: I am a vice-president of the LGA and I also employ



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councillors in my office.

Ben Everitt: I am a vice-president of the LGA. I employ a councillor and I should direct the Committee to my entry in the Register of Members' Interests.

Chair: Can we go to our panel this afternoon? Thank you all very much for joining us. I will go down the table with Sir Tony first and ask you to say who you are and the organisation you are representing this afternoon, or why you think you have been invited along in terms of your particular expertise.

Sir Tony Redmond: Good afternoon, everyone. I was the author of the Redmond review into local audit, which you are discussing today. My background is that I was Chief Executive of a local authority and Chief Financial Officer of two local authorities. I was also subsequently the Chairman of the Commission for Local Administration in England and the local government ombudsman. Since that time, I have worked on a number of local authority assignments and I am currently the Chair of the Improvement and Assurance Board, Nottingham City Council.

Sarah Rapson: I am the Deputy Chief Executive and Executive Director for Supervision at the Financial Reporting Council. I am also the incoming Chair of the Liaison Committee, which is the body that convenes all the different parties in the local audit ecosystem, which is important for us as we take on our role as the incoming shadow system leader for local audit.

Neil Harris: Good afternoon. I am the Director of Local Audit for the Financial Reporting Council. I am responsible for building a dedicated local audit unit within the FRC ahead of ARGA to perform our roles and responsibilities in the memorandum of understanding that has been agreed with DLUHC, associated with our role as shadow system leader for local audit. My background is that, prior to the FRC, I was a key audit partner for EY for 10 years, responsible for a multiplicity of external audits of local government bodies, police and fire bodies, and NHS bodies. Prior to that, I had experience through graduate trainee up to district auditor in the Audit Commission.

Q2 **Chair:** Thank you all for coming this afternoon. I said this is a complicated subject. Can we begin with a nice easy question, then? What is the purpose of local authority accounts and what role should they have in supporting local accountability and democracy?

Sir Tony Redmond: There is a technical answer to that, but I am going to start with one that I think best represents the way in which people view local authority accounts. First of all, I think that they are there to ensure a proper and accurate historical record of spend and income over a period of 12 months to conform to statutory responsibilities and, I think most importantly, to hold the local authority to account for the way the money is being disbursed, and then—this is something close to my heart—to try to communicate with council taxpayers and service users



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exactly how the local authority has discharged its responsibility by spending money on local authority services.

Sarah Rapson: I would make three points. First, the accounts themselves are a vital part of local democracy, enabling users of accounts, taxpayers and local elected representatives to be able to hold public bodies to account for performance as it relates to financial, risk, VFM and decision-making. Secondly, and importantly, is being transparent on the financial resilience and sustainability of a public body. Thirdly, for audit it is important that the accounts meet the standards that they are supposed to and the audit is the assurance that gives us confidence or otherwise that that happens. It also has a role in identifying any early warning signals that there might be problems at particular public bodies so that mitigation actions can be put into place.

Chair: We will come on to audit in some of the questions a bit later. It is just the purpose of the accounts at this stage and what they are there for.

Neil Harris: The only item I will add is that I think that, since I started in my role, there has been an acceptance that the local authority financial statements and accounts have been described—certainly to me and a number of others—as being impenetrable, and they are becoming increasingly complex and harder for taxpayers and other stakeholders to understand the financial position of a local authority. For that reason, we very much welcome the timing of this inquiry. I think that this will very much support the work that we are doing, as a shadow system leader, to set out our priorities on the local audit system and having sustainable reforms.

Q3 **Chair:** All the questions have been answered in all the responses in terms of looking backwards: this is an indication of how the local authority spent its money, so you can question it and hold it to account. What about the other side of it, how far the accounts are there to help decision-makers going forward as to what budgets are available and what finances are available to do the things that councils might want to do?

Sir Tony Redmond: It touches on what Neil was saying about financial sustainability and, indeed, what was said before. For me, the biggest problem is that the accounts are perceived to be—and rightly so—an audit of historical accounts. They are 12 months, which is the ultimate responsibility of the auditor to verify. That is fine, and alongside that there is a duty about going concern, to make sure that there is an acknowledgement that the auditor is looking not only at the actual spend and income within that year but is also looking beyond to see what that tells the auditor about the financial resilience of the council and how it is going to be in a position to manage its affairs subsequently.

That is one of the areas that worries me because, although I recognise that there is a responsibility there—and I recognise that some attention is given to that—I think that sometimes there is an opportunity to look



more critically at the underlying situation facing a local authority, in terms of finances, to test whether or not there is a resilience issue and to highlight that as quickly as is possible.

If one looks at local authorities generally at the moment, a number of local authorities struggle and they end up in difficulty, or most “failing authorities”. This does not happen overnight. This happens over a period of time. Therefore, the quality of the management of those accounts and the auditing of those accounts could be looked at in a forward look rather than simply an historical look.

Q4 Chair: Isn't there just a basic piece of information? Sarah and Neil can answer this. If you are a councillor—and it is a long time since I was a councillor—each year you come to a budget-setting process, and one of the first things you want to know is how much money is in the bank, how much money is in the coffers, what form those reserves take for the council and how spending in the past allows you to think about spending going forward. Do the accounts do that at present?

Neil Harris: I will answer this question, Chair. There is a lot of information already within the financial statements that would answer those particular questions. The difficulty is that they are hidden within financial statements that, in some places, are close to being over 200 pages long. If you were to unpick certain parts of the accounts, you would see that there is something called a movement in reserve statement. As Tony has already set out, there is much more information provided on going concern disclosures, narrative statements on the future financial position of a local authority, levels of borrowing, and exposure to commercial investments, for example, that you can pull out of financial statements.

The problem is that they are too complicated to unravel and I think there is a case to ask what the key bits of information are that are important for the users of the accounts and those who are making the decisions, and whether they can be summarised in such a way that those making the decisions—in terms of providing funding to local authorities, decision-makers within councils themselves, and particularly taxpayers and others—have the information at their fingertips to be able to understand how an authority is performing and its future challenges.

Chair: I think that Ben Everitt is going to follow all that up in more detail. Do you have anything further to add, Sarah, at this point?

Sarah Rapson: I am sure we will get on to it. When you have more than 500 accounts that are not laid, it is not decision useful at all, is it? It would be important to have a conversation about what we need to do about the timeliness of more than 500 local authority accounts not laid at the end of last month.

Chair: We can follow that up in due course.



Q5 Ben Everitt: Sir Tony, thank you for your first couple of answers there. They were incredibly clear both on the purpose of local authority accounts in and of the annual statement of what is in the bank and what the authority is up to but, also, in terms of how it can or should provide a bit more of a view. How are we in the situation that we are clearly not getting that, and that accounts from local authorities are falling short of giving that fairly basic level of accountancy transparency?

Sir Tony Redmond: I would start by saying that the accounts are correctly representing the activity of that particular financial year. Some of the difficulties that local authorities encounter is that there are underlying weaknesses and shortcomings in the way the authority is investing, how it is spending its money, and how it is financing particular projects, including commercial ventures. The question then arises: if none of those appears directly in that year of account, how will the auditor identify, spot and action anything that should flow from it?

We can talk about the capacity of the audit. It is already very difficult. There are so many years of accounts outstanding, not closed, not audited, and, therefore, there is a capacity problem in how the auditor focuses on that that is essential to complete the task of the year account. What that means in practice is that there is not perhaps enough attention given to the financial suitability and sustainability of the council as things that happen in that year will impact subsequent years. As we all know, the last thing one wants to do is to see this situation deteriorate. It is better to action it as soon as is possible.

I do not think that the current structure, given the resourcing of the audit function—even though it has been significantly improved with the recent PSAA contracts and there is more resource given to it, there is still such a series of accounts remaining unaudited, a huge number. That must be the challenge for auditors on the ground. What you are saying is, “Why cannot we deal with the wider question?” I think that the wider question cannot be addressed because of the capacity problem. It is a fundamental weakness at the moment, which is causing concern. We have local authorities that are subject to intervention, commissioners being appointed. When one looks behind those, one might take a view that there could have been an earlier attention given to the shortcomings and weaknesses in the way that authority has been operating.

Q6 Ben Everitt: Is this capacity in local authorities themselves or is it wider in the sector as well? Essentially, what we are doing is we are asking local authorities to produce or procure a set of accounts that, by and large, is not telling them what they need to know. You don’t know what you don’t know, and the system we have at the moment is not flagging up the things that would give those early indications of financial unsustainability, exposure to commercial risk and all the rest of it.

Sir Tony Redmond: I think the fair way of looking at this is that the auditors are giving attention to that that they must do first, and they



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must audit the year of account. That is absolutely fair and reasonable. That is fundamental to what they seek to achieve.

They have other responsibilities, as we said before, such as the going concern question. There is just not enough capacity to explore that in the depth it should be. While the last thing I want to do is revert back to pre-Audit Commission days in terms of what might now happen, I think that there is an important question that was raised in my review by so many chief financial officers, and indeed auditors, that there is not a dialogue and engagement continually between the two parties to talk about things that may be going wrong or could go wrong. That dialogue is so important. Before you get to the formality of issuing public interest reports, there is an opportunity here to identify the problem and stop it at source rather than allow it to get worse.

I think that is the underlying problem. The informality that used to exist between the two parties, which I hope now will return—there is no reason why it should not—that engagement will head off some of the major problems that local authorities are facing.

Q7 Ben Everitt: Given that, as we have heard, some of the accounts are so massive that they are almost impenetrable, do you think that there is a need to focus on those key things that would drive out the issues that are of most concern around financial viability and risk? If that is the case, then is there a need for some simplification, within the current resource constraints, in the way that we look at accounts and produce accounts?

Sir Tony Redmond: My review concluded that it is essential that the impenetrability that Neil referred to be addressed, and I am suggesting a standardised statement of service information and cost. Every local authority has to produce a minimum of financial information that is readable, understandable and comprehensible to the wider public. Everybody will be able to understand what is going on. That is the first thing.

The second thing is that in terms of accountability for what a local authority has done, I think more can be done to explain that in a simple fashion rather than rely on the accounts and say, “We produced the accounts. You read them and tell us what you think”. There is a need to be much more transparent in the way the local authority conducts its affairs from a financial perspective.

Ben Everitt: I am assuming that you have concerns in relation to the delay on the implementation of summarised accounts.

Sir Tony Redmond: Yes. I think that is fundamentally weak if one has a situation like that. It is not acceptable.

Q8 Ben Everitt: I will throw it open to Sarah and/or Neil. The FRC is about to catch this ball. What concerns do you have?



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Sarah Rapson: To start with, you are right, we are about to catch the ball. We are currently the incoming shadow system leader. We are waiting for our remit letter from the Department, which will set out our role in a bit more detail. Of course, to become the full system leader, we are waiting for legislation so that the FRC can become ARGA. It is really important.

Frankly, as the incoming system leader, our top priority is to get the right people in the room to tackle the backlog issue, the timeliness issue. As Sir Tony said, you cannot see the wood for the trees at the minute. You do not know what problems there are because so much of it is late.

I would agree with Sir Tony that there are problems around capacity and there is a problem around complexity. On capacity, it is both the audit firms themselves and the financial teams in the local authorities. There are capacity constraints there. There is not enough of a pipeline coming through in the profession, frankly, and it is hitting both sides. I think that we would all probably agree that the complexity of what needs to be produced is impenetrable to the user, who wants to be able to make decisions and to hold the public bodies to account. On your phraseology around simplification, I think that proportionality also needs to be an objective for us to make sure that the system has as we become the system leader.

Neil Harris: The only thing I will add is that, when we look at the role of local audit in the memorandum of understanding, it does not just cover local authorities, police and fire bodies, it also includes the NHS sector. To get to a sustainable solution, you need to look at the interdependencies across all those sectors, not least that the audit suppliers work across those sectors as well in terms of their resource deployment.

