

Levelling Up, Housing and Communities Committee

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

Monday 5 June 2023

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Members present: Mr Clive Betts (Chair); Bob Blackman; Ian Byrne; Kate Hollern; Andrew Lewer; Mary Robinson; Nadia Whittome; Mohammad Yasin.

Questions 97 - 144

Witnesses

I: Gareth Davies, Comptroller & Auditor General, National Audit Office; and Mike Newbury, Director, Code of Audit Practice, National Audit Office.

II: Conrad Hall, Chair, CIPFA LASAAC Local Authority Code Board; Rob Whiteman, Chief Executive, CIPFA; Iain Wright, Managing Director for Reputation and Influence, ICAEW; and Lynn Pamment, Chair, Financial Reporting Advisory Board.

Examination of witnesses

Witnesses: Gareth Davies and Mike Newbury.

Q97 Chair: Welcome to this afternoon's session of the Levelling Up, Housing and Communities Select Committee. Thank you all for coming along. We have a continuation of our inquiry into the financial reporting and audit of local government with two panels of witnesses. Before I come over to our first witnesses, I will ask Committee members to put on record any interests they have that may be relevant to this inquiry. I am a vice-president of the Local Government Association.

Kate Hollern: I employ a councillor.

Nadia Whittome: I am a board member of One Nottingham.

Mohammad Yasin: I am a board member of Bedford Town Deal Board and I also employ a councillor in my office.



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Bob Blackman: I am a vice-president of the LGA and I employ councillors in my office.

Andrew Lewer: I am a vice-president of the LGA and I am on the Northampton Forward Board.

Chair: Thank you for that. I will go over to our two witnesses. Would you like to introduce yourselves?

Gareth Davies: Hello. My name is Gareth Davies. I am the Comptroller & Auditor General, head of the National Audit Office. I am central Government's auditor. For the purposes of this hearing, it is also relevant for members to know that I spent 32 years before this job auditing local authorities. Most of that time, 25 years, was at the Audit Commission, including a spell as a district auditor auditing local authorities, and then subsequently seven years at a firm leading their public sector work. I have been out of that sector for the last four years, so it is important to say that I am not bang up to date in first-hand experience.

In my role now as head of the NAO I am responsible for setting the code of audit practice for local government audit and for providing guidance supporting that code. Mike Newbury on my right, who will introduce himself, is responsible for running that part of the NAO's work.

Mike Newbury: As the C&AG said, I am the director responsible for the local audit code and guidance team. We maintain the code of audit practice and issue guidance for auditors. I am also an audit practitioner. I lead the audit of the Department for Levelling Up, Housing and Communities. Prior to working in the NAO, I was a local government finance leader and before that, in common with Gareth, I was a district auditor and audited a range of local public services, principally in North Yorkshire, Yorkshire and Humberside.

Q98 **Chair:** We might come on to the district auditor role and whether things were all better when we had district auditors, but we often get into that discussion when we talk about local government audit. To begin with on local authority accounts, to Gareth Davies first, what is the purpose of local authority accounts? Should they be seen as something that actively supports local democracy and local accountability of councils to their electorates?

Gareth Davies: Like any major sector of the economy, it is vital that proper accounts are produced annually to inform all the stakeholders of that organisation. Particularly if a body is funded partly through compulsory taxation, it is absolutely essential that there are timely, high-quality accounts to explain how the money has been raised, how it has been used and whether the authority is in a robust financial position. I take that as axiomatic for any sector that wants to be taken seriously.

Clearly, how much members of the public use the accounts of their local authority will depend on their interests. I think a busy citizen is entitled



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to assume that someone else will make sure that the accounts are being properly produced, that they have been properly audited and that they are informing good decision-making, but where citizens want to interest themselves in the affairs of the local authority they should be informative, as clear as possible and available to use promptly after the year end.

Q99 **Chair:** Do you have anything to add to that, Mike?

Mike Newbury: I will only add that the local public audit regime comprises not just the accounts. There is a much wider set of duties of value for money, electors' rights and the public reporting duties, which I am sure we will come on to in due course.

Q100 **Chair:** They are actually unintelligible to most people, aren't they, including councillors?

Gareth Davies: There is clearly a challenge there. I think parts of them are very difficult to follow. Most of this arises because the public sector as a whole in the UK follows the IFRS, international financial reporting standards, approach. There are complicated adjustments to convert local authority accounts to IFRS, which make them hard to follow. I think that is the core challenge here and that applies, for example, to the valuation of assets, pension fund disclosures and other similar things.

With core spending against the annual budget and so on, it is not too difficult to follow what is in the income and expenditure part of the accounts, but you are right and I agreed with Sir Tony Redmond's recommendation in his review that a simplified, user-friendly set of financial reports was available alongside the IFRS-compliant version. The reason that it is not easy to abandon IFRS for local government is that at the moment they consolidate into the whole of government accounts, which have to be prepared on that basis. If it was decided to remove the requirement of IFRS compliance from local authorities, it would no longer be possible to include local government spending in the whole of government accounts.

Q101 **Chair:** The solution then is to produce one set extracting some of the key points from the more complex accounts and use those for informing not just the public—it is councillors and some council officers as well, to be fair.

Gareth Davies: I think that was Sir Tony's recommendation and I agree with that.

Q102 **Chair:** You mentioned assets and pension valuations. Should there be changes there or, again, is that something where we can get totally bogged down with things that do not really affect the ongoing expenditure and decisions in local government?

Gareth Davies: We are getting bogged down in the local government sector in those questions at the moment and it arises because I don't



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think that anybody would say that some assets should be exempt from robust valuations. For example, if you take the very topical issue of commercial investments by some local authorities, it is absolutely critical what they are worth year to year because the solvency of the local authority depends on that and we are seeing spectacular examples where that has gone wrong in some cases.

For other assets, though, which are just for the purposes of the local authority's functions, such as highways, potentially even schools and so on, there is a strong argument to say that the annual valuation of those is of less direct impact in the short term. It is still important to know exactly what your asset holdings are because they come with a responsibility for maintenance and a cost implication of that, but I think it is a fair point to question the precise value of every school every year, particularly if that requires expensive valuations from surveyors and for auditors to hire their own surveyors to go and challenge those valuations.

That is what we meant in the evidence that we provided to the Committee on getting consensus on which areas of the accounts required the most effort and why and then everybody working to that agreed position.

Q103 Chair: You have to be consistent in how you are looking at government accounts as a whole. I was surprised to learn just recently that motorways are valued but other roads that local authorities maintain are not. How can you get consistency across the piece nationally?

Gareth Davies: We have to qualify the NAO opinion on the whole of government accounts to reflect some of those differences. The reason why the national infrastructure is valued on that basis is that central Government decided they were going to do that and put in the resources required. Clearly they have to do it for one national network, not for 300-and-something local road networks. Whether that is the right way to proceed I think is exactly the review that we and others have been calling for to make sure that there is a single agreed position here and that auditors, those who are regulating the auditors and the quality of the work they do, everybody is working to the same definition of what is required. The absence of that agreement at the moment is the core problem and is leading to a lot of the delays.

Q104 Chair: To raise some things that have transferred from central Government responsibility to local government responsibility—you might say a particular aspect of the rail network in the future—does that mean that you change the way that it is valued in accounts going forward?

Gareth Davies: That is a good question and of course it would certainly arise. The rail network is valued on a depreciated replacement cost basis and so if a chunk was transferred to a local authority and not accounted for on that basis, you would obviously have inconsistency across the valuation of the rail network. That is why it is important that there is a strategic view taken here about things like asset valuation across the



public sector. Rather than just waiting for auditors to clear the backlog and hope that this problem does not arise in the future, it is crucial that it is sorted out and made clear now; otherwise we will end up with a repeat of the same problem.

Chair: Moving on to local authority audit, Ian Byrne.

Q105 **Ian Byrne:** I will go to Gareth first. Sarah Rapson of FRC and the future chair of the liaison committee said to us, "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". What should be the purpose of auditing local authority accounts in local accountability and democracy in your opinion?

Gareth Davies: Well, you would expect me to say this as somebody who has spent their entire professional life doing it but I think it is fundamental to trust, which is the word I use here. Without an independent audit, it is very hard for those using the accounts to trust their accuracy. A fundamental purpose is to build trust in the financial reports being produced by any organisation, in this case by the local authority. It is important in turn that the auditor is trusted to do a good job, which is why the regulation of auditors is so important, as I am sure Sarah Rapson would have covered because that is her organisation's role.

When you focus in on the local government audit, independent audit is a fundamental part of our democracy. It is crucial that the accounts are shown to be independently audited so that they cannot be skewed in a particular direction by those responsible for the administration of the authority in question. It is absolutely crucial that independent audit gives the public the assurance that they have been properly prepared and they give an accurate picture, and it goes beyond the accounts. The auditor has a responsibility to comment on the value for money arrangements at every local authority and always has done since the 1982 Act setting up the Audit Commission set out the responsibilities of the auditor.

