

## Public Accounts Committee

### Oral evidence: Timeliness of local auditor reporting on local government in England, HC 1292

Thursday 20 May 2021

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Members present: Meg Hillier (Chair); Olivia Blake; Dan Carden; Sir Geoffrey Clifton-Brown; Craig Mackinlay.

Housing, Communities and Local Government Committee Member present: Mr Clive Betts, Chair.

Gareth Davies, Comptroller and Auditor General, Mike Newbury, Director, National Audit Office, and Marius Gallaher, Alternate Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-70

#### Witnesses

**I:** Tony Crawley, Chief Executive, Grant Thornton, PSAA, Catherine Frances, Director, Local Government and Public Service, MHCLG and Jeremy Pocklington, Permanent Secretary, MHCLG.



## National Audit Office Report

### Timeliness of local auditor reporting on local government in England, 2020

#### Examination of witnesses

Witnesses: Tony Crawley, Catherine Frances, and Jeremy Pocklington.

Q1 **Chair:** Welcome to the Public Accounts Committee on Thursday 20 May 2021 for the second of our two sessions examining local auditor reporting on local government in England. On Monday we heard from the auditors, the private audit firms that account for 70% of local government audits: Grant Thornton and EY. Those external auditors, with the other companies that still do this work, are responsible for assessing £100 billion a year of net revenue spending by local authorities in England. We had a really interesting session then. We also heard from Sir Tony Redmond, whose review made 23 recommendations about the future of local audit. I think it is fair to say we came away with some serious concerns about the state of the market and the sector. The Government have delayed: they pushed back the date for audit returns and opinions to September, and in March this year they extended that for another couple of years. So some work is being done by Government to try to mitigate the challenges.

Today, we have witnesses in front of us from the Ministry of Housing, Communities and Local Government and from Public Sector Audit Appointments, which is the body that commissions or procures over 90% of local government audits in England. We are also delighted to have guesting with us again today Clive Betts MP, Chair of the Housing, Communities and Local Government Committee. We will be asking questions of our witnesses, who are Jeremy Pocklington, permanent secretary at the Ministry; Catherine Frances, director general for local government and public services at the Ministry; and Tony Crawley, chief executive of Public Sector Audit Appointments. Welcome to you all.

Before we get into the session today, I just want to check in with you, Mr Pocklington. As permanent secretary, you did a review in your Department about senior civil servants doing more than one job. Can you tell us whether that threw up any concerns?

**Jeremy Pocklington:** No, I found nothing that concerned me. You are correct that, like other Departments, we reviewed our approach to identifying and recording conflicts of interest, and business appointment rules. We confirmed what we knew, which was that quite a number of civil servants, including senior civil servants, have other roles—in volunteering, as trustees of charities and school governors and doing other things,



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including holding academic positions—but I found nothing that concerned me or was inconsistent with the “Civil Service management code”.

Q2 **Chair:** When you say “academic posts”, are they paid or unpaid?

**Jeremy Pocklington:** A very, very small number in my Department have paid roles—nothing, as I say, inconsistent with the “Civil Service management code”.

Q3 **Chair:** Thank you. That is heartening to hear. And thank you for the letter that you sent yesterday. This is a letter coming alongside an announcement, which is on the gov.uk website, about the Department’s latest response to the Redmond review, and in particular which body is now going to be dealing with public sector audit. Do you want to make a quick comment about that? We will go into the detail of it during the session, so we are relieved that it arrived yesterday—even though it was late for us—rather than this afternoon. Could you explain in simple terms what the key headlines are, to save us from having to repeat it during the session?

**Jeremy Pocklington:** The spring update that the Department published yesterday confirmed the Government’s view that the system leader for local government audit should be the new Audit, Reporting and Governance Authority—ARGA is the acronym that I suspect you will hear through this hearing. That is being established to replace the Financial Reporting Council as part of BEIS’s wider reforms to corporate audit.

It’s important to confirm one detail at the outset. Our view is that PSAA, whose chief executive is here today, should continue with the procurement of local government audit. It is a variation of the proposal in Sir Tony’s review, which is that the system leader would take on that role.

**Chair:** It is helpful to get that laid out on the record. We will be probing some of the detail. There is quite a lot of information on the website, which we have been on top of overnight. Without further ado, I am going to ask Sir Geoffrey Clifton-Brown to kick off. Over to you, Sir Geoffrey.

Q4 **Sir Geoffrey Clifton-Brown:** Good morning, Mr Pocklington. My first question is how can you be sure that these changes are not just merely the shifting of deckchairs and it will not happen—there will be no real effect on the efficiency of local government auditing?

**Jeremy Pocklington:** Thank you, Sir Geoffrey. There are a number of aspects to that question. First, I think we all recognise the scale of the challenge that we are dealing with, with delays to local government audit and the weaknesses in the market. This issue has been looked at in detail, particularly by Sir Tony Redmond but involving many stakeholders from the sector. On the proposals that we set out initially in December and that we gave further details on yesterday, I think there is widespread consensus that this is the direction of travel that we need to take in order to tackle the underlying weaknesses in the market and the fragmented nature of the different responsibilities of the various bodies involved. We have focused in recent months on taking action that will have an impact



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most quickly; we will come on to talk about that in more detail. In particular, a consultation has just closed on allocating more money to affected bodies, and there is a consultation on changing how fees can be set and varied. We have now set out further details on longer-term reforms that will provide more confidence to the market.

- Q5 Sir Geoffrey Clifton-Brown:** I do not know whether you followed our proceedings on Monday—I suspect you probably did. One of the most important things that we learnt from our hearing on Monday was that 70% of all local government audits are carried out by just two firms: EY and Grant Thornton. Does it worry you that there is an existential threat to the entire system, because if one of those two pulled out the system would be in deep trouble?

**Jeremy Pocklington:** I do think we need to see more new entrants and more capacity in the audit market. Mr Crawley will understand the market in more detail, but as you say, the market is dominated by two firms—there are other players as well, but the two firms you highlight do form the majority of the market. One reason for deciding that ARGA should be the system leader is that we think there is a very strong alignment between the challenges we are dealing with in local government audit, with some of the broader challenges that the Government is dealing with, and audit in other sectors as well, so we do need to see a stronger profession. We need a more competitive market, new entrants and a stronger pipeline as well.

- Q6 Sir Geoffrey Clifton-Brown:** Given that ARGA is not going to be set up until 2023, does that not give rise to real worry about what will happen in the interim?

**Jeremy Pocklington:** That is why we are taking action now on some of the issues that I have already highlighted. We are providing more money to affected bodies—£15 million—but even more importantly a consultation has just closed this week on how to allocate that. We are consulting now on changes to the regulations that set the fees in the sector to enable fees to be set closer to when the audit work is actually being done, and to enable variations in fees to take place more quickly so that they are more responsive to changes in workloads.

We have also recognised that it will take time to establish ARGA. We have set out that in the interim MHCLG, my Department, will chair the liaison committee that Sir Tony proposed in order to bring all the affected bodies, all the responsible bodies, together. In due course, that leadership will transfer to ARGA, but in the interim it is important that we have stronger system leadership during the transition.