Therefore, one of the challenges we are already seeing is whether we have a whole system view of what is happening within local audit, where the risks are and where we need to prioritise, notwithstanding that our immediate issue is addressing this backlog position that has been well set out by Sir Tony and Sarah. We do need to get sustainable reform, so having a comprehensive understanding of whole system risk is critical as well.

Sir Tony Redmond: Could I add something else? That is the role of the audit committee in terms of good governance and the way in which it operates and holds the council to account for what it is doing. It obviously works closely with the external auditor and internal auditors within the committee. There is a strong argument to look critically at the capability of that committee, whether they are properly trained and whether they have the skills, understanding and experience, particularly in the context of accounting, which is not straightforward by any means.

Even commercial accountants sometimes ask questions about how these local government accounts work. There is a lot to be done to improve the



capacity of the audit committee to do the work more effectively. I also think that there is a very strong argument to have at least one independent member on the audit committee, someone who has the background knowledge and expertise to support that committee in an effective way.

Q9 Ben Everitt: Finally, Sarah, the FRC has been pitching itself as an improvement regulator for years now. What would be the key thing to focus on working in partnership with local authorities?

Sarah Rapson: Timeliness is a top priority for us. The workforce strategy that was set out in the MOU is going to be very important. That is about building capacity, as we have talked about, one of the root causes of some of the issues there. We also have a role to support some of the smaller audit firms that are stepping into local audit for the first time. There are some of the larger audit firms that have been successful in the recent procurement, but there are also some smaller firms. There is some support and guidance that the FRC can provide, as we are doing with smaller firms in the audit market more generally, building on our expertise there to support the smaller firms coming in to do some more of this local audit.

Q10 Mary Robinson: Just quickly, Sir Tony, this issue of the lack of dialogue between auditors and councils I think is a very important one because then that is not going to flow through to the transparency that needs to be had. I wonder what the reasons are behind it. In all this we have to remember that there is a political dimension, and that may be the make-up of the finance committee, whether or not the right people are there on the right day, whether there is sufficient questioning. Is there another dimension to this rather than just that they are not communicating properly?

Sir Tony Redmond: I don't know whether it is another dimension, but I will try to explain what I believe to be the background and lead-up to what has happened.

When the new Act came in to change the nature of local audit, the abolition of the Audit Commission and so on, there was undoubtedly a shift in emphasis in the way in which auditors practise within local authorities. They took the responsibilities very seriously, but they took them in a very strict way limited to the audit of accounts, with less time given to the wider dialogue and conversation with the council, whether it be members or officers, so that they had a continuous understanding and appreciation of how the local authority was operating.

Equally, that was the opportunity for members and officers to give feedback to the auditors about how they think they are doing and comment upon individual matters that they think warrant attention. That has disappeared because we come back to the capacity problem. There wasn't a lot of time to do all these things. They are already running behind in trying to close the accounts for the year and audit them, so



there isn't the time and facility to do these other things, which are so important in terms of an effective dialogue and in apprising people of what was going on, on the day, at the time, and how they may impact the future.

It is not difficult to reinstate that, but it has to be consistent with the resources available within the council, at both officer and audit level, so that they can work together in an effective way. I am certain—I think that I can say this—that if that dialogue were to take place, the problems that have been encountered by some local authorities, in terms of underlying financial viability, could be headed off if those serious adult conversations could take place before anything went too far.

Q11 Mary Robinson: Is part of that perhaps down to the tendering process? Of course, these are private companies. The auditors are very different, aren't they? It is a competitive tendering field. Is part of it the tendering for exactly what is set out that they have to do and nothing else?

Sir Tony Redmond: It is part of it, but I think it is a cultural issue now. It is the way in which auditors perceive the role and they are perceiving in the context of the amount of time they have and the resources they have to do the job. One can well understand why they do not have the time to do these things that used to be part and parcel of the process in the past.

Chair: Moving on to the purpose of local authority audit, Natalie Elphicke.

Q12 Mrs Elphicke: We have touched on some of this material already, but there are a couple of aspects that I want to delve into on the purpose of auditing the local authority accounts. I am mindful that in those responses earlier there were a whole range of stakeholders. I guess the first question is: to whose purpose is it? Is it for central government? Is it for taxpayers? Is it for the councils themselves? Who do you think we are auditing for? Don't say all of them.

Sarah Rapson: I think this is the question of the day, really.

Mrs Elphicke: It is.

Sarah Rapson: As the incoming system leader, it has become clear to us that there is no common view as to the purpose of local audit, and we think that is the problem. Only when we have the answer to that question and are clear about it—and we might not get consensus but we have a definition and we know what we are corralling around—then we can start to make sure that the system is in service of that. At the minute, the complexity that we see is that you have lots of different participants in the system with slightly different and, at times, competing views. We welcome this Committee's inquiry because we think that this might help us to shape it, if we can get to consensus about the purpose of local audit, because we think it is missing at the minute.



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Neil Harris: I have nothing to add to that, but I want to pick up on comments that Sir Tony made about the culture.

I spent 10 years as a key audit partner in EY. I have seen it on the other side in terms of undertaking external audits and issuing audit opinions, and I was previously a district auditor. There has been an incremental shift in the professional standards that have been expected of external auditors. If you go back to the comment we made about the impenetrable nature of the accounts and the complexity, it has probably become more understandable that there are certain complex areas of the financial statements where further and more detailed audit work has to be undertaken to meet the high professional standards that you would expect.

The issue now is the challenge of resolving this in a sustainable way, back to what the purpose of it is and making sure that the framework fits that. We have seen some good examples, and I accept Sir Tony's point that we do not see this consistently across the system. We do see a couple of recent examples where external auditors have used their powers within the National Audit Office code of practice to raise early warning flags of councils that are getting into potential decisions that increase their risk. The framework exists for auditors to do this. I think that we just need to encourage that a lot more and make sure we are clear on priorities and purpose.

Q13 **Mrs Elphicke:** Can I delve a bit more into that? Sometimes there is potentially a danger in seeing some parts of the public sector as not relevant or similar to other parts of business and industry, but if we just pause for a moment on what you have described there, Neil, this is a normal business relationship, isn't it? You will know this from your previous experience. The role of the external auditor is to observe, to review, to assess, to make recommendations, to advise, and to strengthen. It ultimately adds value and accountability. Why do we not see the same processes and themes come across from the private sector into public sector accounting?

Neil Harris: Unfortunately, it does go back to this complexity and what is set out within the framework. There are a lot of accounting adjustments—or what are called statutory overrides—that are included in local authority financial statements, which reverse accounting impacts so that they do not have an impact on the overall financial position that is disclosed at the year end.

Mrs Elphicke: That is no different from complex derivatives trading. Public accounting can be complex but there are lots of other areas that are equally, if not more, complex, particularly in financial services.

Neil Harris: I agree.

Mrs Elphicke: That complexity is just within the operation of the organisation. It is not intrinsic. It is not just a feature of local



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government, is it?

Neil Harris: No, I agree. However, the example that I would draw out is the level of work that is undertaken on auditing the valuation of assets in particular. Local authorities hold a significant book of assets. Some are called specialised operational assets used in the delivery of public services. Those assets will never be sold. Local authorities also have investment properties and increasing commercial ventures. That is probably the bit I am referring to. Do you need that level of complexity and extent of work across all those assets, or can you be proportionate about the ones that are important to decisions that are taken by the local authority and important to the users of the accounts?

Q14 **Mrs Elphicke:** Wouldn't it be the decision of the particular external audit manager to assess what the key risk and key proportion was of those assets to its future? To the question—and I will come to you in a moment, Sir Tony, on this—in relation to the current and future performance, again this is not unusual looking at the shape and nature of accounting with regard to commercial, non-commercial, residential and combined assets.

Neil Harris: The external auditors have to undertake their work under the current financial reporting requirements. The current reporting requirements for specialised assets is that they are valued on depreciated replacement cost and contain a significant amount of estimation uncertainty, a degree of assumptions and reliance on external specialists, so they have the same complexity as any other asset. The auditors then have to work within that framework and say they can represent as much of a risk of material misstatement in the accounts as anything else. The auditors have to follow that framework.

The point is that if that framework was to be revised to say that there is a different way of valuing some categories of assets, it might then reduce the level of external audit work that is undertaken and the risk that external auditors assess.

Q15 **Mrs Elphicke:** We have seen some of that approach in other sectors; for example, the housing association sector and the different approaches in accounting there. Do you see this as a role of the FRC going forward to recommend areas where there might be a review of the type that you have described?

Neil Harris: Yes, we do have a clear role on that because we are convening a whole system. We have an ability to make policy recommendations either to DLUHC or other Government Departments but also to the professional institutes. Clearly, the timing of this Committee is extremely helpful because we are using the outcome of that to shape our priorities and the actions that we think should be taken across the system. Yes, it is very much going to be part of our role.



Sir Tony Redmond: One of the other challenges for local government is that if one looks at the balance sheet—and you talked about the private sector and the commercial sector—the balance sheet is not something that one can use to test the financial viability of a council. Yes, you can look at the reserves, the debt levels and so on, but an awful lot of what it contains does not represent a good test of the council's financial viability because it does not show it.

The other thing that I would add, in the context of your conversation a moment ago, is that the councils have to abide by the International Financial Reporting Standards. They have to comply with the Whole of Government Accounts arrangements. Therefore, all the late adjustments that Neil referred to in the accounts—which in a sense really distort the whole picture that you are trying to represent—make it more difficult and time consuming. There may be something that needs to be thought about in the wider context around Whole of Government Accounts and IFRS, the International Financial Reporting Standards.

Q16 **Mrs Elphicke:** I would completely endorse that as the next piece of work, if I may.

Following on this theme of what the purpose is of the auditing and who it is for, I am mindful that in your remarks there was a lot of very good comment about transparency, accountability, and the ability of the local taxpayer to get involved. When I look at the FRC MOU responsibilities, it is much more about setting the system up in place. It is all about that system, stronger governance, competition, capability, market supply, the entire framework of audit reports on the audit system. Do you think that we need to make sure that that element that you have described, which is so critical in your work of local accountability, is at the front of this new system?

Sir Tony Redmond: In answer to the question of what this is all about—from the point of view of why one audits and what one seeks to achieve by it—I come back to the basic point that the auditor is trying to ensure that they can give a fair and representative view of the financial position of the council by auditing the accounts, and that the outcome will then give some historical indication of how the council has done.

The problem then arises of what the council is trying to achieve internally. First of all, it wants to be assured that the accounts represent a fair view. Secondly, doesn't it want to hold itself accountable to its council taxpayers, its service users, the wider public, and the community? It is not going to do that by virtue of what is represented at the moment.

The financial stewardship of the council, which sits with the chief financial officer, is an important feature here, too. All these things come together in trying to represent to the public that we have looked after your money well. We have gone through the process of following the rules and regulations within the council and we have now had the accounts audited



and we have assurance that the money has been disbursed properly and the income has been received in a proper way as well.

That does not happen. Therefore, there are two things that I think come from that. First, as Neil has touched on, there needs to be a recognition that the purpose of audit is to give assurance. That is very important. However, the second thing is that it is about the way in which the council—and the democratic process comes into play here in accountability terms—can represent to its public how it has disbursed the money in a way that is consistent with the quality of the service that it is delivering to the public. Then we come into best value.

You quite quickly move away from a purely financial process, which you are trying to audit and verify here, into how you can look at quality and cost effectiveness of services. Deployment of the resources becomes critical then, and I think that is not disconnected from the purpose of audit. That assurance on best value is as important in some ways as how they have audited the accounts themselves.

Q17 Mrs Elphicke: As my final point on that, building on Mary's comments, would you agree that in making some of those decisions, where councils will have a different method, a different approach, a different risk appetite, those are political decisions for particular councils? How would you ensure that the audit function does not undermine that democracy for people to be making those decisions for the current and the future of their areas?