The code of practice that we oversee requires auditors to make sure that they have a good independent understanding of the governance arrangements of the local authority, they understand how risks are being identified and managed and they are able to comment on the robustness of financial sustainability and whether value for money is being attained and improved by those arrangements. That is all within the scope of the local auditors.

The reason I think that is critical for local government is that people have no choice over whether they pay their taxes or not, or at least should not have any choice whether they pay their taxes or not. As soon as you have compulsory taxation, you are not in the equivalent of a private company where an unhappy investor can withdraw their investment and go somewhere else. The public has the council they have and so they are entitled to an independent view on whether the governance arrangements and value for money arrangements are operating in



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practice. That has always been the bedrock of public audit. It is the same for central Government, which I am now responsible for, and it is important that we don't lose that principle in the case of local government.

Ian Byrne: Trust is hardwired through your answer.

Mike Newbury: The only thing I will add the C&AG's answer is that one of the distinguishing features of the local government audit regime is the ability of local electors to raise questions about the accounts and speak directly to auditors and to have their concerns aired and potentially publicly addressed. I know that in evidence to you Public Sector Audit Appointments Ltd has provided the Committee with some evidence about the questions and objections regime. That has been a fundamental part of the local audit regime over a number of years, recognising, as the C&AG has said, that there is no discretion here in the requirement for local citizens to pay tax. That is an important distinguishing feature of the public audit regime in so far as it relates to local government.

More widely, auditors also have the power to report publicly, which again is a distinguishing feature to the commercial world, and auditors in the public sector should be able to report without fear or favour about what they find in their audits and make public recommendations for improvement as well.

Ian Byrne: I think that is a very good point because trust in politics is at an all-time low, so the auditors' role in this is absolutely fundamental, isn't it, that bedrock of confidence and trust for the people out there?

Q106 **Chair:** Talking about a particular development corporation, obviously bodies like that can be set up by combined authorities and under the levelling-up Bill by local councils as well. Is it clear that local audit arrangements cover those sorts of bodies and have the same rights to report publicly about any concerns?

Gareth Davies: Combined authorities definitely are covered by the public audit arrangements and by our code of audit practice. Auditors are appointed to combined authorities in the same way as to other local authorities and they follow the same code of practice as the auditors of other local authorities. As I understand it, it then depends on the precise structural arrangements that are set up by the combined authority as to what kind of corporate structures are set up underneath a development corporation, for example. I know in some cases the auditor of a combined authority is also the auditor of a development corporation but, as I say, I don't know all the arrangements across the country. Mike, can you add to that question?

Mike Newbury: I don't think I can. I will add to the C&AG's response that we are also responsible for setting a code of audit practice and guidance for the auditors of the very smallest local public bodies, the truly hyper-local parish meetings, parish councils, internal drainage



boards, and there are some 10,000 altogether of those sorts of bodies. The public audit regime ranges from the very large public bodies, spending many billions of pounds, through to, as I say, the very hyper-local.

Q107 Mary Robinson: I think that this will lead on in some ways to the next question, when we are talking about trust. The auditor is there to put that stamp of trust on the accounts of the local authority, let's say, but we heard from the auditors who audited the books for several years in Croydon, who said that they were raising issues that were not being acted on by the local authority. Does that pose a question about the value of the audit?

Gareth Davies: Clearly, if that was the common position, yes, it would. I think Mike's point about the public reporting powers of the auditor is relevant to that question. I know in Croydon there were public reports and there is an escalating set of reports that the auditor can use, including a public interest report that is not commonly used but is available where there is a serious matter that the auditor thinks needs to be brought to the attention of the public. Often the reason for doing that will be a poor response from the authority to a previous report, a report at a lower level of escalation. One of the reasons for doing a public interest report is inadequate response and insufficient improvement action being taken. Those tools are available.

I think it also helps when central Government take an interest promptly because these reports are public and there is absolutely no reason why one of the avid users of those reports should not be central Government. I know that does happen. We will talk about the Audit Commission comparison a few times maybe but I know this from my time at the Audit Commission. One of the roles the Audit Commission played was making sure it was, first of all, aware of the local issues being identified by its auditors and then being able to have a single dialogue with the Department, the predecessor of the current Department, with an identified risk list of authorities, sometimes just to be aware of the issues that are emerging. In some extreme cases—and I remember cases like Doncaster, Hull and others—intervention is eventually required from central Government.

The audit can play a role in highlighting issues promptly, making sure they are publicly reported locally, but also acting as a trigger where necessary for national intervention and hopefully in extreme cases only. That is how the mechanism should work, in my view.

Q108 Mary Robinson: Is the PIR system robust enough to set alarm bells ringing in society generally about how the local authority is working?

Gareth Davies: It should be. I remember issuing public interest reports myself—not many because they are quite rare but I did in my time as a district auditor—and it was certainly front page news on the local and regional press in those cases. You would have to try quite hard to be a



resident in one of those areas and not know about it. It does not guarantee effective action, of course, so we would follow up very publicly about whether the right action was being taken in response to the findings.

It can be an effective tool, but I think there is a more general question about the adequacy of response to audit qualifications, for example, as well as public interest reports. Even in central Government sometimes I have cause to raise a concern that I do not think sufficient attention is being paid to qualified audit opinions. It is hard to believe when you are an auditor that not everybody reads these things from front to back, despite all of our efforts to make them plain English, non-jargon-filled and so on. A bit of a challenge to the audit practitioner there is making sure that you communicate in a way that engages attention without being sensationalist but is accurate and clear.

Chair: Coming back to issues in local audit at present, Nadia.

Q109 **Nadia Whittome:** I will ask Gareth first. In your written evidence you said that “urgent action is necessary to return the local public audit regime...to the position it enjoyed a little over a decade ago”. In what ways should the local audit system be returned to that position?

Gareth Davies: The scale of backlog of unaudited accounts that we have is unacceptable. Timeliness is a crucial component of audit quality. An audit is no use if it is technically perfect but three years late. It is just not of value. As well as getting it technically right, you have to make sure it is timely. That is the first point. That is what I meant by urgency because it is now an urgent crisis for local government and its auditors that we have such a big backlog and it needs clearing quickly. That is why I said the first thing it must do is prioritise timeliness as well as technical quality. I think that both are crucial.

To do that, we need consensus on the audit effort needed on key areas of local authority accounts, which is where we started this afternoon on things like asset valuations and so on. As I said, I am four years absent from working in the sector first hand but my observation is that the ratcheting up of the requirements from the regulator on what must be audited to get sufficient assurance in some of these areas—quite rightly those expectations have gone up as a result of the scandals in the private sector but the impact of that in local government has been that longstanding expectations of what was an acceptable level of assurance of things like asset valuations and pension fund valuations no longer apply. The auditors have found that very challenging and it has led to many of the delays. Not all of them but many of the delays are down to the perception from the auditors that they are now at much more significant regulatory risk in carrying out their work than they used to be.

That is why I think it is very useful that the FRC, as the regulator of auditors, is being given the role of system leader here, in other words being charged with making sure that this is a functioning regime that



delivers timely as well as high-quality audit opinions. I think it is crucial that the FRC's remit covers both so that it can take into account the behaviour of the audit firms and their reaction to the way they are being regulated. It is so crucial.

It is important that we find a way of clearing the historic backlog here. It goes back three years in some cases and many hundreds of accounts are outstanding now. In our role as the guardians of the code of audit practice for local authorities, we are working closely with all the other players here to work out what unpalatable but necessary options we should be considering now to get this backlog cleared, even if it means that we see high numbers of qualified audit opinions, for example, as a temporary measure—I stress temporary measure—to clear the backlog and allow auditors to return to a more disciplined, high-quality, timely annual cycle with local authorities.

This has implications for the resources that councils are applying to producing timely accounts but, probably even more significantly, the audit firms themselves having the resources, once this backlog is cleared, to make sure that it does not return. It is using the period of clearing the backlog to achieve the clarity on financial reporting that I was talking about at the start of the meeting, coming out of it with a zero backlog and clear agreement on what is required from the councils preparing the accounts and from the firms auditing the accounts to achieve a satisfactory asset valuation and a satisfactory measurement of the pension deficit and so on.

There is no point in having an exceptional effort to clear the backlog if we just return to further delays. The time must be used by the standard setters and the firms themselves to reach agreement on what is required here.

Q110 Nadia Whittome: When do you think those changes could be implemented and do you have anything to add on how they could be implemented? You mentioned a moment ago the local audit system leader; what powers and rights do you think they need to fix the current system and also sustain it?

Gareth Davies: This is a whole system problem so we need a whole system solution. We have learned that there is no point in one bit of the system identifying a way of speeding things up only for everybody else to find it too risky and sit on their hands. I think it is absolutely crucial that there is agreement from all players in this system—so the people setting the accounting standards, who you are going to hear from shortly, the regulators of audit work, who you have already heard from, and the firms themselves—on what is required in the future because then there are no excuses. People can be held to account for their performance in both the quality and timeliness of the work. It is not many years since we had really good discipline on this in the sector and we need to return to that promptly.