- Q7 Sir Geoffrey Clifton-Brown:** There are two important parts of a local government audit: one is the assessment of financial resilience, and the other is the assessment of value for money. In our previous hearing on local government finance, we had considerable discussion about the need to ensure that a local government audit really probes the financial resilience of each local authority, the functions of the section 151 officer,



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and whether they are likely to issue a section 114 notice or are getting close to it. Are you convinced that the new system will be at least as robust, if not more so, as the present system in assessing financial resilience?

**Jeremy Pocklington:** Yes I am, Sir Geoffrey. That is an important part of the audit system. As you say, for us there are two fundamental pillars of audit. First of all, it is the preparation of the statutory accounts, so that they are audited in accordance with CIPFA's code of accounting practice. Secondly, and this is the point I think you were alluding to, there is a proper value-for-money assessment, consistent with the code of audit practice covering financial sustainability—the very important issue that you highlighted—and covering governance, and the economy, efficiency and effectiveness of the use of resources.

As you may know, that code was changed by the National Audit Office at the start of last year; this is the first year that change is coming into effect and the code is moving to a commentary rather than a binary assessment. I think that is a positive change and will be more useful to both the officers of local authorities, and to MPs and the wider public.

Under our proposals, responsibility for that code would transfer from the NAO to ARGA, which would require legislation. We have also said that there will be a post-implementation review of the code. However, the importance of financial resilience and sustainability is at the heart of our thinking in the Department, as we have discussed in several hearings of this Committee.

Q8 **Sir Geoffrey Clifton-Brown:** Of course, and as you would expect, my two questions are linked. Given that this is a free market, any auditing firm can bid to do this work, and if they do not think they will make enough money out of it, they don't do it, which is why we only have two firms doing 70% of the work. If you are going to beef up that value-for-money function in the way that you are talking about, isn't that likely to make the situation even worse? And I put it to you again: how are you going to encourage a greater number of firms to want to do this work?

**Jeremy Pocklington:** It is important that we maintain the quality of local government audit; you would expect us to say that, as stewards of the system. Of course, it also needs to be proportionate, and we may come on later in the hearings to consider ways to focus on that further.

The steps that we are taking to change how fees are set will help. Shifting the deadline will provide greater confidence and alignment with the market, but it will take time to right the market. Providing clarity about the future direction of the market will provide confidence to auditors about our future plans and direction. And PSAA and Mr Crawley are already beginning work on the next procurement, which will also be an important moment.

I think there is widespread acknowledgement that although fees were set through a process at the time, ultimately—with hindsight—we are in a



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position where audit fees are insufficient for the challenges of where audit has reached in recent years.

- Q9 **Chair:** Before I bring in Craig Mackinlay MP, you mentioned fees. My own local authority—obviously I was in touch with them ahead of this—very much recognise the complexity, as a busy London borough, and would welcome a more detailed audit, but then there is a cost, as you say. If fees go up, will the Department look at a settlement for local government to reflect that?

**Jeremy Pocklington:** We have already put in more money this year for affected bodies. It is not directly going to audit companies, to be clear.

- Q10 **Chair:** That is the £15 million, but that is one-off, isn't it?

**Jeremy Pocklington:** Yes it is; obviously, future fees will be a matter for the spending review. That is what I would say, but the reassurance is that the Department does recognise the importance of this issue and it is a priority for the Department, as I am sure it is for the Committee.

**Chair:** If it is £15 million in one year, we will see how that is spent, but that seems to me to give a direction of travel, in your carefully coded way, about the spending review. If we value local government audit, it needs to be funded, and local authorities are already very squeezed, as we have covered in other hearings.

- Q11 **Craig Mackinlay:** To declare an interest, I am still a partner in a firm of chartered accountants; I am an ICAEW member and a senior statutory auditor. I used to be the chairman of the audit committee at Medway Council, a fairly sizeable unitary.

I will start with Mr Crawley and the PSAA. Sir Geoffrey mentioned the domination by two firms across this provision of services. I am fully in favour of public-private partnerships in these types of things, because the choice that we have is either to go back to an almost nationalised route or to keep the market trying to do what it can. In your estimation, Mr Crawley, what is the reason why so many other firms either have chosen not to be part of the process or are missing out on the opportunities?

**Tony Crawley:** Thank you for the opportunity to come along today. The bottom line is that it is a specialist area. The local government accounts are different: the value-for-money assessment is different and there are the other duties that auditors need to take on when they do a government audit, such as the quasi-judicial role around public interest reporting and so on. It is a specialist area.

About two years or a year ago we looked at the market and did some research. A company called Touchstone Renard published a report on our website which identified that there are challenges and barriers to coming into the market. We would like to see what can be done to overcome those barriers. You need to be accredited to be able to do this work, in recognition of the specialist knowledge needed, so we can only contract with firms that have gone through the ICAEW process to be able to do this



work. Each individual person leading the audits needs to be a key audit partner. Again, they need to have individual accreditation.

In recognition of that specialism, there are some processes that firms need to go through to get accredited to be able to contract with us, or with individual bodies if they choose to procure their own audit. It is about trying to make that whole package attractive. The firms are able to bid what they see as an appropriate fee for the audit. We recognise that to come into this market there is an investment aspect. One of the things that we are looking at for the next procurement—we were very pleased to be confirmed as being able to carry out the next procurement in the note that was issued yesterday—is starter packages and ways that individual firms can come into the market with relatively small packages of work.

We are also open to consortia where you have an accredited firm working with an unaccredited firm, so that they can learn the ropes and work through the unusual aspects of local government audit. There are ways to attract them, although it is not going to be easy. At the moment there are only eight accredited firms, so the idea would be to try to build that number up. As has already been mentioned, it is going to take time to work this through.

- Q12 Craig Mackinlay:** There are hundreds of registered audit practices across the country, with mine being one of them. We do no PSAA work or SAA work. You could argue that some of the SAA work would be a stepping stone into this field of work, but is it becoming a bit too much of a closed shop? Because a firm with an ICAEW or one that is a certified accredited firm for audit technically should be at a level to allow them to do this work. Are the barriers to entry becoming so great, with the domination of eight firms overall and two in particular meaning that other practices say, "This isn't for us," because they would have train staff and have a pool of staff and specialisms that take time to build up? I guess we are now reliant on a few hundred people across this country with the requisite skills within the firms to audit £100 billion of public expenditure. Do you think we are in a very sustainable place?

**Tony Crawley:** We are on record as saying that the challenges facing this market are serious and pervasive. That is the case, and I think you have heard that reflected already. So it will take time to work the challenges through. Having clarity on systems leadership is an important first step. I think yesterday's announcement was about how the way that will be implemented will be subject to further a paper by the summer.