Sir Tony Redmond: I think what you have described is correct, but I would say that the council—and I am talking about the council, not just the officers, both members and officers—has a fiduciary responsibility to council taxpayers to act responsibly and properly in the discharge of expenditure and the discharge of the functions and services for which it is responsible. That is very important because if that is not fulfilled, then the fiduciary role is not fulfilled. I think that sometimes one sells it short. That is what I would say is critical, in answer to your question.

Mrs Elphicke: That is very helpful. Thank you.

Q18 Chair: I have one simple question. Why is so much money wasted valuing the roads that a council manages?

Neil Harris: In answer to my previous question, I think that this is just driven by the current reporting framework under IFRS and the fact that the valuations of roads are undertaken on the basis of depreciated replacement cost. There is a requirement then to account for those assets in a particular way. The information that needs to support that valuation needs to be robust and subject to audit. There have been enhancements in auditing and professional standards over the years, which require auditors to undertake and apply more scepticism over those valuations and to determine whether there is a risk that there could be a material error in the accounts.



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Chair: Sir Tony is anxious to get in at this point.

Neil Harris: I think that has led to all the extra cost.

Sir Tony Redmond: I think that one of the frustrations that local authorities experience is that infrastructure assets are treated the same as other assets in terms of valuation, auditing and lots of technical assessments that go with them. Of course, infrastructure assets are not going anywhere. Yes, they can be subsequently sold in some way and there could be a question of how one values those in circumstances like that. There is quite a lot of frustration within the local government community about the fact that the time spent to audit infrastructure assets is not worthwhile.

Neil Harris: I will just add that the Treasury is undertaking a thematic review into non-investment asset valuations. The direction that the Treasury is going in is certainly one that we welcome, particularly on specialised assets. I think that there is a conversation still to be had on infrastructure assets.

Q19 **Mary Robinson:** I have a few questions on the FRC's dual role over local and private sector audit. Sarah Rapson, what mechanisms are in place to ensure that the new local audit unit is sufficiently focused on the local government sector and independent from FRC's remit for the private sector?

Sarah Rapson: First, I would like to say that the FRC's overall purpose is to serve the public interest by promoting high standards of financial reporting, governance and audit. For us, this new role is an extension of the day job and there is a lot that we can bring to bear to help to improve the way the system operates.

You are right that there is a need for the FRC—perception as much as anything else—to demonstrate that we can operate with the two hats that we have. One is the system leader and one is the regulator, and we regulate local audit. We feel very strongly that we can do both. We can hold both objectives separately. In fact, we have set up governance internally to make sure that Neil and his team are separate, that he feels very comfortable in challenging the rest of the FRC in our traditional regulatory role around, for example, inspection and policy development, all the way up through the oversight that the board will have on our work.

You may be aware that we will shortly be recruiting a non-executive director who has experience in the local audit market to add some strength to the overall governance. We are conscious that people have questions about us being able to operate with these two roles.

Q20 **Mary Robinson:** What are the challenges that you see that you will have to face in managing that role?



Sarah Rapson: In the same way as you look at all the different contributors and participants who have a role to play in the system—we have talked a bit about capacity and we have talked a bit about complexity—it is entirely reasonable for Neil in his role as system leader to check and to test the rest of the FRC’s work in local audit regarding its proportionality.

If in a system where we have a requirement that auditors need to value roads and our inspection activity is assessing that they have done that properly, is that right? It is an entirely legitimate question for Neil to pose to the inspection teams to say, “Are you looking at the right things and grounding the risk that is real in local audit as distinct from corporate audit?” That would be one example.

Q21 **Mary Robinson:** Neil, how much bandwidth do you think you will have for doing this?

Neil Harris: A lot. Since I have been here—I have been at the FRC now for about eight months—I would say that to date I have had no difficulty at all in being able to set out my view on what the FRC’s role is corporately and in terms of its regulatory functions in its key role in local audit. You are probably aware that the FRC has four faces. I think that it is important across local audit that we show that we are not just a system partner and an assertive regulator, but that we can be an improvement regulator and facilitate change as well.

I think that we have to show all that in our work on local audit, and I have a role to say, “Are there parts of the FRC that could do a lot of that and be visible and transparent about that?” That example that Sarah referred to is a very important one at the moment, about where the focus of the inspection is and clarifying what our inspection focus is and how we go about inspections of local audits.

The only other thing I would add is that, clearly, there is a question about our depth and expertise. I have come from a local audit background and I am delighted that I have a deputy director of local audit who is a local government finance practitioner. I am building up a dedicated team. I am pleased to say that we went out successfully to recruit for three senior project manager roles last week, who will again bring expertise into the local audit sector. In addition to an independent non-exec, I have a senior advisory panel member as well. There is that degree of integration within the FRC but we are building a very solid and dedicated unit that understands the sector as well.

Q22 **Mary Robinson:** Sir Tony, with regard to these mechanisms and building the relationships, do you consider that they will address the concerns that you expressed in your review around the system leader’s need for detailed expertise and a clear focus on the local audit sector?

Sir Tony Redmond: I have little doubt about the first part, the expertise, and I am increasingly reassured by what is going on in FRC to



try to maintain a separation of this function from the rest of the organisation. As you know from my report, I advocated an entirely separate operation.

The principles that I would want to see protected are those principles of being entirely separate from the rest of the organisation and having the ability to manage the resources available without a level of interference from elsewhere that might undermine the audit in any way, as well as the underlying principles and values attached to an oversight of local audit that are specific to that particular territory and field. I am hearing from Neil and colleagues that that is the direction they are seeking to go. We will have to wait and see how it turns out.

Chair: Moving on now to the district audit models. You might think that was a golden age that occasionally gets referred back to. Ian Byrne?

Q23 **Ian Byrne:** Thanks, Chair. I want to touch on the golden age. We have had a couple of statements as written evidence and I want to read them out to you to see if you concur with them. Professor Heald, who we will listen to later, writes: "The abolition of District Audit—was a serious policy mistake resulting from ministerial antagonism to Audit Commission". The audit committee at Horsham Council writes: "The demise of District Audit has been a catalyst for a reduction in governance, a reduction in accountability, a reduction in standards, a reduction in timeliness and reduction in quality". Would you concur?

Neil Harris: Not entirely. We have already expressed concern about the increased complexity of local government financial reporting, where the focus has been over time and the need to reset that. I accept that there are two areas where the system needs to work better. As a shadow system leader, I think we will have a role to provide more annual reporting on the state of local audit—a function that I think was always recognised within the Audit Commission—to set out our view on what is happening within the system. Are there areas of good practice? What are the common themes of improvement? I think that is something that has been lost over the years and something that has been a groundswell of whether we can reintroduce that. We think that it is an important activity.

Q24 **Ian Byrne:** Are there lessons you think we should learn from what we lost in 2012?

Neil Harris: Yes. I think that is one, but the second one is on the role of the district audit. I have operated in the role of district auditor and a key audit partner in an audit firm. I agree with Sir Tony that the principles of the district auditor having an ongoing dialogue with the senior management of the council, police, fire body, throughout the course of the year to understand their business, to understand risks, and to be able to have conversations at key points, not to prejudice the outcome of their audit, but to be able to come in at the right point and say, "We think there might be a risk in this particular area". Not to sign it off, but to come in at the right point and say, "Here are the questions that we would



ask". We will come back to it when we do our audit, but that dialogue and ongoing sense check can be valuable.

I recall having that type of role as a district auditor and, I would say, to some extent as a key audit partner within EY as well. I think that we need to create the proportionality of the work, so that more time and energy is spent by those key audit partners in the areas that matter and to bring the current view of value for money for councils and other bodies up to date.

Q25 Ian Byrne: Thanks for that, Neil. Sir Tony?

Sir Tony Redmond: First of all, I made the point in my report that I was not advocating the restoration of the Audit Commission, but there were features of the Audit Commission that I strongly argued should be restored or retained. One of them is about relationships. We have talked about the relationship and dialogue and so on. The relationship between the auditor and the local authority could be improved. I don't think there is any deliberate move on the part of the auditors to distance themselves from the council. It is a resource problem. It is the inability to do all they want to do within the resources available. That must be addressed because that is a critical factor.

The second point is that there is a fond memory of the district auditor among local authorities. It was there for a long time. There was an established process whereby they would work together and would hopefully highlight any weaknesses on either side and deal with them. We have to move on.

The underlying principle of a DA can still be preserved under the new arrangements, but I do not think I would go so far as to restore the Audit Commission because the underlying weaknesses that I have described in my review do not warrant the restoration of the Audit Commission. They warrant a very clear system leader. They need coherence and co-ordination in the audit effort, to ensure that it is clear and concise in the way it is represented to local authorities and discharged in local government. Yes, I think many regret the demise of the Audit Commission, but I think there is an ability to take out of what that Audit Commission represented as good practice and to retain it in the new arrangements.

Q26 Ian Byrne: I will touch on something then. If we use the example of Liverpool. Say we had the district auditor and that system in place the police used to have then as well. Would that have highlighted some of the issues so that we would not have had the commissioners in before then? Is that something you concur with?

Sir Tony Redmond: I was saying earlier that one of the biggest challenges that has been faced, since the demise of the Audit Commission, is early warning of problems. Those early warnings can be identified by either a statutory officer—chief financial or chief executive—



monitoring or by the auditors. It can be highlighted by either or both, and I think that has been lacking.

Sarah Rapson: I am not an auditor, and I hear lots of positive things when people describe the role of the district auditor. I think that we need to find a way of re-establishing the audit profession as a noble profession in the modern era. It is a noble profession. People should be proud to be part of this profession. Part of the workforce strategy that we are responsible for is about engendering and improving the overall attractiveness of the profession in the round. It is not just in local audit by the way, but we have the issue in audit more generally, which is why I think the FRC can bring something to the local audit conversation around that. Something that lifts the prestige and the perception of this being a noble profession is in our purview.

Q27 **Mary Robinson:** Very quickly, the issues about trust and prestige, if you like, of the audit profession, are important, but it has been damaged by some of the large businesses that have gone under and it has been shown that the relationship between the auditors has been too close to the company being audited. It has been damaging. Do you feel that that same closeness in relationship could damage the relationships with local authorities as well? Will a new system deal with that?

Sarah Rapson: We do a lot of work at the FRC with the audit firms in the corporate world, as you know. One of the things we have been clear about is the importance of having the right culture, which is about professional scepticism and management challenge. There is absolutely no reason why this ought not to be exactly the same.

In any inspection finding or any enforcement case that we undertake, typically one of the root causes is that the challenge was not done at the right moment. There is absolutely no reason why that would not be exactly the same in the local audit world as well. We support firms to build that set of behaviours around management challenge and professional scepticism to shift that culture, as both of my colleagues have described.

Q28 **Chair:** In the past, when the district audit had a problem—maybe a recalcitrant officer in local authorities with some new situation they were not sure about—they could always go to the Audit Commission for help. Is there anywhere now that an auditor in local government could go to get that extra help and advice? Is the process in place and is it used?

Neil Harris: I cannot give you a practical example. I can say from my experience that, yes, I have been able to use that before as a key audit partner in EY and there are networks and technical support available to audit firms when they need it. It is provided through the National Audit Office's code of practice supporting guidance notes, as well as technical networks that exist within the NAO. If something is complex, there can be specialist public sector legal advisors provided.



Q29 **Chair:** Why is it not used then, in the case of councils who have got themselves into real difficulties, for example? You would have thought the auditor there either might have spotted it or might have gone and said, "Can you help us because we are in trouble here?"

Neil Harris: This comes back to the conversation we have had throughout about the fact that we need to encourage more early warnings. I do not think it is the fact that these auditors have been reticent about using that support. It is encouraging the culture for earlier challenge and earlier warning, and using that resource at the right time and creating the conditions to do so.

Q30 **Chair:** Onto the backlog now, which is a key point. Kate?

Kate Hollern: Thank you, Chair. If you look at the outstanding audits, it is alarming that there are so few processed. A question for Neil, why is there such a backlog?