Another important factor is that it helps that the latest procurement for the next round of audit contracts for local government is at a more realistic commercial cost level. It looks like a very steep cost increase. I think it is necessary to return this to being work that is sufficiently attractive for the firms to resource properly. It always should have been, of course, but the next contract means that it definitely will be. It is fair then to say to the firms, "You are being properly paid for this work out of the new contract so we expect absolutely top level performance for that in quality and timeliness".

I think that those are the ingredients: agreement on the financial reporting requirements across the whole system and then good performance management discipline through those holding the contracts with the firms to say, "We are now holding you to timely and high-quality audit performance".

Q111 Nadia Whittome: Thank you. Mike, what do you think about those conclusions?

Mike Newbury: The only area I will add to the C&AG's response is that the extent of the backlog has a gravitational pull over the shape of the local audit regime as a whole. The Local Audit and Accountability Act and the code of audit practice do not give particular priority to council audits. Auditors have responsibility for the accounts but also for arrangements to secure value for money and the public reporting powers that I have talked about before. While you have such a large backlog, it inevitably draws audit effort and system focus onto that and away from those other equally important areas.

That is why we have said it is important for the health of the public audit system to address the backlog quickly—because that enables auditors to have the space and capacity to return to the value for money arrangements work, which is so important and is a key part of the code. In our code and guidance, we encourage auditors to do their work in a timely and cost-effective way, so that requirement has always been there.

Gareth Davies: Can I add an important point? This issue of backlogs also has an impact beyond local government itself. There are signs of strain in the audit of local NHS bodies, which I know is not in the remit of the Committee but it is important because it is the same public sector audit specialists in the firms that do work across health and local government. We are starting to see signs of strain in the health market for the first time as well, which is very worrying and has practical consequences for being able to sign off the accounts of the NHS as a whole, which I am responsible for. This is not a problem that can be sealed off in local government, serious as that is; it is starting to have wider impacts.

One further example is if a central Government Department or its arm's length bodies have a significant part of their workforce who in history



transferred from local government—and many of them do—they are often in local government pension schemes affected by some of these delays. For example, I am unable to sign off the accounts this summer of the Ministry of Justice, including the Prison and Probation Service, because significant pension accounting entries appear in those accounts drawn from a local government pension scheme. Delays in the local government sector are directly leading to delays in the audit of entire central Government Departments. This is a big enough problem for local government and direct accountability at a local level. It also has negative impacts across the whole public sector.

Q112 Nadia Whittome: That is an extremely important and useful point to raise, and perhaps one that other Committees would like to look into. Lastly from me, and again to Gareth first, if PSAA Limited was unable to procure audit services for all local authorities it covers in the next procurement round, would the NAO have to step in to intervene?

Gareth Davies: Not without a significant amount of planning and resource. It is important to explain that you cannot just take a central Government auditor and send them off to a local authority and expect a high-quality audit the next week. A lot of the disciplines are the same, but the context is very different. Having done both, I know that. There are specialist features of local government audit work in which you would need to be properly trained and experienced to be able to do a good job. That is not a trivial question. Practically, there are all sorts of logistical challenges.

There is also a more philosophical point here, which is if it would be right for Parliament's audit body, which is what the NAO is—we are a parliamentary body accountable to Parliament, independent of central Government, and the auditor of central Government. What would the reaction of local government be, for example, for Parliament's auditor to be imposed as the auditor of a local authority? I can imagine some people at a local level will be uncomfortable with some of the implications of that.

Further, to point out how complex this is, I am the auditor of the Department for Levelling Up, Housing and Communities. I audit their accounts. I have to be completely independent of them to audit their accounts. The topic of your discussion, the responsibility for the local government audit regime, is a departmental responsibility of that Department. I cannot be a contractor to the Department and remain independent as its auditor. I am explaining why that would not be a simple step to take.

I am sure that the Committee has considered the arrangements that currently operate in Scotland, where there remains a public body responsible for the audit of local government called the Accounts Commission. There is a complicated set of governance arrangements designed to address the risks I have just explained. It is designed to protect the independence of the Auditor General for Scotland from the



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Department in the Scottish Government responsible for local government. There is an entire Accounts Commission body set up, chaired independently, separate from the Auditor General, to ensure the proper governance arrangements and to secure the independence of central and local government audits. That is for a country with 30-ish local authorities. In England, with 350 local authorities, you can imagine the scale of the arrangements you would need to have in place to guarantee the independence of both local government audit and central government audit. It is not an easy answer.

Q113 Nadia Whittome: Thank you. That is very comprehensive. Mike, do you have anything to add?

Mike Newbury: The only thing I would add there is that the creation of additional capacity takes time and as the C&AG has said, there are some appropriate qualification requirements for people to take on the key audit partner—the KAP role—in local government audit. Any auditors undertaking that work, even if they are employed by the NAO, would need to comply with that regulatory standard. None of that is easy or straightforward.

I suppose the issue is that you need to think about how you make the capacity available to do local public audit bigger overall. If you are bringing in different bodies, all that is likely to happen is that what capacity there is gets shared around in a slightly different way. The key question—and I am sure that is part of the thinking that the Department and FRC colleagues are doing—is, how do you grow the number of people that want to do local public audit? You heard from Sarah Rapson about improving the level of respect and the attractiveness of working in this field. I had a wonderful career doing local public audit but I might be a singular exception. We need to make this world a place where people want to come and spend some time, even if they do not want to spend their entire careers.

Q114 Mary Robinson: One of the issues has been that there has been a small number of the larger firms who have dominated the local government audit sector. There will be a new procurement round. The specialisms seem to be tied to certain audit providers in a certain number of the big firms. Is there room in any of this for smaller firms to be able to get into this procurement round and to have a place in local government audit? Some of these local authorities are not very big.

Gareth Davies: It should be possible, and one new firm did win a contract in the most recent procurement, as I understand it. It should be possible, absolutely. I think that it is important, though, to be realistic about the work involved, even at a district council, that it may not look large—a few million pounds of expenditure—but it is still a political environment. It still has all the responsibilities of auditing in public that we have already described, such as routinely reporting your findings in public, dealing with an audit committee that is composed of elected councillors, not board members from a company or specialists in board



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and audit committee activity. It is a different world, and it is not the case that you can just move from auditing a small company to auditing a small council. You need to know what you are taking on and it is not for everybody.

A lot of firms would need a lot of development, training and experience to come to terms with a different auditing environment. It is important that it is not a closed-off market. It is important that there are ways of supporting the development of new suppliers, and it is good to see that there is at least one in the most recent round.

Q115 Chair: In the past, if you had an auditor doing a local authority audit who was relatively new, who came across a big issue, and who needed to write a public interest report on something—it is a big step out in the public domain—they would always go to the Audit Commission to ask for advice. Where does an auditor go to ask for advice on something like that now?

Gareth Davies: It depends on the issue. Partly to us and to Mike and his team as the providers of guidance and the code of audit practice. “I am coming to this issue for the first time and I want to know what the code expects me to do here.” We would provide advice in that situation. We also co-ordinate the provision of legal advice to auditors through a central contract that we hold. For those kinds of issues, which are rare but important to get the technical bit right, we help with our code responsibilities.

From the angle of building up a commercially viable new supplier, that is more of an issue for PSAA as the procurement organisation here. I know that they take steps to encourage new entrants and support them, partly through awarding them a contract that does not overload them with high-risk work too early. It depends on the question you have in mind, but I think that those are the answers so far.

Mike Newbury: I think that is right. We run a series of forums and technical networks to support the work of local auditors. We think that is important to inform our guidance-setting responsibilities. It enables us to pick up on issues as they are emerging and make sure that we are tailoring our guidance in the most appropriate way.

We now issue what we call supplementary guidance. This is not the standing guidance we issue and refresh on an annual basis. We have covered topics such as going concern, what that means in a public sector context; how to go about thinking about pensions audit; and the need to improve the timeliness of reporting. As the C&AG said, we also provide support through some central contracts that we run on asset valuations, pensions, and actuarial support. There is a wide range of bespoke support that we provide to the sector alongside our general guidance-setting work. We also play a full role with other partners in supporting the new entrants as they begin to build their understanding and capacity to take over the new contracts.



Q116 **Chair:** Say you have a common issue that starts to arise in a number of authorities, such as authorities that have purchased shopping centres and other assets in different parts of the country. Is there a forum where auditors who are experiencing those challenges can come together?

Gareth Davies: Yes, there is and it is the arrangements that Mike has just described. For example, we have a technical issues group with a representative from each firm who attend. Of course, it depends on all of the participants from all the firms being open about the issues they have. Because this is long-established, we think that works reasonably well. As well as having a common task with contracts in this regime, they are also competitors with each other, and that has always been part of the case here. The difference now is that all audits are done by private firms, rather than just a proportion of them, with a chunk being done by the Audit Commission itself.

Q117 **Andrew Lewer:** Looking to you, Mike, initially. Why does the code of audit practice only require auditors to comment on whether local authorities have arrangements in place to establish value for money and not whether they have achieved value for money?