If you can create a system or a framework where firms will feel confident to come into the work—you heard on Monday that those two leading firms would welcome further suppliers. They recognise that we need more suppliers and more people involved. You also heard that there is an issue around the key audit partners and their age profile as well. So there is a real challenge around trying to get people through the pipeline to be able to take on audits individually, but also for firms to take on the audits and come into the market.



Again, it is about trying to get a framework, of which procurement is a part, but certainly not all of it, that is conducive to firms saying, "Right, that's an area I am interested in. I want to learn about that. I want to go into it. That sounds like an area that would be good for our firm."

- Q13 **Craig Mackinlay:** Okay. Mr Pocklington, let's look at figure 3 in the NAO Report and some of the delays we have faced. I am not so concerned about the 2019-20 delays—we can put that down to the experiences we have all been living through under covid—but in 2018-19, when life was as normal as it can be, we still had a huge delay and audit report deadlines not being met. What is your assessment of why that was? Mr Crawley might have some views as well. Let me throw in a couple of my ideas. The whole audit practice has been under some pressure in the last few years and there have been some problems—I will say no more than that. Do you think firms have been tending to over-audit because of worries about the FCA knocking on their doors, or is there something else?

**Jeremy Pocklington:** I think a variety of factors led to the delays in 2018-19. That was the first year that there were serious delays. In 2017-18, it is important to recognise that 87% were completed by the July deadline; it was in 2018-19 that the delays emerged. We have hinted at it, and on Monday you started to explore the reasons for that. I think that the changes in audit quality and regulation following the corporate failures you alluded to are a factor. I would not necessarily describe it as over-auditing; I would describe it as shifts in how audit is being undertaken ultimately under the leadership of the FRC following those corporate failures. However, the result is also one of reduced capacity in the market. Again, we have already alluded to that and started to talk about the actions we are taking to deal with that.

A further factor—again, you noted it on Monday, and it was noted by Sir Tony in his report—is that in some local authorities there is perhaps a lack of capacity and skills to act as a strong enough client in all situations. Again, that has been further compounded this year as a result of covid. Finally, the lack of a systems leader, or the fragmented nature and distribution of responsibilities in this space, also means it is perhaps harder to act and to bring different bodies together in a co-ordinated response to those challenges. We are acting on all those issues. I don't think there is a single cause of the delay; it is due to a number of different factors.

- Q14 **Craig Mackinlay:** Can I just explore some of those a little bit further? You alluded to something that was in my mind: the skills that are in local authorities. Local authorities will have the accounts team. They will be of varying size and varying quality. The problem might be that local authorities that are facing squeezed and tight budgets may not feel that it is an investment that is top of their list when—in very plain language—the library needs a repaint.

Are the internal accounting systems of local authorities presenting their accounts to a standard that will allow external auditors to get on with



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their work quickly and efficiently, without having to reconstruct some of the requirements of FRS 102 and all the rest of it that has not quite been done properly? There are pressures and changes in accounting standards, particularly relating to leases and real-value accounting, and all of this stuff is quite time-consuming and laborious. That is one thing. Within local authorities, are there internal controls that are of a sufficient standard and on which external auditors can rely—hence, minimising their transactional ticking and bashing, in old language?

Also, are their accounting systems really up to scratch? I would not go up the route of telling local authorities which accounting system they need to use, but my experience when I was audit chairman was that Medway Council had an accounting system, but there were a massive variety of spreadsheets that all had to be pulled together in a fashion to put together the annual set of accounts. This is not good working. Is there anything you can nudge local authorities towards, to help get their accounting systems, quality of internal staff and quality of internal audit to a better standard?

**Jeremy Pocklington:** There is a range of factors. I think the first thing to say is that there are some examples of very good practice in local authorities—we should acknowledge that in the hearing—with appropriate expertise, governance and oversight. The accounts only get you so far; it is also about good financial management and good governance, as I am sure we would all agree.

Unfortunately, you are right to say that the skills are patchy in local authorities. It is clear from what Sir Tony found in his review that the sorts of issues that you are alluding to are too prevalent, unfortunately, and that that has contributed to the delays. It has been further complicated by the changes in audit standards that, again, you are alluding to. Some of those stem from the corporate failures.

Another factor that I don't think we have alluded to yet is perhaps the greater complexity we see in local government, which we have touched on in previous hearings. Another factor is commercial investments. It is a factor, and at times it does hinder being a good enough client. Ultimately, local authorities need to prioritise this, and the statutory officers and the council ought to be focused on this, recognising the importance for good governance.

In the Department, we need to ensure that there is an appropriate framework and appropriate sets of checks and balances in place, but we also need to do our bit in supporting skills in local government. This year, we are spending a little over £19 million to support skills in local authorities. Ms Frances can provide more detail on that, if that would help.

**Chair:** Do you want Ms Frances to come in, Mr Mackinlay?

**Craig Mackinlay:** She can do if she has got something to say on that.

**Catherine Frances:** The most important thing about improving the capability and capacity in local government, as Jeremy says and as you all



know, is that we part-fund organisations such as the LGA and CIPFA to do a whole set of sector-based support. CIPFA and the LGA focus as one of their key themes on governance, financial management and financial resilience in the work they do. The Department directly commissions certain work to improve governance and best practice in the sector. For example, we have recently put some funding into the Centre for Governance and Scrutiny, which is an organisation that you are probably aware of. It has put a toolkit out to all local authorities to try to help people understand how best to do that.

At its base, where local authorities have been adjusting to the fact that they have standards that they have to meet and IFRS codes, and are in some contexts dealing with slightly more commercially complex structures, ultimately it is for local authorities to understand what they are doing and are reporting clearly on in. Later, we might want to come on to Tony's recommendations to make the written material that you receive in a council, which you know about, more transparent and understandable to the taxpayer and councillors. We will come on to that, because we are doing some work on it.

**Q15 Craig Mackinlay:** Okay. That is very helpful. To go back to Mr Pocklington, you have described some of the reasons why we are seeing delays—they are multitudinous, and let's hope that what you alluded to in your letter yesterday addresses many of them—but what do you think the problem is in delay? We are focusing on dates. I know that there has been an extension to 30 September for a couple of years, so we have a slightly extended deadline. What do you think is the downside of delay? Any section 151 officer worth their salt should have a good handle at any time of the financial health of their authority. To be devil's advocate, why does it matter? Why do you think it matters to get things in on time?

**Jeremy Pocklington:** Timeliness does matter for local government audit. The most obvious risk is that the audit process discovers something that requires management action, and that action is delayed as a result in the delay in the local government audit. There are also implications of delay for audits elsewhere in the public sector, Departments and, ultimately, Whole of Government Accounts, which does matter.

You are right that there are balancing items that suggest that there are other ways of deriving assurance. Most obviously, as set out in the code of audit practice, auditors should not wait to finalise their accounts if they find a significant weakness during the audit process; they should alert management. They can issue a public interest report or a statutory recommendation at any time. Good governance of a local authority doesn't depend just on the audit process, which by its nature is backward-looking; it also depends on robust financial information, good governance and scrutiny at the scrutiny committees. All those checks and balances matter. To an extent, if audit is late, there can be a degree of compensation from these other methods, but I don't want to downplay the importance of timely audit too much.