Neil Harris: I think that there is a multiplicity of reasons for that. I would say, coming in as the interim shadow leader before we have officially become that role once we get the remit letter, what we have really struggled to get—and I will be open with this Committee—is granular data from across the system that goes through all of the root causes of the delay. Everyone has a particular view about what that is, but we are lacking timely, accurate, reliable data across the whole system to be able to bucket those particular delays into categories so that when you work to determine the measures to address them, you know what measures will have the most impact. I think that is a challenge that we need to address going forward.

There is not one single issue that is creating this. It is a complex set of matters and, in some cases, it may particularly be about auditor resource constraints that may prevent work in some places, as Sir Tony has already mentioned. In other places, it would be the disproportionate amount of time that firms are spending on more challenging local authorities that themselves have finance capacity issues but are entering into very complex arrangements. There have been accounting issues around infrastructure assets as Sir Tony has mentioned. Year on year there are additional technical matters that come in as well. On top of that, it could be somewhere in the middle. It can be a bit of the auditor and it could be the local authority.

It is a complex picture, but we do not know the full extent of it and that is a problem. If you overlay that with the fact that we do not have a picture for the NHS, you can see why it is difficult to get to grips with what the real root cause is and how to tackle it.

In response to your first point, the issue is that it is getting to a crisis stage with 530. If we do not tackle this backlog now, there is a risk that backlog will get close to or over 1,000 by the end of the year. We have to take urgent and decisive action now across the system to address that



backlog, and then put a framework in place, going forward, to prevent this from happening again and have better early warning signs when these delays will happen.

Sir Tony Redmond: To add to that, one of the points that was raised with me during the course of the review was that the local authorities' finance staff were telling me that some of the auditors did not have a local government finance background and, therefore, did not understand the nature and complexity of local government accounting. That meant without that familiarity it took a lot longer to do things.

When I talked to the auditors during the course of the review, they felt some of the accounting staff in local authorities were not of the right order and capability. Combining those two things, alongside the overall capacity and resource problem that we described earlier, it is not surprising that we are now facing this disappointing backlog in the number of accounts that are not closed.

Q31 **Kate Hollern:** There is less resourcing within councils themselves. Do you think there has been any progress made at all on trying to reduce the backlog? I know you said that things are not lined up to get a clear picture, but do you have any sort of feeling that things are getting better?

Neil Harris: Without going into the technical details, the solution that was put in place on infrastructure assets has unlocked some of this; for example, since the start of the year some audit opinions have been signed, but it is nowhere near fast enough for the whole system to give confidence that this will correct itself quickly. All of the system stakeholders are resolved on the fact that more urgent action needs to be taken over the next couple of months, to prioritise what viable short-term measures need to be put in place to address this, to clear this backlog as soon as possible and bring the system into some thought to do as much of a reset as we can.

Q32 **Kate Hollern:** Obviously, we do not know the problems that will arise from the backlog. Could you give us any advice on the sort of things you expect to find because there have been delays and backlogs?

Neil Harris: We have talked about the fact that where we want to get to is a lot more early warnings. My worry is that, sitting in among 530 outstanding local opinions, there are a lot more issues to do with financial sustainability, governance and capacity issues within local authorities that have not yet been flushed out either by those particular local authorities or their auditors. That is the biggest issue of all that I am concerned about, in terms of public interest.

That is why we need to put something in place now to flush that situation out as quickly as possible. Any solution that is provided on the short-term position has to properly distinguish between those local authorities where auditors have particular concerns and the rest of the population that have



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been caught up in the capacity issues that have been well set out in this Committee already.

Q33 Kate Hollern: I have read, “Audited financial statements is one of passive assurance. The absence of red flags and the knowledge that annual financial statements and the external audit have been completed provide a degree of comfort”. If it is just a passive agreement when there is a proper audit, some councils could be in some very serious situations. Is there a map on the different situations that you are predicting could come forward? How would you plan for that?

Neil Harris: I think it is difficult to say. We are working hard across the system on the viable proposals without creating unintended consequences to the system going forward. I do want to say that when external auditors audit the financial statements, they are doing so against the current framework—our international reporting standards and professional auditing standards—and inevitably that is looking backwards.

What we need to get to is the auditors using the flexibility they have within the National Audit Office’s code of practice around the value for money elements of the work as well. The framework already exists for auditors to call out any risks of significant weakness. Any weaknesses are identified as early as possible and, as I said earlier, there are some examples of auditors doing that already. That is the area we need to get more focus on, in my opinion.

Kate Hollern: I wish you well in that.

Neil Harris: Thank you.

Q34 Mary Robinson: Given that we have been discussing the backlog and the capacity and capability issues that are intrinsic to this—and it is slightly off remit, I know—but given that we are setting up 42 ICBs, which are collaborations between NHS bodies and local authorities, do you see any particular issues there?

Neil Harris: I don’t think we have a whole system picture so, yes, I think to begin with we need to understand what is happening across the local audit system as a whole and to understand the challenges within the NHS sector. There are big structural changes this year with the ICBs. There is also the introduction of new standards this year around leases accounting standard and new auditing standards, so I want to keep a close eye on the delivery of the NHS audits this year at the same time as we are trying to address this local government backlog.

When addressing one problem in one part of the system, we need to avoid creating another problem somewhere else. The NHS sector is less complex in terms of financial accounting but, nonetheless, the importance of high-quality audits and calling out early warning signs of distressed NHS organisations, particularly the new ICBs, will still be just as important for the work done on councils. I cannot give you a picture on where that is at the moment, but I recognise the point you are saying.



Q35 **Kate Hollern:** I am curious. When you are auditing, do you do a check on the procurement process used by the NHS or councils?

Neil Harris: The value for money arrangements that are set by the NAO are very broad. In theory, the external auditor can look at procurement and contract management arrangements, but they would do so where they believe there to be a risk of significant weakness. For example, there could be a significant contract that a local authority or an NHS body have entered into—significant to its overall size—and the auditor may take the view that there is a risk that this could have gone wrong and a risk of significant weakness. We will plan work to review the contract management arrangements put in place but not as a matter of course. Typically, you would expect the internal auditors within those bodies to do work on a regular basis to review the underlying systems and controls.

Q36 **Chair:** Mary has raised an interesting point there about ICBs. That is a situation where you have joint partnerships, and often it is encouraged to amalgamate budgets between local authorities and the health service, but local authorities have to balance their books each year and the health trusts do not. How do you go about auditing that difference?

Neil Harris: I think that there are particular rules set by NHS England about the reporting out of that currently within the CCGs. It was always about them breaking even between income and expenditure, and issuing what is called a section 30 referral if there was any breach in that. I may look to Sarah to provide some of her own experiences within the NHS sector, but you are absolutely right, Chair. There are different bases on the reporting for both NHS and local government.

I suppose when we look at this across the system, we need to consider where those differences are and what that tells us about the financial resilience, financial risks, complexity of reporting and if there is way to get a common way of looking at financial stability in partnerships of that nature. I accept the point.

Sarah Rapson: I am also a non-executive director at two NHS trusts and I have just been involved in a tender for an external auditor for one of them. We had a bid of one because there are not that many auditors on the bench. There are capacity issues here. Neil is right. The financial set-up and the more centralised nature of the NHS means it is a much easier system to oversee. The complication will be between the individual trust and how they fit as part of a system—an ICB or an ICS—where the money is delegated in a different way. That is an additional level of complexity which will take up more capacity. We have already described there is a huge constraint in that too.

Q37 **Chair:** You have local authorities who are held to account so they balance their budgets and a health system which basically fudges it, doesn't it? That is what goes on. In *Health Service Journal* the other day there was a very interesting article that applies to my own area of South Yorkshire. Everyone knows that individual trusts are in deficits but the ICB is



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reporting that it will balance up. There is not the same degree of intensity about ensuring that that break-even at the end of the year happens as it would with a local authority. I do not know how you go about putting those two things together, because if the local authority will overspend a bit, you just put it onto the health service to make sure that the combined budget works, don't you?

Neil Harris: There is a complexity we need to get our heads around and bring the whole system together. I would say, though, that when external auditors plan and perform their work, they would always look at the projected out-term position for an NHS body and raise a risk of fraudulent misreporting or management override of controls and undertake work to make sure that those balances that have been reported at the year end are appropriate. There are appropriate audit procedures that auditors should be doing on those financial statements, I would say. Notwithstanding what happens system-wide to bring the NHS finances into a certain position, but individual organisations still have that responsibility to report appropriately.

Q38 **Mrs Elphicke:** Just a quick specific one on that audit backlog. Whose responsibility is it to ensure that the audit is completed in a local authority?

Neil Harris: I go back to first principles. Initially, it is the responsibility of the preparer of the accounts to do high-quality accounts and sufficient work—

Q39 **Mrs Elphicke:** I am conscious of time. Whose responsibility is it to ensure that an audit is completed?

Neil Harris: Ultimately, the audit firms are responsible.

Q40 **Mrs Elphicke:** No, that is the external provider. Who is it within the organisation and the local authority? The reason I mention this—actually, I will listen to your answer first. Who is it?

Neil Harris: I think to address this issue, it is the whole system that needs to come together, but I think we need to be—

Q41 **Mrs Elphicke:** I was afraid you would say that. The reason I wanted to highlight it is because this was a problem in financial services without having the senior management regime of people individually responsible. I have been conscious that throughout the evidence so far we have talked about institutions and we have not talked about individuals and individual responsibility.

I feel very European in that we have such a backlog, 9% of the 2021 accounts of audits published. That is shocking. I have been the chair of an audit and risk committee and I would not accept a situation where an external audit was not managed, and I would not accept a situation where the external auditor said it was the internal team and vice versa. That would be managed and resolved, and those audited accounts and the audit would be completed. Who is responsible and why is someone



not responsible?

Neil Harris: One of the things we will do, as part of addressing this particular backlog, is put in place clearer levers and consequences where timeliness has not been achieved. One of the things that does not exist at the moment within the local government accounts is what is called a statutory backstop date beyond which, if an audit is not concluded, there needs to be appropriate levers and consequences within the system. I think that is certainly one area that we should be actively exploring.

It is also being clear about which participants within the system hold the audit firms to account. PSAA have a contract management role over the firms, but within FRC we have a regulatory and supervision role as well. It is no one single person. I think we need clearer levers and consequences across the system, which, unless anyone wants to say the contrary, do not exist at the moment.

Q42 **Ben Everitt:** It might reasonably be argued that the section 151 officer is the single person that is responsible because, under the Local Government Act 1972, it is their responsibility to make sure—

Neil Harris: For the accounts, yes.

Q43 **Ben Everitt:** No, that the authority is financially managed and that would include the audit.

Neil Harris: Absolutely. That is why I said there needs to be clearer levers and consequences where that has not been met for whatever reason. As I say, I do not think that framework exists at the moment.

Sir Tony Redmond: I think that the problem is that the section 151 officer does have responsibility for the accounts and to make sure they are closed by the due date of 31 May. If they are not closed—and this is the situation in a number of local authorities where they have not closed the accounts—one has to look critically at how that has happened.

We talked about capacity of staff to do it, the accounting principles and so on that need to be followed. If they are not closed, you have the auditors having to wait for the accounts to be closed before they can carry out the audit, and then they may not be able to comply with their own timetable. It is quite complex at the interface between the different parties in trying to decide who is ultimately accountable for the failure.

Q44 **Mrs Elphicke:** Sir Tony, is that at the crux of actually getting to the new system, that you need to be really clear about who is responsible for each stage? Not an organisation, not a to-and-fro. Who is supposed to do what, and what happens if that person—not the levers and drivers or systems and processes—but that individual holding the particular office is accountable for their failure to deliver something that is so important? Otherwise we would not be discussing it today.



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Sir Tony Redmond: I think that the other problem is that the PSAA, which has procurement contracts for audit—they oversee the performance of the individual auditors—but if the accounts have not been closed by the chief financial officer, then they have to wait anyway, so who is then accountable? It is more complex than it should be, but the integrity of the process is lacking as to who does what and by whom they should be accountable.

Q45 **Chair:** If that responsibility and accountability is sorted out, does the backlog disappear?