Mike Newbury: That has been a longstanding feature of the local audit regime. That responsibility has not changed since, I think, the 1983 Act, which the C&AG mentioned. The focus on arrangements enables auditors to be clear that they are not stepping into commenting upon policy. In a local political context, it is important for auditors not to stray into the territory of commenting, "I would not have done that policy. I would have done this in a different way." That is not the proper province of auditors. Indeed, auditors' authority and independence are much better preserved with a focus on the arrangements side of things.

That is not to say that they should not comment forcefully on issues as they arise. In fact, our guidance requires them to do that in a timely way. They are required to maintain an ongoing risk assessment to identify a significant risk to an authority's ability to achieve value for money. Where they encounter those risks, they should report on them and make recommendations quickly. We do not expect them to hold off to an annual set piece of reporting. As we have already said, auditors have a wide range of other public reporting powers. They have many cards in their deck that they can play if they are unhappy with the seriousness with which local public bodies are approaching the issue identified.

The arrangements work covers the things that you would hope and expect—financial resilience, governance, and whether or not there are arrangements to secure improvements. The quality of the commentary that auditors should produce in that should materially help both local public bodies themselves and the communities and the people they serve to get a much better understanding of what is going on. As I said earlier, it is unfortunate that the extent of the backlog means that auditors are not focusing on that to the extent that we would ideally want them to, I suspect.



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Gareth Davies: That is comprehensive. I would say that arrangements does not mean superficial or not interested in whether they are working properly. You have to understand that the arrangements that have been described to you are operating in practice and test whether that is the case. That is the first thing.

The second thing is that, as the auditor of a single local authority, you cannot do the kind of value for money work that used to be the province of the Audit Commission, which would be comparative value for money work pointing out the range of performance on a particular issue nationally, highlighting those areas where most improvement was needed. Perfectly valid national policy decision does cease that work. That means that auditors do not have that information either. Despite some benchmarking tools that are still available in the sector itself, it is quite hard to be clear where the authority you are auditing is positioned on a range of performance nationally.

Q118 **Andrew Lewer:** That is a very useful unpacking of this and some contrast to previous testimony, which I think has not perhaps understood the difference between the robustness of those requirements and saying, "Isn't it daft that they do not say whether it is good value for money?" You have explained that. In a 2019 report we had for this Committee, Professor Laurence Ferry said that he did not feel that value for money was being examined properly, rather than merely arrangements. It sounds from what you have said that that is explained by unpacking this idea of the robustness of the arrangements looking into whether value for money can be achieved or not.

Mike Newbury: In response to that, I would say that the current code of audit practice came into force from 2020. A previous code required auditors to form a binary view on whether or not arrangements were adequate or not. When we were reviewing the code and when we went out to consult, we felt that there was a possibility of enabling auditors to tell a much richer story. That is why the code changed and why we moved to asking auditors to provide a commentary rather than a simple adequate/inadequate judgment. The only feedback that we have had, particularly from the health sector where the VFM commentaries are being delivered in advance of local government, is that these are being welcomed and found to be useful.

Q119 **Andrew Lewer:** Professor Ferry also went on even further than talking about value for money and arrangements to talking about having assessments about fairness in society and equity. I think that is slightly difficult for an auditor to assess and I wondered what your view about that was.

Gareth Davies: Yes. Obviously, you would be even more concerned about straying into policy territory there. The auditor is not there to comment on the perfectly legitimate political agenda of an elected administration. It is for the administration to stand for election and to implement its policies. The auditor gets involved there only if, first of all,



it is outside the law—and that is much harder now to be outside the law than it used to be with the general power of competence and so on—or the arrangements covered by the code of practice are either not present or are ineffective. Some of the high profile scandals of the moment, if you like—unwise investments leading to serious financial problems for councils and the need for government to step in as the funder of last resort—could all be adequately audited using the current code. The tool is there for the auditor to say, “Show me the process you have arrived at in making this decision on investments. Show me how you have considered the risks involved here and how you will mitigate those risks”, and to raise the alarm before those things are being entered into.

We have seen some recent examples. Bournemouth, Christchurch and Poole Council is one where the auditor has done exactly that—identified a potential risk, in their view, not just a different policy but inadequately managed risks, and has pointed that out in an open letter to the leader of the council. In my view, that is an auditor exercising their functions properly using the existing code of practice. I do not think it is not having the right tools, I think it is just being confident in using them.

Q120 Andrew Lewer: Thank you. I think that we have explored the time delay issue already, Chair, so that is fine from me.

Chair: Thanks. Just one point. Not all services are delivered now on an ongoing simple basis by councils. I think about PFI contracts, which often run on for many years. In Sheffield, and Birmingham is the same, we have local authority road maintenance contracts that go on for many years. How do you address the value for money element in something like that in an audit?

Gareth Davies: That is a longstanding question. We have to do that at the NAO as well, because there are Government PFI contracts, or in the past there were. First of all, the question is, have the financial impacts of these been properly assessed before they are entered into? There are well-established techniques that you would expect to be used properly in those situations, such as discounted cash flows and the question of risk transfer. For example, the NAO published a report on PFI contracts coming to the end of their life, which is applicable to local government as well as the rest of the public sector. It sounds like an odd thing to do when you are getting to the end of these contracts, but a lot of the value that the contractor is planning to extract from its PFI contracts lies at the end of the life of the contract. A savvy local authority or central Government Department makes sure that they get good quality advice on how to make sure that the assets are handed back to them at the end of the PFI contract in good order, properly maintained, no dilapidations and so on. It is at that point where there is a huge risk of value for money for these contracts.

We are doing our bit at the NAO to publish advice to all parts of the public sector on that. Again, the reason why we thought that was particularly relevant for local authorities is that they are at a big



disadvantage at dealing with gigantic contractor corporations on these contracts. They cannot afford the kind of legal advice that the contractor can afford. We were urging councils to work together to use collaborative arrangements and so on to make sure that they are not underpowered going into those negotiations. The same applies at the beginning, the middle and the end of the PFI.

Q121 **Chair:** It is a challenge for the auditor, though. If you look at some of these contracts, they are so long in time and during the contract things can change in such a way that it demands a change in the contract. I think that everyone knows, once a contract is changed, then the contractor has the whip hand and will charge a lot more for it. How do you manage value for money in that sense?

Gareth Davies: You will be interested in whether the council has identified that risk. What are the arrangements it has in place to manage that risk? Does it have a high-quality commercial team? Are they on top of the contracts that are up and running within the authority? Does it rely on the knowledge of one person, which it often has done in the past, and if so, how do you make sure that you do not have a key person risk? If that person gets a new job, you have lost all of your corporate knowledge. There are affordable ways of managing those risks properly, and a good auditor will keep that knowledge up to date about the council. It is not about trying to second-guess the commercial decisions of the local authority. It is just about making sure that it has good commercial disciplines in place so that predictable risks—these are all predictable risks—are properly managed.

Chair: Thank you both very much indeed. We have covered quite a few areas there. There is a lot of concern about the current situation in local authorities and identification of some ways forward for improvements in the future. Thank you very much indeed for coming along to the Committee this afternoon.

Examination of witnesses

Witnesses: Conrad Hall, Rob Whiteman, Iain Wright and Lynn Pamment.

Q122 **Chair:** Over to our second panel now. Thank you all very much for coming this afternoon. Perhaps we could go down the table and you could indicate who you are and the organisation you are representing today. Thank you.

Lynn Pamment: Thank you very much. My name is Lynn Pamment. I am the Chair of the Financial Reporting Advisory Board to Treasury. That is the panel that determines how international financial reporting standards, or IFRS, are adapted or interpreted for Government and the public sector. I also sit as a UK representative on the International Public



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Sector Accounting Standards Board. My career was 30 years working for an audit firm, so I have performed the role of an audit partner on public sector audits within both England and Wales. In my current day job, I have Gareth's role for the island of Jersey.

Conrad Hall: Good afternoon. My name is Conrad Hall. I am the Director of Resources at the London Borough of Newham and the Section 151 officer for that council. I have been doing roles at that level for the last 10 years or so. I think that the particular reason you have invited me is that I also chair the CIPFA LASAAC Code Board, which prepares and develops and eventually issues the code of practice on local authority accounting, in other words, it defines popular accounting practice for the UK local authority sector. I have chaired that board for the last three years.

Iain Wright: Good afternoon, Mr Betts. My name is Iain Wright. I am the Managing Director of Reputation and Influence at ICAEW, the Institute of Chartered Accountants in England and Wales. We are a professional accountancy body with a royal charter to act in the public interest and that includes high-quality financial reporting and auditing. Also we have a regulatory and monitoring role of the non-financial reporting council auditor of local government—essentially the smaller local authorities we monitor. We also register key audit partners in local government. Of course, our members are participants in local finance and local audits, and indeed get into the political space as councillors too.

Chair: Nice to see you back. I do not know whether it is poacher turned gamekeeper or the other way around. I will try to work that one out.

Iain Wright: Mr Betts, I might let you know in about an hour's time.