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**Craig Mackinlay:** No. The obvious one that is of interest to parts of Government is trying to put the WGA together, which is quite a job in itself.

**Chair:** Just to be clear, Mr Mackinlay—not everyone will know the WGA—that is the Whole of Government Accounts.

Q16 **Craig Mackinlay:** Whole of Government Accounts, yes. It is a major exercise, and this country makes a very good attempt at putting Whole of Government Accounts together, compared with some of our international counterparts. You often wonder how many people read them, but they take a major amount of work in themselves.

Ms Frances, you alluded to the complexity of local government. This Committee has been looking at the commercial transactions that local authorities have entered into. There is a variety of commercial ones, such as buying high streets and shopping centres, and some other rather more strange ones, such as solar contracts and all of that type of stuff. I think there is an obvious answer, but do you think that has made the whole audit of local government more complex and more risky? Has it perhaps put many firms off getting involved? The downside of reporting, only for a section 151 officer to then issue a 114 within a few weeks of that report, has got a seriously deleterious effect on the reputation—*[Inaudible.]*

**Catherine Frances:** What auditors tell us is that auditing the accounts of local government is a more complex task than, say, auditing the accounts of a major NHS body or something. That is partly because of a different structure in local government and a complexity about income and a complexity about just the sorts of investments that you are talking about. So I do accept that that can make audit more complex.

I think it speaks to the very strong requirements for standards and quality, both in the sort of value-for-money code of practice work that Jeremy has talked about, to make sure that people understand locally what is going on and that there are good processes, but also that the standards are right as regulated at the moment by the Financial Reporting Council.

What we have heard a little from auditors—I would push back on this ever so slightly—is whether the Government are clear about what is and is not appropriate in terms of commercial practice locally. I think we have actually been very clear on this. We have been clear that commercial freedoms can be really positive where they are supporting regeneration, housing and issues like that, but over the last year or so we have reformed the PWLB's access criteria so that an authority cannot access PWLB loans if they are engaged in activity principally for yield.

Our Secretary of State made a pivotal speech in January, setting out the sort of direction of travel here and setting out what he thought would and would not be acceptable, and also indicating risks about crowding out the market at times. We have launched our own data system and collection recently, and when we have supported councils with exceptional financial support, as we have covered with the Committee before, we have



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underlying principles in how we approach that, which is, amongst other things, to look at whether anything problematic has been occurring in the way those sorts of commercial relationships are managed.

I think we have quite a strong set of systems there. I know that there is always a question about exactly how we should manage them. I hope that is not too long an answer, but it is a complex area.

- Q17 **Craig Mackinlay:** This probably goes back to Mr Pocklington, but feel free to answer. What do the delays really mean? Do they have a risk for the budget setting process? If you have a delay into November reporting, it is usually incumbent on the council to try to put a budget together by about February. That has obvious implications when the time in between reporting and the next budget is skinny. Perhaps, even more importantly, there is the democratic accountability. We tend to have local elections in May, but there could be things that aren't being reported on to the general public, who are paying for all of this, at the appropriate time, so that they can make the assessment of their councillors and the authority in general. What do you make of those risks, Mr Pocklington?

**Jeremy Pocklington:** I think that is an area of risk. The statutory accounts often form the underlying basis—it is not the previous year, but the previous year but one—for the budget setting process. It provides that confidence, assurance and transparency that the baseline is appropriate for the budget setting process.

There have been one or two examples recently where an audit has revealed something that ultimately affects the reserves of the local authority and ultimately that will have a knock-on effect on future budgets as adequate reserves need to be replaced. It is possible to manage the situation with an overhanging audit—that does happen—but obviously, it is a better position if the audit has been signed off by, say, the end of September, before the budget-setting process in the autumn and beyond.

- Q18 **Craig Mackinlay:** We always talk about value for money, procurement and all those things. Currently, auditors' reporting is usually a very binary and bland line: "This authority represents good value for money." There is not really much more flesh than that. I think we have a problem here between a normal, corporate audit and local government audit. In a corporate situation, the shareholders might be interested in the value-for-money assessment, but it is not a reportable, auditable type of measure. I am concerned that we are not bringing that sort of discipline uniquely into local authorities. How do you think that might be improved, Mr Pocklington? I have my own ideas, and I might be able to air them, but what do you think should be a proper value-for-money assessment that auditors could be looking at?

**Jeremy Pocklington:** I alluded earlier to the fact that the code of audit practice, which sets out how the value-for-money assessment should be undertaken, was reformed at the start of last year, so the audits for the 2020-21 financial year will be the first year in which it really takes effect. That code moves away from that old binary distinction to a commentary



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on value for money on the three areas that I alluded to earlier: financial sustainability, governance and, crucially, the efficiency, effectiveness and economy of service delivery.

I think that is a very important change. This year is the first year, so we will be looking closely; in due course, we will have a post-implementation review of this. We hope this will be more useful to managers, to officers, to councillors and to the public, by providing that richer picture of how the council could deliver service improvement.

**Q19 Craig Mackinlay:** How are auditors going to make that assessment of efficiency? What code are auditors being asked to tick against? Are you aware, because I'm not?

**Catherine Frances:** Perhaps I can come in there. I do not think it is prescriptive, but the NAO's code of practice—we do have the NAO on the line, and they will be able to comment—basically asks auditors to review whether local councils have the right processes, systems and information in place to make those sorts of assessments. It is not about second-guessing whether you happen to make this investment or that investment and passing comment on the detail there. It is about the systems and whether they look good.

Just to draw another thing to your attention in case you maybe have not seen it—I know our publications have come out very recently—Sir Tony Redmond also talks about the issue of audited accounts being pretty hard to read when they come out. What he suggested is that we put a summary statement on top in very plain English—

**Chair:** Yes, we covered this in quite a lot of detail on Monday, thank you.

**Catherine Frances:** Exactly. I think that is important. We have also asked CIPFA to look at whether there is any prospect of simplifying any aspect of the accounts. Those are the multiple pillars of easy-to-read in combination with the auditor talking about whether the authority has the right processes in place to assess, by describing that rather than just giving a yes or no answer. It is that system leadership and that system framework that we have to do from the Ministry, making sure that the systems are there to do that.

**Q20 Craig Mackinlay:** Finally from me, has there been any thought about some procurement measures that would be universal across all the public sector? It might be something as simple as what you pay for a ream of photocopy paper, or what you pay for a toilet roll, or what you pay for a kilowatt-hour of electricity. I have always advanced that there should be a lucky dip of five out of 50 measures available that auditors could measure. I think that would give a great indication of the procurement practices and financial faults of each authority. I see nothing of that kind coming forward, and it would be very simple.