Sarah Rapson: There are all sorts of issues about the complexity and the capacity, and there is no one silver bullet to fix the system, is there?

Q46 **Chair:** It has to be fixed, doesn't it? The backlog is a complete mess currently. What simple things will be done in the next year to make sure the backlog comes down?

Neil Harris: As I say, this is our urgent priority now over the next couple of months, coming up with viable proposals to address that backlog position. We also need to set in place a framework to make sure this does not happen again. That would include all the things that you have discussed in this Committee about the future reporting framework.

Q47 **Chair:** Who is producing the framework?

Neil Harris: Ultimately, it will be for the Minister to sign off what decisions are taken in the short term to address this backlog.

Q48 **Chair:** Who is producing the framework for the Minister to sign off?

Neil Harris: FRC and DLUHC are working together.

Q49 **Chair:** What is your timescale to do that?

Neil Harris: We are currently working towards the end of June.

Q50 **Chair:** This year?

Neil Harris: Yes.

Sarah Rapson: Yes.

Q51 **Chair:** Okay. Moving on to the issue of the Office for Local Government.

Bob Blackman: Yes. Just when it became clear to everyone, the Government are now introducing the Office for Local Government. There is a clear risk that there could be some overlap or possibly even conflict with the work that is being done by the auditors. Neil, what discussion have you had with the Department in relation to the setup of the new OFLOG, if any?

Neil Harris: I will take this. The first thing to say is that as the director for local audit for the FRC, I will be part of DLUHC stewardship and accountability boards around the local audit system, which means I will



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be able to see and to contribute first-hand to any developments, both in the work that they do to set a framework for intervening in any local authorities and the development of OFLOG. For me, it is important that the work that is done within the local audit system co-ordinates and links in with OFLOG. I do not see OFLOG as being any particular threat or conflict to the role that we will be taking on.

OFLOG, as I see it, has a broader responsibility for local authority service performance. Some metrics are used to assess that—levels of reserves and financial position will clearly be information that will also be collected across the local audit system. For me, the most important thing is how we share information between each other rather than OFLOG taking on the role that we are taking on. If I am part and parcel of DLUHC accountability board, I will be able to spot if there are any conflicts. I am involved already and am part of how that is shaped.

Q52 **Bob Blackman:** That discussion and decision has already been agreed, has it?

Neil Harris: Not at this stage, because OFLOG is still being developed as to what this will look like and its purpose.

Q53 **Bob Blackman:** How will that be resolved?

Neil Harris: That is not for me to comment. That is for DLUHC when they come to give evidence to you. All I can say to you is that I will be watching this.

Q54 **Bob Blackman:** At the moment, you do not know how that will be resolved. Is that fair?

Neil Harris: This organisation is being currently developed and setting out its purpose, so it has not been resolved yet.

Q55 **Bob Blackman:** Has discussion taken place with you about that setup?

Neil Harris: Yes, in overall terms, and I am clear that there is no conflict with our role as system leader.

Q56 **Bob Blackman:** How do you see the two organisations co-operating together going forward?

Neil Harris: I think it leads back again to how can we facilitate earlier warnings across the system. If OFLOG collect a lot more data around local authorities' service performance and other metrics, it will be helpful if that is fed into DLUHC and the local audit system to show some evidence or examples of where we can see some stress within particular local authorities. How is that being picked up within the local audit system? Everybody has one version of the truth, and we are doing relevant work in those places that are higher risk.

Q57 **Bob Blackman:** Sarah, do you have anything to add?

Sarah Rapson: No.



Q58 **Bob Blackman:** Tony?

Sir Tony Redmond: I have nothing to add to that, thank you.

Q59 **Chair:** Right. Sir Tony, going back to your review. If you were doing it again today, would you recommend anything different to the recommendations you made last time? Are you content with the way the Government are implementing your recommendations or are there outstanding concerns where you would like things done differently?

Sir Tony Redmond: On the first question, I have re-read my report a few times in the light of actual experience over the last couple of years since I produced the report. I do not believe I have put anything forward with which I would now disagree. I think everything that is contained within that report is still relevant, some of it more relevant than others in the seriousness of the situation in which the local authorities find themselves, with accounts not being signed off and so on.

On the response from Government, 19 of the recommendations are being progressed in some shape or form. Yes, the principal one of the office of local audit regulation is not, but in its place is a separate part of FRC to deal with much of what I was advocating. I think that some of the recommendations are now in a much graver situation than they were before. They are more urgent. They require more immediate action.

We talked about the signing off of accounts, but I also think that the financial sustainability and the resilience of local authorities is an increasing problem. I would argue that that has to be given the highest possible attention in the way in which these things will be addressed in the future. It sounds almost arrogant of me to say I do not believe I have got anything wrong, but I do not wish to revisit anything that I said at the time.

Q60 **Chair:** Your concerns are more about speed than direction.

Sir Tony Redmond: Yes, indeed.

Q61 **Chair:** Do you think the system that is being developed now rather than your simple office recommendation is more complex than it needs to be?

Sir Tony Redmond: The outcome is more complex in the sense that the operation relating to local government audit in FRC is a part of that operation, but, as long as that is given a separate and distinct position within the organisation, then I think that it fulfils the role without too many difficulties. I do not believe that there is anything being progressed at this point in time that is causing greater problems than I had anticipated, if that answers your question.

Q62 **Chair:** Two simple suggestions. Should local authorities have to produce a statement each year which basically says our finances are sound? If there are any serious difficulties, just as a company would have to report to the stock exchange, should local authorities have to report to their constituents, their local residents in that situation?



Sir Tony Redmond: I think that there are two parts to this. First of all, it is extremely important that the annual audit is concluded with a report by the auditor to full council. I think that it is important for transparency that the audit partner attends council and presents the findings. That is No. 1 for assurance.

Second, as we talked earlier about the financial reporting, I think every local authority should produce an annual report which reflects the annual accounts outcome alongside a comparison with the budget that was set when the council tax was determined, so that the council is holding itself accountable for what it said it would do and what it actually did. I think those two things together—the assurance that has been provided by the auditor alongside the council’s own accountability for what it has done in finance service terms—should suffice.

Q63 **Chair:** Any further comments?

Neil Harris: Nothing further to add.

Chair: Okay. Thank you, all three of you, for coming and answering a lot of probing questions about the current situation. Clearly, there are real worries and concerns about the situation of local audit and what that may be hiding away if auditing is not done in a timely and effective way. Hopefully there are not too many surprises down the way, but there could be and that is a concern. Thank you very much indeed, all of you, for coming today. That concludes our first panel. We move onto our second panel now as well.

Examination of witnesses

Witnesses: Professor David Heald, Dr Henry Midgley and Ed Hammond.

Q64 **Chair:** If we could move onto our second panel. Thank you very much for coming along today. To begin with, I will go around the table and ask you all to introduce yourself, who you are and the organisation you represent.

Ed Hammond: I am the Deputy Chief Executive, until last week having been the Acting Chief Executive of the Centre for Governance and Scrutiny.

Professor Heald: I am Emeritus Professor at the Adam Smith Business School, University of Glasgow.

Dr Midgley: I am an Assistant Professor at Durham University and Co-director of the Centre of Public Accountability there.

Q65 **Chair:** Right. We will go through some of the same questions that we went through with our first panel and see if we get any different answers. We can spot the differences as we go along. What is the purpose and role of local authority accounts? Do they have one in supporting local accountability and democracy? Ed Hammond?



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Ed Hammond: Thank you, Chair. I think that you will find similar answers from me as you heard from some of your previous witnesses. I suppose in a basic sense, there are two functions—ensuring that accounting standards are being adhered to and a purported attempt to provide assurance on VFM. I use “purported” advisedly because, as we know, there is a challenge in the ability of external auditors to be able to provide a deep, more fundamental sense of audit.

Regarding who it is for, I suppose it provides assurance to taxpayers. It also provides support and assurance to members. We talked briefly in the last session about democratic accountability and that is certainly an element that is less explored in this space, I think.

Professor Heald: I agree with much of what was said in the previous session about users, but I noticed it was very confined to local accountability. There is a broader point that local authorities are part of the public sector as a whole and much of their expenditure is financed by central Government. There is a broader accountability. Part of that broader accountability works through the whole of Government account that is prepared by the Treasury.

At the moment, the whole of Government account is running more than two years late, or two years after the end of the financial period. One of the reasons why that is the case is the crisis in local audit. The point I want to make is that crises in local audit is an English problem. It does not happen in Scotland, it does not happen in Wales, it does not happen in Northern Ireland. That is not to say there are no problems in those jurisdictions, but there is nothing like a crisis. That is the first point I want to emphasise.

The second point I want to emphasise is that in 2011, I attended a meeting chaired by yourself about the abolition of the Audit Commission run by your ancestor Committee, the Communities and Local Government Committee. At that point, I forecast trouble from both the abolition of the Audit Commission and district audit, but also from the obsession of cutting the costs of audit. That is where the problem has really arisen in England. There has been the collapse of central co-ordination of the system—and we heard many examples in the previous session—plus the fact that local audit has been made unattractive for the private firms.

If you want to outsource all audit to the private sector, you must make that audit profitable for the private sector firms. If you do not do that, you will have a problem with prestige of the local audit within the audit firms and a loss of interest. The one positive message I pass at the moment is that Public Sector Audit Appointments did a brilliant job in getting auditors appointed. There could have been a complete collapse of the system, but that was a lucky escape, in my view.

Dr Midgley: I would basically agree with much of what has been said. I think what is interesting here is to point you in the direction of the Treasury’s financial reporting review in 2019, which did exactly the same



exercise for central Government. They basically concluded—and I think that I would endorse this for local authorities as well—that there are three aspects to what accounts and audit as a system are delivering. Both of them deliver parts of this. That would be financial conformance, the fact that the money is stewarded well. The fact that the money is spent in a way that obeys the legalities, proprieties and regularities that we would expect from public money.

Secondly—and I think that Ed is absolutely right—value for money. That the money is being spent in some way in accordance with principles of economy, efficiency and effectiveness, and underpinning that, that the information that the outsider uses to scrutinise those assertions is credible and can be relied upon for the purposes of scrutiny.

Q66 **Chair:** Is it working?

Dr Midgley: I would say that there are significant problems that the previous session brought up with it, in particular, the accounting. You have a range of written evidence suggesting that. One of the areas that I think is difficult at the moment is to get a sense of local authority performance. If we are talking about the value for money part of this equation, you have some of the money element but you have very little of the value element that we can actually scrutinise.

Q67 **Chair:** We will come onto the value for money in full detail later on.

Dr Midgley: Yes. That would suggest to me that there is a problem here in things not working.

Ed Hammond: I would agree. I think that it is acknowledged by many that the system is in crisis. That word has been used many times. I would agree with that. The backlog is part of that. I think that there are systemic challenges, which you have heard about in the previous session, which will make it very difficult for the situation to be turned around quickly and easily, more fundamental issues about the structure of the market and the way that—obviously the recent PSAA exercise has highlighted the ability, the fragility of systems in this space. Is it working?

In respect of the core accounting elements of it, it probably is despite the backlog. In the wider VFM and performance landscape there is an argument that it does not. The challenge is that obviously by the time you have reached a certain backlog on VFM issues, conducting those exercises feels superfluous really because the situation has moved on.

Professor Heald: But that is not an accident. There was a deliberate rolling back of the VFM part of local public audit after 2010. You had a rolling back of the VFM part, which is the part that is most likely to interest citizens, and the financial audit part got into problems less because of the complexity that everybody is emphasising. The complexity is not causing a crisis in the devolved Administrations' local government or in central Government. The crisis was caused by underfunding of the private audit firms.



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I was quoted in the previous meeting as saying that the abolition of district audit was a serious policy mistake. I stick to that. I also say in my evidence that I would not argue for the restoration of a public sector audit capacity for local authorities. I would be very worried that that would disturb the private audit firms. You have to give the private audit firms incentives to get into the market and to stay in the market.