Rob Whiteman: Good afternoon. I am Rob Whiteman, Chief Executive of CIPFA, the Chartered Institute of Public Finance and Accountancy. We set financial codes for the local government sector for all four nations of the United Kingdom and that includes the CIPFA LASAAC committee that Mr Hall chairs that sets the accounting code.

Q123 **Chair:** Okay. You are most welcome. If you find yourself agreeing with a colleague on the panel, just say that you agree with them rather than repeating the agreement. That is helpful to try to get through all of the questions we have today. Going back to the question that I began with the other panel, what is the purpose of local authority accounts? Does it in practice really support local democracy and accountability? I will go down the table.

Lynn Pamment: In my view, local government accounts should support democracy and accountability. Their fundamental purpose is around presenting appropriately and fairly in accordance with an agreed set of rules, both the financial position of a local authority and also its financial performance during the course of the year. In order to be useful to its readers, it needs to be understandable, but equally it needs to follow an



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agreed framework. You heard from the C&AG that he agreed with Sir Tony Redmond's recommendations around ways of making them more useful. The only thing I would also add is for local authority accounts to be useful they need to be timely, and that is clearly a subject of your Committee's discussions.

Chair: Yes, and we will come back to that in due course, I am sure.

Conrad Hall: I agree with the basic point that accounts are important for local residents above all. They are a record of what the council has spent its money on, they provide an assessment of financial stability and they help to inform future decision making, all of which affect local residents. I think that it is also important to emphasise the point that the accounts are likely to be complex. We have heard that even small district councils are substantial in size. Even where I work, for example, the gross expenditure is probably in the order of £1.5 billion a year.

Of course they are going to be complex and therefore not all of them will be directly accessible to all residents, but I think it is important to emphasise that a lot of the information is directly accessible to residents. They understand whether the local authority has spent within its budget or not. They understand disclosures around senior pay, for example, and many other examples as well. I think that it is important to emphasise at the outset that although they do contain complex information, there is a lot of useful, practical information in there as well, supplemented by a narrative statement that explains it. That is why the audit of them is so important—because it provides a resident with the assurance that the information in those and on which other decisions are based, such as a local authority's budget, for example, is grounded in fact.

Iain Wright: At a basic level, the accounts should provide a position of an organisation's financial performance and financial position over the previous 12 months. In that regard, it should be no different in local government to any other entity. In a local government context done well—and I think we will talk a little bit about doing this well—it should provide that improved level of governance, accountability and improved decision making. Council tax payers want to know how their money is being spent, and ultimately local authority accounts are the best way of being able to distil that.

Rob Whiteman: We have all said, Chair, that all entities should produce high-quality accounts to standards in order to give assurance that resources are being properly applied. That is true for a local authority as much as it is true for an NHS trust, Government Department or a large corporate. The Comptroller and Auditor General said earlier that the importance of doing that to the standards of whole of government accounts is because local authority accounts are consolidated. I would add that producing the accounts is an important part in any organisation's regulatory cycle and the way that it organises its own governance and therefore does support accountability in assessing risk.



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The “but” becomes here that those international standards, IFRS, which we adopt for closing public sector accounts, are not designed for public bodies. They are designed to give assurance to the capital markets. That leaves something lacking.

I agree with Sir Tony Redmond's recommendations that because we are public bodies that are also accountable to the public, there should be something beyond usual corporate reporting to these high-quality financial standards that the public can understand and use in a way that they will not be able to use the accounts of a local authority, a health trust, a Government Department or a large corporate. The standards are not designed for straightforward accountability to the public. We hope they are used and we have a duty to make them as accessible as possible, but local authorities are large, complex organisations. They are, in accounting terms, more complex than Government Departments or NHS trusts. They manage their own pension funds. They are often involved in complex regeneration vehicles. There was a comment earlier about small councils. Even district councils maintain a statutory housing revenue account. We do not account for local government on a group basis. There are a number of requirements for individual statutory accounts. By any standards, local authority accounts are complex. Therefore, Sir Tony was absolutely right to suggest that we produce something else for the public and key stakeholders.

Chair: Moving on, then, to the adequacy of accounts, Mary.

Q124 **Mary Robinson:** Thank you, Chair. I will stay with you, if I may, Rob, speaking about Sir Tony and his comments. He commented on the complexities, as you have set out, and the council and local authority accounts have grown in complexity year on year. We have seen this.

Given the importance and the purpose of being understandable and helping local democracy through accountability and all the purposes there, what are your feelings on how local authority accounts fall short of achieving their desired purposes? How can they be improved?

To point to you one issue that was raised by Sir Tony Redmond, he said, “The lack of transparency and understandability of local authority accounts raises a fundamental and serious challenge in terms of transparency and public accountability”.

Rob Whiteman: Thank you very much for the question. There is a real risk that if people do not understand the accounts, they appear opaque and therefore may appear untrustworthy. Here is a group of accountants saying that these are complex accounting standards and all organisations in the world have to meet them.

We can do things outside of Sir Tony's recommendation for a streamlined account. Some of them would, conceptually, cost money. We have a number of statutory overrides that make our accounts quite complex. If you think of a pooled investment vehicle, a local authority will not sell that pooled investment vehicle if it is running at a loss. But in accounting



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terms, you would provide for that loss at fair value in the revenue accounts to make a provision for a potential loss. But it would cost real money and it would cost real council tax to provide on the basis of fair value.

Similarly, we have arrangements for the paying down of debt called minimum revenue provision, but we do not depreciate assets as a real charge to profit and loss and setting aside cash for the replacement of those assets.

What would CIPFA like to see? I would like to see us move to have some of the overrides removed over time if funding were available. I would like us to move to group accounts, if that were possible, remembering though that there are a number of statutory individual accounts; for example, the housing revenue account.

Most of all, I would like to see audit mattering again so that we can get rid of the backlog and can prepare accounts and have them audited on time. CIPFA has created a better reporting group, which will work with CIPFA, LASAAC and other stakeholders, to look at where there is a lack of transparency at the moment because they are not audited on time and are seen as complex and that must be a bad thing.

There is no easy solution. The streamlined statement that Sir Tony recommended did not land well with some stakeholders because it would be produced at a different time of year to the council tax leaflet. Accounts are audited later in the year and so it would mean writing to the public twice rather than once at budget-setting time and would appear like an extra burden.

We can do things—the shortened statement, looking at the basis of group accounts, looking at capital accounting and depreciation—but all of them have consequences, particularly in funding terms, even though they would make our accounts more manageable to understand.

Q125 Mary Robinson: Thank you. That was comprehensive. Those will be big changes. Iain, do you have something to add?

Iain Wright: It is a great question. I want to continue with what Rob was saying. Local authorities and their finance teams essentially try to ride two horses. The preparation of the financial accounts is based on accruals and on IFRS, but the whole culture and the nature in which their statutory management is carried out is cash accounting. It is the receipts and payments. It is where a budget, which has to be balanced, is thought through. It is through the communication with council tax payers in terms of, “This is what the budget will be. This is what your council tax will be”.

How you try to transition between those two systems provides an enormous amount of complexity, as said by Sir Tony. Trying to avoid volatility for council tax payers means that you have to have statutory overrides and what have you. You have to try to reduce those statutory



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overrides as much as possible. You should try as much as possible, notwithstanding the culture and ethos that I have mentioned, to ensure that accruals accounting, IFRS, is a means by which you improve financial reporting and decision making. That is the first thing I mention.

The other thing is that an awful lot of boilerplate disclosure and reporting provide no value to anybody whatsoever. The one that always strikes me is the contingent assets policy. What is the economic benefit of some future event over which the local authority has no real control? Many local authorities do not have contingent assets but notes in the accounts provide pages upon pages of what the policy will be. How does that help the user of those accounts there?

There are statistics that always strike me, Mr Betts, that sum up complexity, and complexity comes with length as well. Manchester City Council is, by all accounts, well run, well governed and has no issues certainly as far as I am aware. It has an annual spend of about £1.8 billion. Their accounts are 235 pages long or 293 pages long if you include the narrative report. Manchester University Hospital NHS Foundation Trust, with a spend of £2.5 billion over the same period, has a report of 55 pages. It is much easier to understand. Trying to reduce those unnecessary, immaterial or irrelevant factors and disclosures is key to that.

Gareth in a previous session touched upon this as well. Where you can, decouple the pension fund accounts from the main local authority accounts because one can slow down the other. There is often no need for them to be together. By decoupling them, you can save time and make the accounts easier to understand.

Maybe we can touch on other things in the discussion, but I would focus on those key areas.

Q126 Mary Robinson: Would there be anything to add to that? That was comprehensive. It sounds a little bit also like reporting by exception could be considered.

Conrad Hall: I agree with many of the comments made and so I will not waste time repeating my agreement with them. I acknowledge the point that more local councils could always do more to improve the presentation and look of their accounts to help the way they look.

I want to emphasise the point that Mr Whiteman made. Many of the complexities in the accounts derive from the Government legislating to override the ordinary accounting practice and that is not always, in my view, the most helpful approach. It has been said that one of the benefits of that is that it helps avoid volatility for local authorities, for example, which is true. Equally, if local authorities do not want investments that have volatility with them, no one makes them acquire them. We need to remember that the accounting standards are there to help disclose helpful information for residents.