**Jeremy Pocklington:** Ultimately, "what is the most effective way of providing information to local taxpayers?" would be a question for the system leader to determine. At times, in Government—I can only really



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speak for Government on this—we have looked at these sorts of issues, and unit cost data, which I think is effectively what you are talking about, can be useful, but in an environment as complicated as the public sector, it only ever in reality gets you so far. I do not generally think it is the procurement of very basic items, the commodities, that really determines the efficiency of public service. It is important, though—I do not want to underplay that—but the complicated nature of the landscape means you only get so far with that.

**Craig Mackinlay:** Thank you, Chair. I will finish.

**Chair:** Thank you very much for now, Mr Mackinlay. Clive Betts MP, Chair of the HCLG Committee, over to you.

Q21 **Mr Betts:** Thanks, Chair, and I apologise for being missing for the beginning of the session. I was looking at a different review, the Crouch review as opposed to the Redmond review; both very important in different ways, but you might be relieved to know, Mr Pocklington, that I am only going to ask you about the Redmond review today.

The Redmond review was generally well regarded and supported in its recommendations by local government, but the Ministry was a bit diffident about some aspects of it, and you have now produced your own suggestions. Could you just explain the key differences between what Sir Tony recommended and what you are now proposing?

**Jeremy Pocklington:** Of course, Mr Betts. The first thing to say is that I would not describe us as being diffident about Sir Tony's review—far from it. We think it was a very high-quality review and a very valuable contribution to the work of the Department and this area, and we are very grateful to Sir Tony for that work.

However, you are right: in this area of the system leader, there is an evolution in how we are implementing Tony's recommendation, rather than the end point we are trying to get to. Sir Tony recommended creating a new body as a system leader, an Office of Local Audit and Regulation, or OLAR for short. That would have responsibility for the code of audit practice, which I have already talked about; for regulating performance and quality; for producing an annual report on local audit; and for procurement of local audit. However, in that model, responsibility for the overall regulation of audit and standards would remain with the Financial Reporting Council and ARGA in [*Inaudible.*]

What we have decided to do, after further reflection and engagement with stakeholders, is ask ARGA to take on the system leader role itself. In our model, ARGA will be responsible for the code of audit practice, for regulating quality and performance, for producing the annual report, and for chairing the liaison committee that brings all the bodies together. It will also retain its responsibility for audit standards, but—this is another difference—we are asking PSAA to continue as the appointing body for procurement, although we have said we will keep that under review. Those are the key differences. Would it help to explain why, or is that good for you?



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Q22 **Mr Betts:** I think it would, yes, because obviously Sir Tony spent a lot of time and consideration making his recommendations, and what you are now proposing is not little changes; it is a substantial change to what he recommended.

**Jeremy Pocklington:** It is a significant change, although I would stress that we strongly support Sir Tony's recommendation of a system leader, Mr Betts, so I would not overstate that. There are three reasons why we have made this decision. First, the Government remain of the view that it is a very high bar indeed to create a new arm's length body, and to do so would be costly. I think you have heard me say at Select Committees that the Government are concerned about the risk of recreating something like the Audit Commission, or a body that could become like the Audit Commission.

The second reason is that, on further reflection and following consultation and engagement with stakeholders, we are of the view that the model that included procurement within the system leader created a potential conflict of interest. We think there is benefit of independence between the procurement process on the one hand and the oversight of quality on the other. To be specific, the risk is that auditors would defend poor performance by criticising the contract that they have got. We think that is better managed in separate bodies.

The third reason, which is particularly significant and important, is that, on further engagement and reflection, we think that there is real benefit for local audit to remain within the broader audit framework. Under the reforms being led by BEIS, ARGA is being tasked with creating a new audit profession, building a more competitive market, with a stronger pipeline, and diversifying new entrants. In this hearing, we have already discussed that those issues also apply to local government. We think there are real benefits in bringing that alignment together.

May I say two further things? First, we recognise that in taking this approach ARGA will need to recognise that there are places where local government is different. ARGA have indicated that they will be establishing a new unit within the new organisation, with the appropriate expertise of local government, to ensure that its specific nature and circumstances are not ignored in creating this. That is important and to be welcomed.

Secondly, under any option, it is important to recognise that there will be a boundary. It is not possible to put every aspect of this into one organisation. There would be a boundary in the original recommendation coming out of the review and there is a boundary with procurement in our approach here. We think we are making the right decisions. We have engaged stakeholders throughout our work on this in recent months.

Q23 **Mr Betts:** That was a really helpful explanation. You unpicked the three key elements there, and I would like to come back to them. One I won't spend as much time on is that I know Sir Tony recommended that procurement should be part of the new body as well, but I can see some sense in having regulation separate from procurement. I can see some



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logic in that.

I would like to explore the other two issues a bit further with you. I have to say that I think that the first of your explanations is probably the real one. Anything that looks like the Audit Commission is not going to be set up. You probably cannot comment on Ministers' views, but I suspect that is where they are coming from. In the end, the issue is not that we are going to have a separate body—you won't recommend a new separate body—but you are going to recommend a separate unit within an existing body or a to-be-created body. That begs a lot of further questions. Is that separate unit really going to have any degree of independence to look at the specifics of local government audit, which, as you have just identified, are different in a whole number of respects from private sector audit? In the end, is it going to be local government audit on the backseat and your Ministry not really having any role in **this**?

**Jeremy Pocklington:** Thank you for that question, Mr Betts. The approach that we have outlined here strikes the right balance between securing alignment with the wider reforms to audit, of which local government is part, but also recognising that local government audit is separate and a separate sector. We have said that in the summer we will be consulting on further detail on exactly how these arrangements will work.

We will need to work within the oversight arrangements that are being set up for the new body for ARGA, to ensure that the interests of local government are properly reflected and represented in that. That is something the Government will want to do, for example through the remit letter that will be set for the new body. We think what we are doing here gets the balance right and does not just try to have a single size to fit all different sectors of the **economy**.

Q24 **Mr Betts:** I can understand that there are some things that private sector auditors and local government auditors would want to do in a similar way. This has already been explored in the previous questions that Craig Mackinlay was asking on value for money, but there are key differences in public sector audit, aren't there? I am thinking about value for money and public interest. We have seen around the role of the auditor in the Croydon situation that there are key issues where public sector auditors behave differently, quite rightly, and are given different responsibilities. Isn't it rather strange, in the end, that you are recommending taking out of this process the NAO, which has incredible expertise about audit in the public sector, and giving responsibilities to a body that primarily deals with private sector audit, under the responsibility of BEIS, a Department which has nothing to do with local government at all?

**Jeremy Pocklington:** No, I don't accept that characterisation. First, under Sir Tony's proposed model the responsibility for the code of audit practice would have transferred to OLAR from the NAO. The NAO will of course continue to play an important role as a member of the liaison committee that in the interim we will chair but in due course ARGA will chair as well. It will not be BEIS that sets the remit; it will be Government



that sets the remit. We will be fully involved and fully engaged as part of that process.

There are key differences—we have already discussed them—but there are also similarities between local government audit and audit of other parts of the economy. It is not accounting for the sake of accounting. It is important that IFRS standards, for example, are applied in local government. That is also the basis of Whole of Government accounts, for example. It provides better quality financial information for local leaders, so I think our approach here is the right approach and will get the balance right.