We have had the strange position over the current PSA round whereby several key audit partners were in firms that did not have any contracts. We have a shortage of capacity, a shortage of expertise, but we have stranded key audit partners. That reflects the failure of regulation of the system. Having abolished the Audit Commission, which was essentially the early warning system for local authorities in England, nobody stepped up. What is now called the Department for Levelling Up or the Treasury or anybody else stepped up to move into that early warning space.

Dr Midgley: Can I add one last observation, Chairman? One test of this is: do people use it? There was an interesting survey in the journal *Public Money & Management* earlier this year, which pointed out that I think it is 50% of back-bench councillors don't feel that they understand their sets of accounts.

Chair: Let's move on in more detail to that question.

Q68 **Andrew Lewer:** What is the most significant way that local authorities are falling short, that these accounts are falling short of their desired purposes? Is it citizens, is it value for money, is it accountability to central Government? Where do you think the main shortfalls are? I might as well bundle all this together. How could accounts be improved to address those problems and what are the barriers to that happening, if any?

Professor Heald: I think that you should not expect most electors or council tax payers to read local authority accounts. For most people, the assurance comes from the fact that the accounts have been prepared by professionally-qualified people and have been audited by professionally-qualified people and both of those sets follow prescribed standards. The assurance comes from the fact that you will get timely production of audited accounts. That is on the financial accounts.

I totally agree with Tony Redmond's proposal but, given the fact that you cannot expect the average elector to take an interest in complex documents, because local authority activities are complex anyway, you need a standardised summary prescribed by some organisation at the centre, presumably now the FRC, that sets out how the summarised accounts should be organised. You basically need a digest with a narrative about how to interpret it.

On local authority performance, local authorities, particularly in England, have taken very big cuts in their spending since 2010, so part of the problem is the fact that the finance functions of local authorities have



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suffered. If I was an elected councillor, I would rather have teachers than accountants working for the authority. You can see that it is difficult to maintain the actual in-house finance capacity of the council.

In direct answer to the question, the evidence of failure on the part of the accounting and auditing system is that accounts are ludicrously late. The policy mistake was to downgrade value-for-money audit. My personal view, reluctantly, is that improvements in value-for-money audit will have to wait until the accounts get up to date. I agree with the comment a member made earlier that it is not much point having a value-for-money report on a year that is several years ago. Crucially, you have to get the financial accounts up to date, have a summary that is accessible to a significant number of members of the public and timeliness is the driving point.

Dr Midgley: I agree completely with the statement about the summary from David and Tony Redmond's idea on that. Another improvement that you could make is to turn some of this more digital, so look at what you can do in not just publishing a 280-page PDF but enabling people to drill down if they wish to. That is an improvement that could be made and the Department or somebody else centrally probably should lead on spreading best practice.

On your other question, the flaw is definitely on the performance audit and value-for-money side and the performance data side. I think there is some issue around if we are publishing this data we might as well, as David said, get it not just in the long-form accounts but also in a format that can be used.

Ed Hammond: I agree with much of the foregoing. I will add that part of the shortfall here lies around a lack of understanding about where local leadership and accountability in this space arises. I think back to Mrs Elphicke's challenge to your previous panel about who is responsible ultimately, which individual person.

There is an issue there where it is a bit too easy to say there is a collective responsibility for all this stuff, and I think that is great, but we need to think about who at local level holds distinct individual responsibility for action in this space too—the chair of audit is a member or an independent person, chairs or a specific chair of scrutiny, the cabinet member for finance, the section 151 officer, the head of internal audit. All these people should have defined responsibilities and duties clearly articulated, and shared responsibility within that as well, for the responsibility that they have in this space.

A lot of that is about the work that they do to create and bolster a culture and attitude within the authority of accountability and ownership on finance issues, the control environment, risk, performance, which ensures that everybody in the authority is pulling in the right direction.



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There is a risk in talking about this issue that we look at and think about audit as being in a separate little box on its own, and that the duty of ensuring the financial security of the authority rests with the external auditor and the section 151 almost exclusively. There are many others who have specific individual responsibilities and I think we should do more to articulate that.

Going back to the point that was made briefly earlier about there is a clear councillor responsibility in this space as well, there is a need for councillors to develop significant additional skill and acuity in understanding finances, the accounts and also the interrelationship between risk, finance, performance and how that impacts on the council's ongoing financial position. Ultimately it is members who set the risk appetite of the authority and that can only be set based on an understanding of the financial challenges and pressures the authority faces. That is something for all members to be responsible for.

Q69 Andrew Lewer: We have members on councils who are receiving an allowance of £6,000, £7,000, £11,000, who have six, eight, 12 hours a week to give to this on top of everything else. Is that a very reasonable expectation on their part?

Ed Hammond: It is a fair point. I think that the amount of time that councillors are able to spend specifically on committee business may be even less than that. The weight of expectation on councillors for their ward individual responsibilities is enormous. I think that is why understanding how and where that responsibility can be shared between them, while keeping a sense of where individual responsibilities lie, is so important and also making sure that members have the support they need from officers to transact that duty effectively.

There is an issue at the moment where—and I would not say this is shared across all authorities—there is a tendency for support from professional accountants generally to focus on the needs of the executive rather than the broader needs of the authority at large. I think that we can develop more of a cultural understanding among finance professionals and also senior officers that back-bench members need that as well. In the last couple of weeks there have been significant changes of control, a significant turnover of members. There is a business continuity benefit in making sure that all members feel supported and they understand the financial needs of the authority, because those back-bench members could very well the next day become your new cabinet.

Andrew Lewer: Having become the leader of a council that had been run by opponents for 28 years previously, I can certainly say that rings some bells with me.

Q70 Mary Robinson: My question is on the purpose of local authority audit. You have touched on a lot of this, so feel free to add to it but not to go over the same points about what you feel the purpose of local authority audit should be. A lot of this has been about the figures summarised in a



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way that people can see them and so on. To what extent might some local authorities think that it is not in their best interest for the democratic function? They might not want people to be able to look at and examine accounts because the first thing that people would do if they saw the summary is say, "Hold on, you have spent so much on this but you have not fixed the potholes". Does this work in the interests of poor local authorities?

Professor Heald: I have a more positive view generally of the motivations of elected representatives than that question suggested. Very clearly, people under pressure claim to be transparent and then try not to be transparent. Clearly one is aware of that incentive, but I think it is much more a system problem than something where I would wish to put the blame on individuals. One of the things that is very striking is that some local authorities took on much more risk. They engaged with fundamentally risky activities—and I question whether local authorities ought to be doing that anyway—partly in response to the reduction of block grant funding from central Government. To some extent their motivations might initially have been good but some undertook reckless activity.

I think the fact that the early warning systems did not bring up those is the crucial point. Even if local authority leadership would not welcome more transparency, I think there is a democratic argument for more transparency. That applies across the board at system level.

Dr Midgley: I agree with all of that. On your first question about audit, quite a lot of the importance of audit is providing either assurance or independent insight through reporting. I think that is the key element of audit. It is an independent check or verification or an independent insight or an independent publication of information about the council. Some of the complexity of what we are looking at derives from the ways local authorities are structured, for example the separation of certain funds like the housing revenue account that derives from legislation, or some of the complexities of government accounting, which relates in part to what David has just talked about in making electors and everyone know about the kinds of risks local authorities are taking on.

Ed Hammond: On the issue of the summary and bringing it to a wider audience, I don't think any council would come out and say, "No, we don't want to do this". I think you would find some councils probably saying, "We don't think this makes sense because the data is not sufficiently contextualised". That is often a useful proxy for when people don't want to publish something, to which the answer is, "Well, obviously you are free to contextualise it". I argue that seeing this duty alongside the duty that councils have separately to produce the annual governance statement is a good way of saying how can you take a rounded picture of finances to the public in a way that provides a holistic sense about the authority's strengths and weaknesses in given areas.



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The AGS is meant to be preceded by a review conducted by the authority where you are putting the system and processes under scrutiny. That review should be picking up some of the early warning signs that we have been talking about this afternoon. I argue that that review could be seen alongside the short summary of the accounts but also alongside any other narrative that the council might want to put out by way, for example, of an annual report, as we have mentioned previously, to close off the previous year's accounts, so you have an idea of bookending at the annual budgeting process. One bookend is the full council's agreement of the budget multi-framework in January, February every year and then maybe the following May or June or July the previous year's budget is bookended through the production of the AGS, your simplified summary of the accounts and through an annual report. That feels like it has a degree of completeness to it.

It is about saying that the production of the simplified version is one element, one part of the story. It should provide you with a hook that you can use to go out to the community and explain, not necessarily always justify but justify also, what you are doing, why you are doing it, how you are doing it. It is part of the duty that the council has to talk about and communicate with its residents what its priorities are and should be informing and influencing wider approaches that the council is taking towards public involvement.

Q71 Mary Robinson: It is not really a legal duty though, is it? It is a responsibility more.

Ed Hammond: Yes, that is fair.

Q72 Mary Robinson: If it was a private sector set of accounts they may be qualified to set hares running but for local authorities it seems that it can be so unclear that people don't really know.

Professor Heald: I agree with much of what was said in the previous session, but where I disagree is that basically the problem is the use of IFRS and current values. The UK in the 1990s and 2000s became a global leader in moving to commercial-based accounts derived from IFRS. Much of the developed world is following but largely going to IPSASB international public sector accounting standards, which are very close to IFRS anyway. I think some people never accepted the move to IFRS and the Treasury 20 years ago pioneered the use of current values.

There was discussion earlier about the problems of depreciated replacement cost as a method of asset valuation and, for example, about roads, but the point is that the Office for Budget Responsibility shows every couple of years that the UK public finances are not sustainable at the present levels of taxation. Either taxes have to go up or spending has to go down in the longer term.

There are two issues there. One is about fiscal sustainability; our public finances are not sustainable. The second point is about intergenerational



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equity. The UK is bad at infrastructure investment. It is bad at maintaining existing assets. I dispute the idea that the valuation of assets is purely a technical accounting matter. It is very important because we want to know what depreciation charges should go through to the present generation of citizens and taxpayers.

There was also discussion about some of the complexities of local government accounts coming from statutory overrides but the statutory overrides are quite often ad hoc things that have been done at various points in the past to stop the effects of genuine economic developments hitting council tax payers. It will not be a simple thing getting rid of the statutory overrides without regard to why those statutory overrides were put in place.

My final point on this theme is that one of the other aspects where the UK has run its local government system very badly is that England and Scotland are still charging council tax on the basis of 1991 values. That is positively ridiculous and makes it very difficult to defend a residential property tax, which I think is an important part of the tax system.

Q73 Chair: Going back to the assets, why do we need to value roads? You need to know what is the cost to repair roads but no one seriously is going to replace an A road through a local authority.

Professor Heald: The reason why you need to know the current valuation of a road is that one of the things the valuation process tells you is how much that road has depreciated, and that is the crucial point. The UK is not as bad as the United States in neglecting its infrastructure, but it is pretty bad. One of the ways we know that there is a problem is from the information produced at the whole of government accounts level. One of the things that worries me about the Treasury's current proposals to move away from current values is that that will make the whole of government accounts based on a whole set of different kinds of valuation principles for different kinds of assets.

My hunch is that they will transfer some of the problems of audit from the local authority sector to the whole of government accounts level. The auditor will be saying that the assets in the accounts are not valued on a consistent basis. It is important because I remember when resource accounting and budgeting came up, there was a Scottish health board that in the first set of accounts forgot it had a hospital. The important point was the fact that people do not keep proper asset registers unless it is central to accounting.

Dr Midgley: There might also be an argument that what matters is what is measured. To some extent if you are measuring the depreciated cost of the road network and you discover that the depreciated costs of the road network falls to zero, you know that you need to make repairs. There may be an aspect of that and that relies, of course, upon the actual cost reflecting the usage of the roads, but that might be one argument.



Q74 **Chair:** We value parks on the same basis, do we?