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To emphasise again the points I made at the start, although some of the information in the accounts is necessarily complex, a lot of it is not. Everyone can understand spend against budget. Everyone can understand senior pay disclosures. I could give many other examples of that. We must be careful not to lose that thread that important and easily available information is in the accounts.

Lynn Pamment: I will add one thing to what has been said. You have heard a lot about how the accounts have become lengthy and more complex because of the statutory overrides that, in effect, reverse out some of the entries based on IFRS types of rules.

My observation is that when you take Mr Whiteman's example of a volatile investment, the fact that that investment is volatile and has changed value in the year is in itself a useful piece of information, even if you then do not adjust your council tax because of it. The statutory disclosure and the reported IFRS result are both useful pieces of information.

Rob Whiteman: We have to be careful to focus on why there are such delays to the audit because that is the material problem. Local authority accounts can be too long, but no audit is delayed because of its contingent asset policy. Audits are delayed for reasons other than the length of the accounts. I imagine you will want to move on to those points, Chair, but sometimes collateral information is given that is not the reason we have delayed audits. I believe in streamlining the accounts. It is not the reason for delayed audits. That is for other reasons.

Lynn Pamment: I agree with that and I also note that it is not that we have suddenly changed the accounting framework. It has been pretty stable.

Chair: We will come on to the audit issues in due course. We will move on now to the further complexities of the accounts with Mohammad.

Q127 **Mohammad Yasin:** My question has been answered already, but I will still go ahead with it. We all agree that local authority accounts are often long and complicated. I used to be chair of the audit committee when I was a councillor and I understand how complex this process is and how difficult it is for local people to understand.

The challenge is how to make it easier for the public to understand. Would making changes in reporting requirements to prioritise a clearer distinction between elements related to council tax funding and the standard financial statement help?

Rob Whiteman: It is something for the public that can be used. If we streamline the accounts from 365 pages to 180 pages, it is still long. The public deserves five or six pages in plain English of issues that they want to know about. The same is true for elected members. The auditor should issue a certificate to say, "Although this is in plain English and not IFRS-



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ese, it completely conforms to the main set of accounts that we are signing off”.

Anything else we try to do, although we will try to do it, will fall short of giving the public something that they can understand, which is, “What have we spent? What have our main performance issues been? What are our reserves like? How much is the chief executive earning? Have there been any losses on investments?” These things are, in a way, lost in the accounts unless one is a professional auditor or accountant. We need to bring something out for the public that will give them those key issues.

Iain Wright: I will add several things. First, I reiterate the points I made earlier about things like the removal of statutory overrides, making sure that immaterial disclosures are left and trying to streamline the model accounts.

To your question, I mention and stress that you have to look at the primary user of those accounts. It is not necessarily the public. It is councillors. If there is a general acceptance that councillors are the primary users, you start getting into much better financial reporting and indeed accountability. The councillors running the local authority on the executive come up with sharper information to make decisions. Opposition councillors as well can hold those executive councillors to account. In the main, without finance teams and auditors getting into a political space, that level of governance and scrutiny increases if you acknowledge who the primary user is. It should be the local councillors.

Conrad Hall: The residents are the prime users of the accounts. I made my points earlier about the complexity and accessibility of those. Of course, I acknowledge that councillors have a massive role in then using the information on them, but it is important to start with the philosophical principle that they are for the resident. That is why I strongly agree with the recommendation that Sir Tony Redmond made about a streamlined statement that combines the value of all that full information in the set of accounts for those who need it with a simplified and more accessible statement for all residents. To emphasise again the point that has been made, it is vital that that is audited.

Q128 **Mohammad Yasin:** The Government accepted the Redmond review recommendations but still delayed implementing them. Do we need legislative changes to do that?

Conrad Hall: I do not know whether a full legislative change is required to achieve that. My simple answer: whatever the means of achieving that, we should move on with that as swiftly as possible. It would be a significant improvement to have, in addition to the full IFRS accounts, a simplified short version with a primary focus for residents. That would be an important step forward.



Lynn Pamment: I would like to emphasise the point so that it is not lost that that would be in addition to a full IFRS-based set of accounts that would continue to be prepared. It would be an additional statement.

Chair: Moving on to the issue of audit now, Ian.

Q129 **Ian Byrne:** Thanks, Chair. It is the same question that we asked Gareth before. I have touched on what Sarah Rapson said. In case you were not here, she is the executive director of supervision at the FRC. "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." Gareth in his answer had trust hardwired right through what he was talking about. Lynn, I will go with you first.

Lynn Pamment: Yes, I absolutely echo what Gareth said in his response here. The fundamental purpose of audit is to create trust in society so that they can trust the information that is produced as fair, balanced and understandable by local authorities. Audit plays a fundamental role in creating and building that trust. Clearly, late audits do not generate trust.

Conrad Hall: I have little to add to that. If a single word sums it up, "trust" is the one that nails the point of local audit. As the point has been made, unless that audit is provided in a pretty timely way, its value is at best limited and, arguably, when we get into two or three-year delays that exist in some parts now, almost useless.

It may come up subsequently but it is worth focusing on the value for money aspect of that audit. One issue we have at the moment is that the focus of the audit has become narrowly on whether the accounts accurately follow the IFRS requirements, all of which is important. Certainly in my view—and I know you have heard evidence to the contrary earlier—the value-for-money side of that audit, to me, does not provide the effective assurance that I would like to see from that.

Iain Wright: Distilling it down to its basic level, the purpose of audit is to provide an opinion that financial statements are free from material misstatements and are properly prepared in accordance with the relevant legislative and accounting framework. Put more simply than even that, it is one of the best checks and balances in the system that things are working as they should. Of all the large volume of data that local authorities provide, statutory accounts are the only ones that are subject to that independent assurance.

In response to your question, Mr Byrne, trust should run through this like letters through a stick of rock. It is all about trust. It has been audited in a timely manner. It is a high-quality audit. I can take assurance that I can make decisions based on the information that has been audited.

Rob Whiteman: To add to what has been said rather than repeat it, local public audit is a vital safeguard to the public, and to local and national taxpayers.



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If I had any advice to the Committee—and it in a way answers Mr Yasin's point as well about Redmond—responding to the Redmond review on the timeliness of the audit needs to be accelerated because I fear that things could get worse. We heard from Mr Newbury earlier about the importance of the key audit partners. A number of key audit partners who trained under the Audit Commission are coming up for retirement. On the whole, most authorities are preparing accounts by their deadline and auditing accounts has fallen off a cliff. Yet it was done for decades on time.

I echo something that the Comptroller and Auditor General said earlier. What has happened in England has not necessarily happened in Scotland, Wales and Northern Ireland, where you still have accounts commission processes where—

Q130 Ian Byrne: If someone is watching this evidence session, paint out what is happening in England, in your view.

Rob Whiteman: What happened in England is that auditors used to be appointed by a public agency on behalf of those authorities and that public agency would consult on fees but auditors were independently appointed by the Audit Commission in England. This process still happens through the Accounts Commission in Scotland or the Auditor General in Wales. Because each authority appoints its own auditor, on the whole, fees halved over a decade. The vital work that district auditors did as public officials going back to the Victorian era—looking at effectiveness, economy and value for money and advising on good governance, good decision making and what they see in other authorities—on the whole got squeezed out because audit became commoditised for a cheap fee.

We must all hope that the FRC can take on its system leadership role, but it has a tough gig because it co-ordinates a number of agencies. It co-ordinates the PSAA, which is a company effectively owned by the LGA, to appoint auditors. CIPFA is the account setter. ICAW has the appointment of key audit partners. The other part of FRC deals with the regulation of audit and NAO at the moment produces the code that will go to FRC.

My risk is that that remains quite a complex system, even though there is now a system leader. I would like to see Redmond's recommendations accelerated because I fear that things could get worse before they get better. Probably the changes that are happening are a stepping stone to changes that will happen later on. More reform may be needed but, for now, we have to hope and support the FRC to carry out its system leadership role because the number of audits completed on time, which was traditionally done year after year in the sector, has fallen off a cliff since the abolition of the Audit Commission.

Q131 Kate Hollern: On the point of audits falling off a cliff, there were only 12% in 2021-22. That has to be concerning right across.

It was interesting listening to the comments on why it has all gone so wrong because, obviously, it has. That makes more challenges for local



authorities when they are already under great pressure. This is to each of you. What would your three top priorities be to get the system moving and moving fast?

Lynn Pamment: It is a good question. You heard some of this in the evidence that was provided. An immediate solution needs to be found for the backlog so that you can almost reset. There seems to be a bit of—I was going to say reluctance, but my observation would be to help auditors to draw a line on those that are outdated. If accounts have been prepared and they are of insufficient quality and auditors for whatever reason are unable to get the audit evidence they feel they need, they should be qualifying those accounts. Help auditors find a way to deal with that backlog.