**Q25 Mr Betts:** Is the Ministry then specifically responsible for this public sector unit within ARGA? Have you any overall responsibility for ARGA itself? Do you have statutory responsibilities, or is it simply some letter that you are going to sign somewhere that agrees that this is the way it should be done?

**Jeremy Pocklington:** May I bring Ms Frances in now to give you a bit more detail on the proposed governance? I think that this is subject to consultation.

**Catherine Frances:** Yes, it is subject to consultation. Just to explain, first, as Jeremy said, I think we took a view that there was actually a risk of local government audit regulation being somewhat marginalised if it was not together with the wider regulatory function and the strengthened teeth that the Government propose that ARGA has, which includes all the issues about market development, audit capacity, skills development, and so on and so forth. It is very much a decision to put it together with that.

There is a need for Government to speak with one voice to this new regulator, so the proposals that we put out in the document that we issued yesterday are that the way that we will articulate that voice will be via a statement from BEIS to the new regulator. However, what we are additionally proposing, which I think is the assurance that you are after, is that first, say in accounting officer terms, it would remain Jeremy's responsibility to make sure that the local government system is working fine. We would be communicating via that single communication with the new body what the requirement was in terms of local government audit for the new body to take account of.

Just to reassure you, we have restated our commitment to the code of practice and the value for money element of this new regulatory system, and we have proposed that that is put into statute. What we are really talking about is a couple of twin pillars, if you like, going into this system, value for money being locked in there alongside the basic accounting standards that are absolutely pivotal across the whole economy, and then channelling that communication with the single new regulatory body, but with our accountability very much being clear for the local government system working well.

**Q26 Mr Betts:** And public interest, which again is a difference?



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**Catherine Frances:** Absolutely. Public interest reports, section 24 reports and all those things remain a key part of the local government audit system and accountability system. They are absolutely pivotal towards this.

Q27 **Mr Betts:** And that is accountability back to the Ministry is it, ultimately?

**Catherine Frances:** It depends on the nature of the statutory response. As you know, a section 114 notice is issued by council officers to the council. A public interest report is issued to the public and absolutely notifies the Ministry, and we have no desire to change that statutory obligation to notify the Ministry of public interest reports or other statutory notifications.

Q28 **Mr Betts:** I just want to follow up on one of the other areas where there has been real concern, namely that often individual auditors work in silos—well, that is what they do; they work with their own individual authority. They do an audit of that authority and they produce their findings to the authority.

Given the extent to which there are problems across local government that have been picked up by individual auditors auditing individual authorities, how will this new system enable the Ministry to get information when things are starting to go systemically wrong across a number of authorities? How will that feed-in happen?

All right—I will mention the words “Audit Commission”. It was part of their role to look at this issue. I am not asking again to recreate the Audit Commission; I am asking whether someone has access to that sort of information, which could stop wider-scale problems from happening before they really get serious.

**Catherine Frances:** Of course; maybe I can come in there. So, one of the proposals that Sir Tony made, which we absolutely agree with and want to put into this system, is that the new system leader will write a report describing the state of audit of local government. Sir Tony proposed that that should be done by the system leader; in his model that is OLAR and in our proposed model it is ARGA. But we are proposing exactly the same descriptive process of, “This is what audit looks like and these are the themes that are being picked up.”

In the Department, we anticipate that we will use that system and it will be a critical part of our infrastructure, and it will be available publicly as well, I think, although the details of that are yet to be finalised. But in the Department, as I think you know, when we regulate the system and when we look at what is going on in local councils across the country, we absolutely take stock on a very regular basis of what is coming out of the audit system in terms of formal notifications. We do join the dots and we listen to concerns, which is exactly why we have taken steps such as—for example, and prompted by this Committee and the NAO, but also by our own systems—looking at things like commercial practice.

Q29 **Mr Betts:** May I just pick up on this overview from ARGGA of the audit of authorities across the board that will happen? Will the responsibility for



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that overview rest with ARGA as a whole body or with the unit in ARGA that will deal specifically with local government and public body finance?

**Catherine Frances:** The absolute details of how ARGA is constituted and how this standalone unit works are not in any of the public material yet. We are working through that with key colleagues and our commitment is to publish more information on it in a consultation before the summer.

You used a term earlier that we should make sure you understand fully. You talked about this unit being an independent unit in ARGA. We are talking about a standalone unit with a degree of real expertise in this area, but we are not talking about a unit that is separate from the wider body, in the sense of being independent—if that makes sense.

Q30 **Mr Betts:** Well, it makes sense to explain the convolutions that have been gone through to avoid the term “separate Government body”, but maybe not a great deal about how it might work in practice. It seems that it is almost becoming a separate body, but not by that name.

**Catherine Frances:** No, I think—

**Jeremy Pocklington:** *indicated dissent.*

Q31 **Mr Betts:** Of course you’ve got to deny that—I understand that.

**Catherine Frances:** Mr Betts, I think it is actually quite an important point of principle that the BEIS reforms—the White Paper and the consultation that is out—are describing an organisation that will take responsibility for standard-setting but also for looking at the wider failures in the market, for capacity questions, for developing a new audit profession and for diversifying the market. Those are exactly the sort of tasks that you want the system leader in relation to local government audit to do as well.

So this isn’t a sleight of hand; it is an absolute joining together of, if you like, all of the functions that set the exams for auditors and that mark the homework, too, and brings together the longer-term development of the market and the ways in which a regulator can interact there. It is quite a serious connection.

Q32 **Mr Betts:** Okay. Thanks for that. I note the points—I will not go into them now—about the simplified audit that people can actually understand. I was going to ask Jeremy Pocklington whether he had actually read the audit of his own local authority. If he had, he is probably the only person who has done it and understands it. I will not pursue that this morning. It is an important issue, which we will want to return to, because it is something that will be of great benefit—actual benefit—to constituents.

Q33 **Dan Carden:** May I start with Ms Frances again? Just going back to the issue of governance, you mentioned the Centre for Governance and Scrutiny and the extra funding that it would be receiving. My question is about leadership and governance models and whether there is any discernible impact, or different impact, where you have city Mayors, leader models and cabinet models in local government, on the overall



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effectiveness of good account-keeping and auditing.

**Catherine Frances:** I am happy to come in on that, but our colleague from PSAA may also have reflections on that.

In terms of the actual shape of how an organisation is run, our reflection is that what really matters is the basic culture of transparency and scrutiny. We don't dictate from central Government exactly the form that an audit committee should take or whatever. Different councils take different approaches on that. Our view is that it is best practice to have all those things in place. We find that, when you look across from council to council, it is an organisation's ability to hold a mirror up to itself and have a straightforward conversation about what its information is telling it, and then to have effective scrutiny, bouncing out of that culture, the clarity in the documentation and the right relationships, that really defines the level of scrutiny that seems to stand up locally. The answer to your question is that it is not a particular form, one way or another, that produces strength and scrutiny; it needs to run through the whole organisation's culture and way of working.