Professor Heald: Street furniture gets valued. The responsibilities of the public sector are difficult to define in the limit and it is always difficult to know quite what assets and liabilities should go on to a public sector balance sheet. What the UK has done with more extensive balance sheets on an accruals basis has provided better information at the aggregate level and the judgments behind what I said a few minutes ago about the UK's fiscal unsustainability.

Chair: Let's move on to the adequacy of the current local audit.

Q75 **Kate Hollern:** What is the most significant way that local authority audit is falling short of its desired purposes?

Professor Heald: The most obvious one is everything is incredibly late. I go back to my previous point that this is an English local authority problem, not the problem elsewhere in the UK.

Q76 **Kate Hollern:** Why is it an English problem and not a Scottish problem?

Professor Heald: I will give three explanations for that. The first point is that Audit Scotland, just using Scotland as an example, continues to organise local audit using a mixture of in-house auditors and private sector auditors. There was never the disruption that was caused in the early 2000s by the abolition of the Audit Commission, and of district audit. The kind of relationship that one of the previous witnesses described about the interaction between authorities and the auditors has been maintained.

The second point is the pretty obvious one that England is a big country. Scotland has 32 local authorities. It is possible for people at the centre of government in Scotland to have a pretty good idea of which local authorities are financially capable and where the problems are. With more than 300 local authorities in England, it is very difficult. Also, the English local authorities started taking far more risks in commercial investments, town centre redevelopments and so on, than happened in Scotland. That partly reflects the fact there was tighter supervision. When the Audit Commission was abolished, the Department for Communities and Local Government, as I think it then was, had to take over the supervision role and the early warning role. That role has not been lost in Scotland, Wales and Northern Ireland.

Dr Midgley: To come to your main question, I think the real issue—aside from the timeliness on which I completely disagree—is the absence of value-for-money auditing. That is a real gap in the English system at the moment in the democratic accountability of the authorities and their accountability to back-bench councillors in particular. I add that to David's list.

Ed Hammond: I wholly agree. For me, the paucity of information about VFM is a big element. Also a big shortcoming in authorities' ability to be



able to manage their finances effectively at the moment—and that feeds through into the response to and engagement with audit—is the lack of multiyear settlements. That has an enormous impact on how councils think about their finances, risk, their future plans. Councils obviously are under an obligation to produce a medium-term financial strategy. However, given the inherent uncertainties involved in everything at the moment, that is exceptionally difficult to do. Connected to that is the difficulty that local authorities now have in making political choices about complex issues with multiyear ramifications.

One drawback and shortcoming of audit as it currently stands is about materiality, and auditors not being able to consider and necessarily having the skills and the reflective—it is unfair to say the reflective capability, but I suppose the ability and capacity to be able to think about the political implications of a given issue when it is presented to them. Local authorities obviously work in inherently political environments. Decision-making is all about high profile, contended political issues and yet to what extent does audit, in considering either VFM or other issues, engage with that political dynamic? That feels like a shortcoming, a shortfall at the moment.

Professor Heald: One has to accept that during the catch-up period there will be more audit qualifications. That is my message. It will not be possible to catch up over a reasonable timescale without accepting the fact that there will be more audit qualifications and that is a system-wide problem, not necessarily just a problem for the individual local authority. The other point is I would encourage the strong local authorities—the local authorities who do not have a problem—to demonstrate what can be done in the context of value-for-money audit and of pioneering the Redmond style summarised accounts. There is scope for innovation by the stronger local authorities, but it will take a significant number of years to deal with the tail.

One aspect of the problem is that the Financial Reporting Council fining Mazars for the audit of an unnamed local authority sent shock waves through the private auditors, and—from what people tell me—after a local authority has had its valuers while preparing its accounts the private auditors are now getting their valuers to do a valuation, both adding cost and taking time. Speeding up the system will require some guidance about what is proportional in the context of getting multiple valuations of the same thing.

Q77 **Kate Hollern:** Do you think this problem will be made worse by the number of pots of funding that councils have to bid into where there are lots of little pots? Of course, that is going to be much more difficult to audit and demonstrate value for money and accountability?

Professor Heald: I think that is a question to be put to auditors in terms of how much work that causes for the audit. It certainly causes a lot of work for the local authorities. It diverts the limited finance teams of local



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authorities into the process of being involved in the bidding for money and accounting for separate streams.

Q78 Kate Hollern: If there was one single thing that could help to ease these problems, which in turn would make it easier for the public to hold local authorities to account, what would you do? What would you change?

Dr Midgley: I wonder if to some extent—as the evidence in the previous session suggested and what David Heald has just said—some of the issues around timeliness are unravelling several issues at the same time.

As for improving accountability at the other end, I think the simplified accounts and value for money are the two things to point to, but there are two separate issues here. How we get the system working is one of them and then, when the system is working, does the system as it operates when it works, function the way that we want it to function? Those are two separate questions that would probably require separate solutions.

Q79 Kate Hollern: One must be done first; we need to get the system right?

Dr Midgley: To some extent. One of the things about getting the system right—and listening to the evidence of the previous panel was very interesting—is also deciding what it is that we are aiming to get to. We can all agree that timely accounts and audits and so on are the right places to go, but we need to have a clear understanding of what the roles of accounting and auditing are. That gives people something to aim for. It is one of the areas where I think this Committee can play a useful role, by telling the Department to set out its approach to getting from where we are to where we want to be.

Professor Heald: I would not normally say this, but pay the audit firms more money. I have not looked at the numbers recently but if you look at how much audit fees went down in the 2010s, which was claimed as a great success by the Department for Levelling Up, Housing and Communities, given that, given the withdrawal of resources from the audit sector, catching up would require more resources into the audit.

Local audit is a relatively marginal activity for the big audit firms and the partners in local public audit have to justify their use of staff and resources of the firms for doing the local audit, and so much uncertainty has been built into the system by the things that we have been talking about that it has become unattractive. Therefore, we have to accept that catch-up will cost us a lot of money.

Ed Hammond: I agree with Henry, in as much as saying that there is a short-term thing here and then there is a medium- to long-term thing. On the short-term thing, you have heard from others how we can bolster and support firms and their capabilities. I would point towards what I said earlier about addressing within local authorities those more cultural and attitudinal issues of individual and collective responsibility for finance, ownership of finance, performance management issues, risk management



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issues and risk appetite in the political space. In the short term, I think a lot can be done to develop more acuity and understanding about some of those dynamics and some of the trade-off decisions that councillors are making.

In the medium to long term, as an organisation, we suggested some years back the establishment of local public accounts committees as a way to create an almost intermediary space between accountability at the local authority level and national stuff. The idea is that you would have committees that would operate at a slightly sub-regional level that would be responsible for looking at spend across an area—not just exclusively limited to local authorities—and making judgments about VFM in that context. It strikes me that that would deal with some of the VFM challenges that we have talked about this afternoon.

That said, I am always cautious about making broad structural suggestions, saying, “If you just set up this body, all the problems would dissipate somehow”. However, it feels as if there is a need for some function carried out by somebody to exercise more rigour, in and around VFM, in a way that understands the political dynamics around VFM. That is the challenge because it is inherently political. Asking auditors to make judgments about VFM in what is a political space is very challenging.

Q80 Kate Hollern: Very difficult. A very quick question for Henry. Who is ultimately responsible for the effective functioning of the local audit system?

Dr Midgley: One of the interesting places to go for that is the 2019 National Audit Office study on the governance of local authorities. In that, you will find an observation that it is the Department that is ultimately responsible. The Department agreed with that observation in agreeing that report. I think, in that sense, the ultimate responsibility here and the ultimate accountability belong to the Department for the overall system across the whole of England. To me, that is absolutely crucial. Lots of this stuff—and we have talked about audit firms and technology—will require more resource and it is the Department’s responsibility to make sure that local authorities have the resource to buy in the appropriate audit to be able to technologically develop their accounts.

Q81 Kate Hollern: A final question for Professor Heald. I think you have covered this but, just so we are clear, why do you think the crisis in England is different from the in the devolved regions?

Professor Heald: I tried to answer that before. It is basically the vacuum created by the abolition of the Audit Commission. Wales, Scotland and Northern Ireland are much smaller places so the local knowledge and informal networks survive to a much greater extent. My third point was that in England, the private audit firms seemed to be completely unnerved by the fining of Mazars. It is reputationally damaging for the firm and reputationally damaging for the local audit



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practice within that firm to be fined by the FRC. They are probably the three most important points.

Chair: Moving on now to procurement.

Q82 **Ian Byrne:** You have touched on this, and David has probably touched on the solution, but what are the ongoing risks in the procurement of sufficient numbers of auditors in local government?

Professor Heald: When you say “auditors”, do you mean audit firms or people within the local authorities?

Ian Byrne: The Public Accounts Committee concluded, “There is a pressing risk of market collapse due to an over reliance on a small number of audit firms and significant barriers to entry”, and further, “The commercial attractiveness to audit firms of auditing local authorities has declined”.

Professor Heald: After 2010, local audit became unattractive to private audit firms. Before then—and I am talking about England—they were protected by the Audit Commission. If they got into a serious dispute with their local authority or they found particularly serious problems, they knew they had the Audit Commission as a backstop. That backstop has disappeared and once an auditor gets into a dispute with a client, the question arises of: who is going to pay for the extra audit costs? When auditors get worried about being fined by the FRC, they are not going to be keen.

Q83 **Ian Byrne:** How can we resolve that?

Professor Heald: The PSAA did a good job in getting enough auditors for the present round. That was chaos avoided. However, it depends on those firms staying in the market over the period and there is obviously no spare capacity.

Q84 **Ian Byrne:** It is not long term, though, is it?

Professor Heald: No, it is not long term but, given that the Governments have not wanted to restore a public sector audit capacity, I think there is a strong argument now for leaving it with the private firms but making sure that it is profitable for them. In effect, the Audit Commission ran some kind of quasi-insurance policy. Audit firms knew that, if they had a particularly difficult client that was undertaking activities that were questionable or illegal, they would get the protection, so there might be a way in which the FRC or the Department could offer protection.

Q85 **Ian Byrne:** Underwrite the risk?

Professor Heald: Yes. Audit firms are becoming more worried about the risk to themselves.

Ian Byrne: Henry, would you like to add to that?



Dr Midgley: What we have described above—when we were talking about the purposes of all of this—is quite a complex constitutional, democratic function, which is quite different from the world of the private sector auditor. Therefore, I think that making sure that there is appropriate training and thinking about how the people who are carrying this role out understand the importance of the work, and also where to put their emphasis in the accounts, is quite important.

Professor Heald: One point I picked up from reading all the evidence that was sent to the Committee was to do with issues about the dates for accounts finalisation. You have to remember that private audit firms tend to use the same staff for NHS and local authority audits. Given that, if you do not co-ordinate the setting of the deadlines for completion of those audits, what will tend to happen is that the deadlines will just be missed and we are now in a climate where everybody expects deadlines to be missed. That is part of my point about the lack of system overview and system overview also applies to the work of the private firms.

Ian Byrne: Ed Hammond?

Ed Hammond: I have nothing to add to that.

Chair: Bob Blackman will follow up on intermediaries.

Q86 **Bob Blackman:** Henry, in your written evidence you pointed to the shortage of intermediaries between auditors and citizens. Why is that important?

Dr Midgley: It comes back to something David said earlier, which is that when you are faced with a 280-page statement of accounts, it is hard for the public to understand it and for ordinary people to have the time to look at it and spend their time reading it.

If you are talking about central government in the UK, you have a lot of people processing information, digesting it and presenting it in different ways. The Institute for Government's performance tracker is a great example of that. If you go down to the local authority level, there are far fewer of those people redigesting and trying to present or represent that information in different ways. There are a couple of organisations, such as Ed's, but there aren't many and most of them are functioning at the national level, not at the individual council level.

That goes together with—if you read the Cairncross Review of 2019—the slow slip in the number of local newspapers, local journalists and people covering local councils, and adds up to the fact that these statements of accounts are documents that are being published to a world that is not translating them to the general public. I think that is a real problem.