You have heard in terms of the FRC system leadership role. It is great to see that now being put in place. Audit firms need to be held to account for their performance. We have the new framework contracts that have been let on this. There is an important arm now of holding audit firms to account for their performance in both completing the backlog of audits but also not falling further behind. That is absolutely crucial as well among this. I have named only two things there, but those two things are important to the reset.

Once a system reset has happened, that then enables the longer-term things that also need to be started now. You have heard from people around making sure that there is sufficient capacity in the audit firms of high-quality public sector auditors to then continue and have appropriate succession planning for those audits to be completed and implementation of some of the nicer-to-have additional statements as recommended by Sir Tony Redmond in terms of improving the accounts and making them more understandable to the public.

We should not start with the five to six pages. We should start with clearing the backlog and resetting the system so that we can then move on to the more nice-to-have things around summary sets of financial statements.

Q132 **Kate Hollern:** Is there any capacity to clear the backlog?

Lynn Pamment: You need to understand the root cause of the backlog. Some of that root cause you heard in evidence this afternoon is in terms of the way that audit firms feel pressure from the regulator about the level of audit evidence that they need to gather. Fear of a regulatory failure on the part of an audit firm in itself causes delays.

Audit firms and auditors need to be helped. If you do not get the evidence you need, at which point do you draw a line and qualify an opinion? That should be an acceptable outcome. That is an important area to look at.



Conrad Hall: There is always a danger with a question like this that you will hear some fairly similar points and so I will try to make a couple of different ones. I will start, though, by emphasising that I completely agree with Lynn about clearing the backlog. Unless and until that is done, all the other things in the system that are important will not be able to proceed. Find a way to achieve that. I know that you spoke to Neil Harris last week or the week before on that matter. The work that he is doing is eminently sensible. I agree with Lynn's point that trying to impose a date by which an audit opinion, whether qualified or unqualified, must be provided may be a part of that.

I have a couple of other points to make, perhaps one small one but I will emphasise it because we talk about audit and the accounts as though that is the only assurance regime that the Government gets. In preparing for this meeting, we get our own accounts. In 2022-23 I received 18 different grants from a single Government Department, each of which comes with a different assurance regime. Some of those require some form of external or internal audit assurance. Others do not. There may be good reasons for that, but it is certainly not apparent from my point of view receiving it that that is proportionate to the risk or the scale of those grants. Other things can be done there.

On this point about capacity in the sector, as a means of building that, it is important to emphasise the wider role that goes with public sector audit so that it is more than just confirming that the accounts are indeed compliant with the IFRS standards, important though that is, and looking at the arrangements that authorities have in place to manage, for example, large and complex regeneration schemes. Many councils will do those. As with any form of housebuilding development, they are inherently risky because that is the nature of undertaking that activity, but if we do not do it, we will not manage to meet housing targets. Yet at the moment, the focus on the audit is largely on relatively abstruse points about how precisely to value a block that may be refurbished and the worth it may have in the future rather than enabling an audit focus on matters that are of much more interest to residents around how the council manages their money and how the council delivers on its priorities. By bringing that forward, you also emphasise the distinctiveness of public sector audit as an attractive career alongside rather than as a junior partner to corporate audit.

Iain Wright: I have several quick points. Backlog is intrinsically linked to capacity. Audit teams and local government finance teams take time up with having to address those things. That needs to be closed off as quickly as possible. That might mean the least worse option rather than anything that is conducive to a favourable situation. What is the value of a value-for-money audit going back to 2015-16? Perhaps we need to do something about that. As Gareth said in the earlier session, timeliness is important in this. A whole swathe of qualified accounts based upon insufficient evidence could be the basis.



Unlike the corporate sector, there is no repercussion if a local authority does not produce its accounts on time. A company would be struck off if it did that. I am not suggesting, Chair, that hard cash-strapped councils get fined for not producing their accounts, but there needs to be some sort of redress in the system to allow that to happen.

That could be part of the system leader, which is my third point. Put in place legislation to make FRC moving into ARGA the system leader. That needs primary legislation to do that.

I do not want to be quite negative or pessimistic towards the Committee at all, Mr Betts, but unless you address those long-term structural challenges about capacity for local government finance in general, for complexity and for co-ordination across the sector, we will be back in this sort of situation quickly. There are quick wins that do not adequately address everything but concentrate on those key long-term structural challenges.

Q133 Kate Hollern: Does the way that local authorities are currently funded with short-term pots add to the problem?

Iain Wright: Absolutely. I reiterate that in two points. First, of course, there needs to be an annual statement and an annual review of things. Going on the financial performance and position of a local authority on a year-by-year basis is absolutely important. Parliament votes on an annual basis. The absence of a multiyear financial settlement compromises the capacity of local finance teams to do their job. That is my first point.

Secondly, this Committee has been extraordinarily strong in this. The levelling up agenda is an important and positive policy initiative. But competing for myriad different funds takes away local government finance teams from looking at the day-to-day running of their authority. You recently produced an excellent report on this issue. It detracts from the main purpose and that undermines the capacity of local finance teams to do the great job that they can do.

Rob Whiteman: I will stick to three. There needs to be some form of reset to get rid of the backlog. It worries me a lot because I want to see that reset. If in effect we say a local authority does not have to have a particular year audited and we will sign that off by override or by qualification, it is important to do that on the right things. A large amount of backlog on audit work is because of fears by auditors that if they do not treat local authority assets as they would treat them in the corporate sector, their regulator—FRC, not FRC the system leader but FRC the audit regulator—may fine them. We have to be careful that we give an amnesty or a reset or a qualification—whatever the term is—and that we deal with the issues where large numbers of audits are not signed off because the auditors have fears about how their regulator may treat that.

I worry of course that local authorities are often involved in seeking investment in their areas. It is important that they are viewed as well-run



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institutions. Saying that they do not have a set of accounts that are properly audited can cause them reputational damage. I worry about that but there is no option but to have a reset because the system has so much backlog in it.

Secondly, another backlog will arise unless the issue that I have spoken about is addressed where the treatment of assets like pension funds, highways and other issues should not give rise to a large number of audits not being signed off. In Scotland, Wales and Northern Ireland, the system tends to work with a bit of common sense in it and audits are signed off. A partner of an audit firm that I shall not name because it would not be fair described the audit regulator as the Taliban. They are auditing purists who will fine them at the drop of a hat if they do not conform to corporate standards on pension funds and highways. That cannot be right. We need to find a common-sense solution for the regulator that is FRC becoming ARGA, allowing for assets to be treated in the public sector differently than they are treated in the corporate sector to still meet the same standards.

Thirdly, we heard from the Comptroller and Auditor General earlier that with a large number of people coming up for retirement and new entrants coming into the market, as was asked earlier, people have to have some form of accreditation or training in public sector accounts. Otherwise, they will not spot the risks that exist for different accounts to anything they have seen before.

If we can do all of that, we should leapfrog then to the next set of changes, which will affect the whole profession. It is not inconceivable that if we all filled out our RO forms to the same standards and we brought back something like SeRCOP—and members of the Committee will remember CIPFA would set how each service was accounted for—someone like Oflog could probably automate or find data solutions to the service aspects, not the balance sheet aspects. Over the next decade, nonfinancial reporting will become as significant for all entities as financial reporting. Within a couple of years, large corporates in Britain will have to report on climate change and then another series of UN sustainability goals, the ESG. I imagine they will apply to the public sector, but would you add that to what is happening at the moment, bearing in mind we are in a crisis?

Deal with the skills, reset the system and then look for some innovative solutions on things that can be automated. We all read articles that the world of audit will get automated over time and start again but, mainly, auditors must not be frightened that they will be fined and so they are failing to sign off accounts that have been prepared, even though these accounts would have been signed off five, 10 or 15 years ago with the same treatment on their pension funds or their highways assets.

Iain Wright: Forgive me. If I may reiterate and expand on what Rob was saying on two points, first, net zero and the role of local government



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have been the main debate on the Floor of the House today. That will only increase in importance and it will need reporting and it will need assurance from an auditor. That could be the next big issue that needs to be dealt with in terms of timeliness, capacity and capability.

On the second thing that Rob mentioned, to be fair to the regulator, the FRC and going into ARGA, it has a difficult balancing act. It wants to create competition and so it wants to bring new entrants into the market. It also needs to ensure high quality, which means it needs to sanction where quality perhaps is failing. But if you go too far in holding a stick, you will see audit firms go, "I want to withdraw from this market. It is not worth reputational risk. It is not worth looking at the various commercial aspects. I will withdraw". That is in no one's interest.

Conrad Hall: I have one quick point to add. Part of what we are discussing here is the purpose of local authority accounts. I feel I need to emphasise one key thing here.

Obviously, without accounts in place, you do not have a firm basis for your financial decisions. The most important financial decisions you make are the annual and forward-looking budgets for local authorities. I feel obliged to point out that the other point of that equation is funding announcements from the Government on time. The way it works at the moment—and this is the practical situation that all local authorities will be dealing with—is that they should start their budgeting process for next year now. The current range of financial targets they need to set is enormous and they will not get an answer to that until much later in the autumn, if not in December. As long as that situation persists, even if we solve all of these problems with the accounts, local authorities still will not be able to approach their budgeting in the way that they ought to because they do not have the multiyear funding settlements from the Government in advance.