Q34 **Dan Carden:** Is that some of the work that the Centre for Governance and Scrutiny will be carrying forward?

**Catherine Frances:** Sorry, I should just be clear about that. I was talking in the past tense. We have provided some funding, along with others, to the Centre for Governance and Scrutiny. It was working with the sector to work on best practice and to launch a toolkit. It is a sector-based solution for the sharing of practice that enables people to ask the basic questions—“How can I do this or that better to improve performance in my council?” It is not a programme of work that we are just launching.

Q35 **Dan Carden:** Thank you. Mr Crawley?

**Tony Crawley:** I would echo that. For the Committee's benefit, I am a longstanding public sector auditor. I was a key audit partner on hundreds and hundreds of local government audit committees. Just to reflect on that, that sort of toolkit can be really useful. Calling a committee a particular name or having an independent member on a committee isn't an instant panacea. You have got to really work at it. The people have to be right; the systems have to be right. It is about the remit and the training that you give to councillors and everyone involved. It is really important to drill down and get to a position where the system is working, rather than just imposing structures on organisations, because that doesn't guarantee any benefit.

Q36 **Dan Carden:** Mr Pocklington, can I come to you on that as well?

**Jeremy Pocklington:** I don't think I have anything to add, Mr Carden, other than to emphasise the point that, in all these things, it is about leadership, behaviours, culture and appropriate financial management. That is the most important thing in governance.

Q37 **Dan Carden:** Mr Pocklington, metro Mayors are a new innovation over the last number of years. How is local government auditing working in



respect to metro Mayors?

**Jeremy Pocklington:** I might bring in Ms Frances on the detail of this, if I may. In general, it depends on the individual settlement and the nature of the responsibilities of individual Mayors. Ms Frances will be able to answer that.

**Catherine Frances:** I don't have with me on this call broken-down information by category of authority, but they are subject to the same frameworks that are in place for the rest of local government, as you would expect. If there is any particular information that you would like, we are very happy to provide it. I have a feeling that we are not quite getting to the crux of your question, so apologies if that is the case.

Q38 **Dan Carden:** May I just follow that up with one more question? Are there questions to be asked about how auditing has not uncovered some of the bad practices at local council level?

**Catherine Frances:** Auditors can uncover what is available in material and in good material, and with good scrutiny. Part of the issue—that audit sometimes takes some time—is that in an organisation that is challenged in some way, particularly in its governance, it can take a while to get to the bottom of that. It is a pivotal part of the system that auditors try to get to the bottom of that, but it is also a very challenging role. The key point about the regulators of audit is that they have to be able to say to auditors, "You haven't examined certain things that we think are pivotal to audit." One of the things that has come through in the work that has been done recently is that over the last few years, following some regulatory changes and some critical cases in the private sector, councils have been asked to review lots of work on their asset base and on their property portfolio. For some of them, that feels like a new set of questions to be going through in such detail with their auditors, but it is a very valuable set of work, as Jeremy alluded to earlier. We need to make sure it is proportionate—that is a question for the regulator to define—but it is a pivotal set of questions for auditors to be asking, particularly given that the sector has a relatively complex set of instruments and property at its disposal.

Q39 **Dan Carden:** Mr Pocklington, I will come back to you with a final question. I am a Liverpool MP, and we had the Caller report recently. I think one of the issues raised in that was around whom the auditors reported to and by whom they were listened to, in terms of the whole council being empowered to know what was coming out of audits. Do you have any thoughts on that?

**Jeremy Pocklington:** Thank you. Mr Caller did refer to that in his report. Unfortunately, there is not much more I can say to the Committee today on Liverpool, because we are in the middle of a sensitive and important process whereby we are waiting to hear back from Liverpool on the Secretary of State's "minded to" decision in relation to the best-value inspection. We now need to receive a formal response from Liverpool and consider that, which we will do as soon as we can.



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Q40 **Chair:** I want to pick up a couple of things that you said earlier, Mr Pocklington and Ms Frances. One of the worries about the delays that Mr Mackinlay was highlighting is that that can have an impact on local taxpayers knowing what is going on, and on local government planning for their accounts. It feels like an impending crisis that will play out in individual local authorities in a very challenging way, and I did not get a sense of urgency from you about that. Are you really concerned about these delays? You have written that they can have a later deadline than usual for the next two years. When do you see this coming back on track? What is the plan? Mr Pocklington, I'll start with you.

**Jeremy Pocklington:** The first thing to say is that we do think this is important and serious. We have been investing considerable time and resources in tackling the issues that we have discussed this morning. We are focused on the actions that will have the most impact quickly: putting more money into the system and enabling fees to be adjusted in the way that we have done, while providing more confidence about the future. But there is no simple short cut here—that is unfortunately also a message, and I need to be candid about that.

Q41 **Chair:** When do you think that we will see the improvements that you hope you are pushing through?

**Jeremy Pocklington:** What we have said is that we are adjusting the deadline to the end of September for this year and next year. We are not going to get through this in one cycle this year, given the impact of covid as well, but we want to get ourselves in a position next year where we have better visibility and a better view. We have made a decision that we will then review what is the appropriate deadline after that. So it is not possible to set a perfect target for the medium term today, but we want to see progress in the next two cycles.

Q42 **Chair:** We get that. However, one of the challenges is that you are putting in the £15 million, but this is not just about throwing money at the issue, is it? Are there enough key audit partners? Two companies—the ones we saw on Monday—deal with 70% of local government audit. If one of them decides to pull out of the market, there is a crisis, isn't there?

**Jeremy Pocklington:** We absolutely do need to see more new entrants into the market as well. We are working very closely with CIPFA, the FRC and others on this question of ensuring there are enough skilled auditors looking at the market as well. Mr Crawley may want to comment on the work on the next procurement, which will also be an important part of the particular issue that you are highlighting.

Q43 **Chair:** But we heard from them very clearly on Monday that there is a crisis in the form of looming retirements. A lot of people doing this work are in their 50s and won't be around forever. There is a big issue about getting the pipeline going. It is already quite thin in places. Perhaps you or Ms Frances could just pick up on that and then I will go to Mr Crawley, and then we will go back to Mr Mackinlay.



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**Jeremy Pocklington:** As you say, Ms Frances and then Mr Crawley would be useful on this.

**Catherine Frances:** 2019 was the first time that the auditors themselves listed, in their explanation of timeliness and delays, this shortage of skills, and, as Jeremy has said, there are the quick fixes that we can try and do, which is alleviating some of the finances and so on, but building the skills is a longer-term issue. What the auditors are telling us—we have in the Ministry chaired roundtables with them, had conversations with them and tried to hear this from their perspective, as well as the perspective of councils—is that they need clarity on the future direction, they need to know that this is a market that they can invest in and they need to know that there's a future there.