Professor Heald: One of the big differences between the private corporate sector and the public sector is that in the private sector, for private corporates, there is a large community of financial analysts who have the incentive to study the accounts carefully. If a company does not



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produce its accounts on time, it is treated by the market as an adverse signal. For the reasons that have been discussed already, the number of direct users for the public sector is low, but you have to depend on intermediaries or information brokers. The people you have to depend on to look at them are think tanks, professional institutes—in this case, accounting institutes—academics and, historically, the local media, as Henry just said. Local newspapers played a significant role in holding local authorities to account.

- Q87 **Bob Blackman:** In my time in local government, we started off with council chambers full of people. Now, you would be lucky if you got one or two and certainly you get no local reporters at all.

Henry, coming back to you, who fills this vacuum? David has given a view about who can fill the vacuum but do you have any views about what could be done?

Dr Midgley: Yes. One of the ways we could close this gap is by moving the auditing and accounting systems towards people. That is why simplified statements, digitalisation and so on are good things.

Another thing is that, whatever you do, there will be some sort of a gap. To me, suggestions such as Ed's about local public accounts committees are valuable because that would be one place where we could get a set of translators, not necessarily directly the politicians who sit on the committees but I am thinking of something like a local scrutiny unit.

- Q88 **Bob Blackman:** When we talk about public accounts committees, I think Ed talked about on an area basis rather than necessarily on a local authority basis. Is it going to be politicians who sit on them? Experts?

Dr Midgley: I think that ultimately, for democratic accountability, it probably has to be some form of politician but I would not want to offer an opinion on the exact set-up. However, I would say that you could support that structure—as the Scrutiny Unit in the House of Commons does—with people who come and offer advice about what the accounts mean and what is going on. That is one way of helping to close the gap, but I do not have the full answer because I think it goes beyond this discussion, almost, into questions such as: what we do about things such as local journalists no longer being in the council chamber that you just raised?

- Q89 **Bob Blackman:** Given that there is a shortage of auditors and a value issue about how much auditors are paid, having a scrutiny unit as in the House of Commons, or someone else, would surely add an extra burden. Where are those people going to come from?

Dr Midgley: This is part of the problem. This is something that I agree wholeheartedly with David on. If you are going to get this system functioning well, you are going to need some form of investment to make it work.



The issue that you raise is true, and there is another issue here in that you will need time, as well as money, for the muscle memory of what this scrutiny looks like to grow back. Even if you create these institutions, it will not be something that appears or reappears overnight.

Q90 Bob Blackman: There was some discussion in the previous session about the Office for Local Government producing comparative data. I did not understand what the relationship between the Office for Local Government and the FRC was going to be, but that is a side point. It does seem to me that comparative data is what is needed. What would be useful to citizens is comparative data for broadly comparable authorities. Looking at the data from one's own local authority gives one a certain level of information, but it would be much more helpful if you could see your local authority relative to other local authorities of a similar type.

Putting such data together is time-consuming and difficult, unless you have very good access to the system, so I think that one thing that could be done—either by the FRC or the Office for Local Government—is to put together good, timely comparative information. That would be helpful to people who want to engage in local scrutiny.

Dr Midgley: I agree with that. That is one way in which local accountability should be better than national accountability because, at the nation level, it is very hard to create comparative information, having tried and failed at the NAO. However, at the local level it is much easier because you have comparable jurisdictions and responsibilities.

Ed Hammond: There needs to be a constellation of people and organisations at the local level to exercise these kinds of responsibilities. The press is part of it. Now we have local democracy reporters. There is more resilience in the local press than there was but, even so, I think we could do more to make sure that those individuals are skilled up to be able to understand and interrogate local accounts more effectively.

I touched briefly on local overview/scrutiny committees—an area close to my heart—and I think we could do more to provide support to them around understanding the finances and these kinds of issues. That is work that we are directly involved in at this very moment.

More generally on other intermediaries, we have talked about local public accounts committees. As you say, that would be across a broader area. I do think that composition-wise we would be talking about a majority of councillors or other politicians being involved because it is about democratic legitimacy.

Then you move on to talk about comparative data and the use of that data by the kinds of people that we used to call armchair auditors, who I think sprung up in a couple of places. The example that people often use is Lambeth, the People's Audit, but that felt like a one-off. You get examples popping up across the country of people doing these things but it is still sporadic and quite ad hoc in nature. A lot of the granular data



that would assist people is very difficult to find or is paywalled. CIPFA has a data analytics service and produces a financial resilience index as well, but that information is all subscription based. I know that there will also be other institutions that will prepare and use that data for their own purposes but it is not publicly available.

We know that one of Oflog's key metrics or performance indicators, areas it is looking into, is financial resilience and it is developing ideas at the moment. Oflog's Chair, a former Comptroller and Auditor General, wrote to local authority chief executives and leaders a few months ago inviting comment on the work of Oflog. I think that will resolve in the very near future into some kind of sense of how it is going to carry out the data analysis and data gathering part of its work.

I do think that it will see—alongside the work the FRC is doing—a bolstering in the central collection, collation and analysis of that data. How will that be presented to the public? I don't know and I don't know whether even the thinking has gone into the question of how that data will be presented to the public yet, because the feeling I have about those institutions and the work they are doing is that it is very much about providing the Government with assurance about its stewardship function for the sector, which has already been mentioned, rather than necessarily saying that there is a wider public communication thing to be talked about here.

It comes back again to the issue of purpose: what and who is local audit for? Thinking about centring the public in that conversation, that debate, and asking: what is it that the public want and need and do we need to think about providing support to the set-up of citizen's assemblies or citizen's juries? Things like that to create more local skill and capability around this space. Does it look like something else or is it all of these things together somehow?

Q91 Andrew Lewer: I think we have covered most of the value-for-money issues in the earlier session, so unless there is something particularly pressing that people want to say about that—Henry Midgley, it is your thing, I know—we will leave it there.

Dr Midgley: I have only one thing to say and that is around the current arrangements for value for money. It is worth thinking about exactly what assurance is being provided on value for money. It is the arrangements for value for money that the assurance is over. As it currently stands, the audit code does not invite the auditor to make a comment on value for money itself, which is an important limitation.

Professor Heald: That is a very important distinction because one of the reasons that the Audit Commission was abolished was that local authorities did not like its judgments, which they felt were imposing upon their democratic mandates.



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When we had a public audit body, whose abolition was significantly due to that factor, I think it is too much to expect private audit firms to make those kinds of judgments. I think they would be criticised as having no democratic legitimacy and would be frightened of the reputational cost.

Q92 Andrew Lewer: I suppose people will not like the value-for-money assessment of a park versus a library or a new primary school here versus one there, but what about a more general value-for-money assessment of massively investing in Icelandic bank accounts or retail centres that are nowhere near your local authority?

Dr Midgley: It is perfectly possible to do those value-for-money assessments. I realise there is always an issue around policy discussions but if you are looking at value for money, in central government at least, you are doing it in a context where you exclude the policy judgment of whether we should have a park versus a library. Having decided what I am going to prioritise as a politician, what you are interested in is whether I am then delivering the park or the library or whatever else I have decided to deliver, in the most economic, efficient and effective way. Even in cases where you say it is difficult, it is possible, but David's point is quite right. Of course, another thing is that if you are resourced to provide a financial audit, that is what you will provide.

Chair: Mary Robinson, do you want to follow up?

Q93 Mary Robinson: Yes, just on the importance of getting this audit process right.

CIPFA figures about local authority fraud say that "fraud costs the public sector at least £40.3 billion annually"—I am looking back a couple of years here—of which about £7.8 billion is specifically in local government. How much of that is down to the issue that we are talking about now, which is whether or not local authority accounts and their auditing are good enough?

Dr Midgley: I find it quite hard to conclude on that because some of that fraud could well have been caught by the financial audits and some of it may have been caught in other ways. Value-for-money reporting is looking, first, at whether people understand if their council is using the resources it was given in the most efficient, effective and economic way; secondly, whether the council itself can learn from its own failures, not necessarily the kind of failure you are talking about around the failure to stop people stealing or whatever else that fraud consists of but, also, the failure to make good decisions when they come to it. Possibly there is some area of value-for-money reporting—had one existed—that would have come with recommendations to help with that, but it is very hard to say.

Q94 Chair: A couple of final points. We talk about transparency. When we did an inquiry into local authority scrutiny a few years ago, one of the issues that came out was that, with the increasing amount of local authority work being done through contractors, even councillors could not get



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access to information about those contracts because they were commercially confidential. Is this also a challenge for audit and does it need to be resolved?

Dr Midgley: I don't know the specific legal set-up of local authority audits so I could not say that. I do know that there are cases in the public sector where the auditor can look into the contract to see various things for the purposes of examining value for money.

Chair: If we talk about transparency, the audit process should be producing information that the public, as well as councillors, can look at.

Dr Midgley: Yes.

Professor Heald: There are two levels to this. In terms of financial audit, the auditor is not looking directly for fraud in general. Auditors are reassuring themselves that there is no fraud that would materially affect the financial statements.

On the question about access to contracts, I agree; that is a very important issue. I do not know the local government context. Certainly the National Audit Office has made sure that in certain cases, the contracts provide for the public auditor to be able to look through the contract to the contractor. I think the extent to which the public body's auditor has access to the financial systems of the private firm very much depends on how the public body sets up the contract with the private firm.

Q95 **Chair:** Isn't it important that that information should be made available to the public so that the public can see what costs are incurred by contracts and what service they are delivering?

Ed Hammond: I think that there is no question that that information should be made available to members as a matter of course. If audit committees need to go into part 2 conversations with the public excluded to have detailed conversations about pressing contract issues, that is fine, but I think there is no reason why members should not have access to that.

We do not have an accurate national picture of the whole country but things come to our attention, as you would expect. I am aware of some instances over the course of the last couple of years where there have been disagreements among members of audit and monitoring officers, section 151s, about the level and nature of the information that they are entitled to in order to carry out their work.

While the situation for scrutiny councillors is quite clear in terms of the information to which they are entitled—and that includes information that might otherwise be commercially confidential—I am not sure that clarity exists for members of audit committees. I cannot speak to whether that is 100% accurate because I do not have the Act in front of me, but I am fairly certain that that clarity is necessary there.



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Councillors have common law access to information where they can demonstrate a need to know it, but that is woolly and the relevant case law is quite old now. Therefore, I think that there may well be a need for more clarity specifically over audit members' entitlements with respect to matters relating to finance. That may well be something that could be extended to all Back-Bench Members, to be honest, but particularly to audit members.

Q96 Chair: Ed Hammond made a point, but Mary Robinson also picked up on it, about the book-end proposal that you put, the legal date by when you have to have your budget set and then maybe another date later on—15 months later—when the signed-off audited accounts are made available to the public. Should that second part be put on a statutory basis as well as the budget part, so that you would have two clear dates that councillors have to work to?

Ed Hammond: You would also have to create a statutory environment for the annual governance statement if you were going to do that, because obviously that is not a document that councillors are obliged by law to produce; it is a regulatory matter.

I think, yes, but I am always cautious about suggesting to people that councils should be subject to yet more statutory obligations. However, it does feel as if it would provide a balance that is otherwise perhaps not there.

Dr Midgley: One thing might be that that is something that probably comes out of sorting out the timeliness of all this information, so probably that is something that you move towards as you get through the crisis in terms of the production of accounts and so on. Because there would be an issue with getting a statutory deadline and waking up the next year and deciding that everyone had missed it. That creates another set of problems.

Also, I want to say that I completely agreed with David's points on the materiality of fraud in terms of the financial audit: that is what that would detect.

Chair: Thank you all very much for coming to give evidence to us today. It has been very helpful. You have thrown up a lot of issues for us to consider and, hopefully, some suggestions that we might make for improvements to the system that are clearly necessary.

Professor Heald: Thank you for the invitation and best wishes for the inquiry.

Chair: Thank you very much indeed.