Q134 **Mary Robinson:** Chair, I am expanding the remit a little. We were speaking about capacity and other things that might be coming, too. The setting up of the new 42 integrated care bodies has been announced. Different accounting systems are in place in terms of the NHS and local authorities and yet they work together. Does that have any impact on the capacity to deal with the backlogs?

Rob Whiteman: Not that I am aware of, although, as other witnesses have said, in truth this is a market and the auditors who provide to local authorities also tend to provide to the NHS. Although there are new bodies called ICBs, they replace the former CCGs and the other bodies. More accounts preparation and auditing are not actually being carried out. The format that those organisations take has varied, if that is helpful.

Q135 **Mary Robinson:** Would it be expected that the same audit bodies would take on this work? Would it be seamless?



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Rob Whiteman: On the whole, the firms in the local government market want to operate in the health market as well. Again, without generalising because some trusts are massive institutions, on the whole, NHS accounts do not have the complexity. They do not have pension funds. They do not have treasury management issues.

If we all in your constituencies want to see local systems one day that are integrating the health and care systems, the more you can align financial reporting and audit to start to have system reports and other benefits from ICBs. That will be a development of that reform. But they were created only last July. ICBs set accounts for their own organisations but they do not set system accounts or bring in social care budgets or other things from local authorities, if that helps.

Q136 **Chair:** Moving on from that, when local authorities and health bodies set up pooled budgets for things, how do you audit those when the local authorities have to balance their budgets but the health trusts do not?

Rob Whiteman: On the whole, the owner of budget consolidates it into its accounts. If a local authority operates a pooled budget with health, both parties will put that into their accounts and would declare the amount of risk carried and will have an arrangement on an overspend. If that pooled budget goes over budget, it can have implications for the commissioner, in the old money, or the social care authority, in the old money.

It is more a matter of financial management and reporting in that you tend to report your own budget in your accounts rather than the other person's budget that you put into a pool, but you have financial management arrangements to deal with the risk and the overspend that you may have to pay for. Does that help, Mr Betts?

Chair: No. *[Laughter.]*

Rob Whiteman: I am very sorry—I tried my best, sir. Conrad will do better.

Conrad Hall: I will be shorter. I do not know about better. We have been operating arrangements like this for years. It is perfectly common between local authorities and health trusts to operate pooled budgets. There have been various changes to the exact structure of those and the legislative format and so on. I could go into all sorts of technical details on it. But the point is that this is not some sort of radically new arrangement that has been invented. It has been in the accounts of local authorities and NHS bodies for years. It has been covered by the audits. You do not need to have a new concern around that if you see what I mean. It is something else that we do. The arrangements for it will change a little bit but we are used to that. It does not seem to me to be a major issue or risk within the system.

Q137 **Chair:** If you have an overspend on a pooled budget, the NHS or at some



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point the Department will deal with it. The local authority cannot act in that way. It is different from the—

Conrad Hall: Sorry, I did not mean to say that the pooled budget was without risk. Of course, as Mr Whiteman was explaining, there need to be arrangements in place that deal with, for example, if there is an overspend, what each body will do to address that, who will bear the cost of it and so on. My point is that these arrangements in one form or another have been in place for many years and so the arrangements for managing them are well known. There is not a new risk in the system as a result of it. Each individual arrangement will or will not work according to how well it is managed in the local teams.

Lynn Pamment: I want to add something. It is implicit in what has been said throughout but it is worth re-emphasising that all of the UK public sector follows the same accounting framework ultimately, being the International Financial Reporting Standards, adapted or interpreted as appropriate for the public sector. It is not that suddenly you have the NHS using cash accounting and local government using accruals accounting. Fundamentally, they follow the same accounting framework, the International Financial Reporting Standards.

Q138 **Andrew Lewer:** Rob, should DLUHC be responsible for funding the publication of the code of public practice on local authority accounting to ensure that it is available for free?

Rob Whiteman: It is a good question. At the moment, CIPFA produces the code and local authorities and auditors pay our publications service for that. In a way, there is an attraction to that because it means that the public purse does not bear the whole cost because the audit firms buy the publication just like the local authorities do.

There is a conceptual issue, I suppose, Mr Lewer, that if the Government were funding the production of the code, might it ask for different treatment or otherwise it might withhold its money? It is probably an argument like the BBC licence fee or something.

CIPFA would of course be open to discussions with the Government about whether the code should be funded in a different way because of course it is too high a fee for an armchair auditor to buy the code in the way that a local authority or an audit firm buys the code. We recognise, therefore, that financial specialists will buy the code. We would happily discuss with the Government if there were alternative ways of funding, perhaps a hybrid model, and how people who cannot afford to buy the code but may want access to it could do so. I hope that gives you an accurate answer.

Andrew Lewer: That is fine, yes.

Lynn Pamment: This topic has come up at the Financial Reporting Advisory Board. Members of my board feel strongly that there should not be a paywall to anybody being able to access the accounting framework



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used by public sector bodies to prepare their accounts. We feel that the code should be free of charge to those who want it. But we recognise that that is not currently the position because of the funding position.

Iain Wright: Redmond said that something like only 35% of local authorities have purchased the most up-to-date code. As an auditor, that would give me grounds for concern in terms of how they keep up to date. But that paywall is an issue that perhaps needs to be addressed to make sure that local authorities and indeed a potential army of armchair auditors have access to be able to hold local authorities to account.

Andrew Lewer: If nobody will read it, you could count it as a saving. Thank you very much.

Q139 **Bob Blackman:** Rob, perhaps you can help us. I understand that CIPFA compiles comparative data, which you make available on subscription only. Would it benefit the public if this was widely available and therefore you should make the information publicly available?

Rob Whiteman: Of course, it may be, Mr Blackman, that over time some of what we produce is produced by others; if Oflog were to expand its remit, for example, beyond its recent dataset. We compile, in effect, data on a number of areas but particularly overheads. People pay to belong to a benchmarking club. In belonging to the benchmarking club, they get comparative data but we will also give anonymised data on near neighbours or other similar people.

It is a little bit like the discussion that we had on the local authority code. In an ideal world, these would be free to air. At the moment, traditionally, local authorities, which are a sovereign sector and make their own arrangements, have paid for that data collection through a subscription to CIPFA. There are arguments about why data and indeed the code should be free to air. It is where the funding would come from. At the moment, authorities in effect pay for us to produce the code and also to run the benchmarking clubs.

Q140 **Bob Blackman:** Have you had discussions with Oflog on what may happen in the future? One of the intentions here is to try to make data more available to the public. We have discussed earlier how to make it easier to understand, but having the data in the first place is a good start.

Rob Whiteman: It is. As Oflog develops, we will gladly discuss that with them. Of course, the Government also gives some money for LG Inform through the improvement grant. There is Oflog, there is the improvement grant to the LGA and then CIPFA charges for some of these things. There ought to be a discussion in the round about how we make as much data as possible available.

Q141 **Bob Blackman:** Do you cover your costs of producing this comparative data by the subscription service you offer at the moment?



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Rob Whiteman: Yes, we do.

Q142 **Bob Blackman:** Iain, would this data be of use to your organisation?

Iain Wright: Benchmarking in the main is a valuable aspect of different sectors in terms of where we are. Without wanting to intrude on Rob's policy and financial decision-making, on that whole available benchmarking data, Oflog could perhaps have a role here but certainly in terms of co-ordination through the system leader, FRC/ARGA, it would be beneficial.

Q143 **Bob Blackman:** Do you use the data at the moment? Do you subscribe to the service?

Conrad Hall: We subscribe to some of the CIPFA benchmarking clubs, but not all of them. We pick and choose where the information is most useful to us. I strongly agree with the general principle. You should want access to that information to tell you where your costs are, for example, relatively high and therefore to understand whether that is because of poor performance or because you have made a deliberate policy decision to invest in a higher-quality service or whatever it might be. The information is definitely useful.

The only other point to emphasise is that there is always a slight risk when information is then shared publicly. I have no problem at all with information being shared publicly, but one always needs to understand the story behind it. In the example I have given, an authority may be high cost because it is not well run or it may be high cost because it has chosen to deliver a different sort of service. It always needs to have that explanatory narrative behind it. Otherwise, the data can be misrepresented.

Lynn Pamment: I have a couple of observations. In the public interest, a degree of comparative data being publicly available and free of charge is appealing. The beauty of a benchmarking club where people pay to participate is that they probably are therefore more committed to it and get more value out of it. To participate in any benchmarking takes time, effort and resources. If you suddenly make it mandatory, you have to be clear about the benefits of doing so because there will be costs associated with that.

Q144 **Bob Blackman:** Also, presumably, the funding would follow.

Lynn Pamment: Yes.

Chair: Thank you all very much for coming this afternoon and having a wide-ranging discussion with us. There are a lot of issues there for the Committee to pick up on. We will give consideration to all of those when we produce our report in due course. Thank you very much.