**Chair:** They made that very clear on Monday.

**Catherine Frances:** Yes. So what I hope we have done is, first, set future direction and system leadership. The pieces are going into place there. We are all working with them closely and, as Jeremy said, we will have a liaison committee to try to make sure we all speak as one voice across the system. But we have also set off working groups. The FRC is currently leading a working group working with the many bodies that participate in this market at the moment, looking at questions of skills development, entry criteria—and I am sure Tony Crawley will want to come in on how the next procurement will also look at this issue of diversification.

It is a complex set of issues. We are not saying it is not complex. We just think that we need the system leadership, the skills development, the governance change locally, so that it feels really relevant to local taxpayers, and then the procurement all to dock into place. It is not all going to come in one go. I apologise for that, but it's just the state of the world and a complex market.

Q44 **Chair:** It just feels like lots could go wrong between now and when all of that comes together. Mr Crawley, what about the situation from your perspective? You are procuring these bodies.

**Tony Crawley:** Yes; thank you, Chair. It's a question of looking at a holistic approach. There are all sorts of aspects to this. There is the complexity of the accounts, which has been mentioned and which takes longer to audit. There is the pipeline for key audit partners. It is about making the key audit partner process as slick as it can possibly be to encourage new people to come in. It is about making this an attractive place for firms to come in and also for the existing firms to stay in the market. So there are a lot of problems to solve. The timetable is one of them. It's about working with the other sectors to make sure that the public sector teams within the firms have a manageable timetable through the year, because they deal with the NHS, housing, education—it's about everyone working together to make this an attractive place, but it is going to take time to sort out.



The accounts are an important issue. It has not been mentioned in detail, but there is mention in yesterday's statement about what could be done around the accounts, what could be done around the audit remit—all those factors will encourage people to come into the market, and that is ultimately what we need. We need a better offer to firms and to people— aspiring CPAs—to make it worth their while.

- Q45 **Chair:** Mr Crawley, has PSAA talked to the firms that have withdrawn? KPMG is no longer in the market. Are those firms in any readiness to come back in? There is a big problem for small firms coming into the market, because of indemnity issues and so on. Where do you see the market expansion, given that the market will stay this way? That is clear from yesterday's statement, and you are the body that procures 90% of these. Where will you get these people from?

**Tony Crawley:** That is the challenge. We are in regular contact with KPMG. We did a market engagement exercise last year, and we are going to do another one for this procurement coming forward. We are at an advanced stage of getting the market engagement documents sorted. That will get the latest views of the firms that are potentially coming in, the ones that are accredited, and also we are looking to expand that market questionnaire to the firms that could potentially become accredited, or could work with accredited firms in a partnership or consortium. So yes, we are taking soundings from them. They are going through all sorts of changes from the BEIS consultation through to the other CMA report. The big four are certainly looking at that separation issue. That is another issue where the external audit teams are being separated out within the firm. So there are all sorts of challenges to come, but we think that there is the potential for them to come back into the market.

- Q46 **Chair:** So really seriously, you think that going down to just two to do most of the work is a prospect—obviously, there are also smaller firms doing the remaining 30%—and some of these firms that were doing it could come back in? Haven't they sent their auditors off to do different work now? Have you now lost the skillset?

**Tony Crawley:** The public sector teams within those firms can be repurposed, but one of the aspects, and a further pressure on the CAP process, is that within the big four some of the work CAPs have gone off to the internal audit consultancy side, so they have moved out of the CAP market. Again, that is another pressure on the CAP numbers. It is about trying to convince those firms that this is an attractive market to be in and something that will be worth their while. They have "channel choice"—that is the phrase they use. They are looking at the moment at which sectors they want to engage with and which ones they want to invest their training programmes in.

So that is the challenge. It will not be easy. KPMG, for example, has got one audit of the opted-out bodies. So there is the potential for them to come back in. As you heard on Monday, the existing suppliers are in an unusual situation, but the existing suppliers are very keen for more



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suppliers to come into the market. The door is open. It is about trying to make the offer attractive enough.

**Chair:** It seems that the market is not working at the moment, but we hope to see some change. Mr Mackinlay, back to you.

Q47 **Craig Mackinlay:** Thank you very much. I think we have had a very good session describing the problems. That is without doubt. We have the problems, if I might summarise them, of the complexity of accounts and the transactions that many authorities are now doing. We have the problem of staffing within local authorities. Do we have staff at the right level? Have we got accounting systems that are good enough and easy to audit? We have a problem within the major accountancy practices, who are now very consolidated within a handful, and there seem to be barriers to entry. Despite what Mr Crawley has said, there are barriers to entry for others coming in.

There are problems within the profession. I am in the profession myself, and it seems that many practices are just feeding off the same pool of professionals and nicking off each other. I think our brightest and best graduates are seeing internal audit and the audit of local authorities as not something that entirely floats their boat. There might be something else they would rather do in life. All of this is solved with money. People will be encouraged to do things for money. So I am encouraged—being the poacher rather than the gamekeeper today—that £15 million is being allocated to the profession, which might make up some of the difference.

We have the problem of litigation and reputation for many of the practices. They are concerned about being associated with problems that are not of their making and that they could not foresee, and I think covid will cause that type of complication as well.

While I was listening this morning, I was looking at part of my constituency. The major part is Thanet, an £18 million-revenue type of authority. The set of accounts is 151 pages long. They are horrifically complex in every way, shape and form. There are notes on reserve accounting. The fee for the plain audit, which is surprisingly low, is £58,000. There are also grant certification fees, which I assume are not quite so subject to limitations—there might well be elasticity in those if work is required. Quite worryingly, £58,000 plus £44,000 was actually noted in the accounts as totalling £97,000—never mind. In my maths it should have been £102,000.

The important point is that it seems we are driving many of the demands to try to get the data into the Whole of Government Accounts. We accept plus or minus variability within parish accounts that have become part of a consolidation, and particularly among academy school accounts, which can be pretty big—some of these groups can easily be as big as small local authorities. We do not have those same rigours: we accept that they are being audited, but we do not quite go on the same route of making them fit the requirements of WGA.

Is there not a case for smaller authorities perhaps to have just a slight exemption from having to produce 151 pages, at enormous expense and



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aggravation for the audit firms, which are struggling to fulfil them? Could there not be a smaller limit, as we have in the corporate world, with perhaps sub-£50 million authorities under a slightly lower regime, which could be streamlined and audited in a better way?

I know that is blue-sky thinking, but we have got a serious problem on our hands. From what I have heard today, we understand the problems, but I am not hearing a long-term solution. I think it is time we thought of something a little different.

**Chair:** Was there a question?

**Craig Mackinlay:** Sorry, that was a broad and lengthy statement. I think the head of the pile, Mr Pocklington, might be best to address it.

**Chair:** A short answer is fine.

**Jeremy Pocklington:** The issue of proportionality is important. It obviously needs to be a core principle of accounting and audit, subject to the two pillars underpinning audit that we have already touched on. In terms of actions under way, CIPFA and the Scottish equivalent, which goes by the name of LASAC, are looking at how we can simplify the code of accounting practice. That will look at some of the issues behind the growth of the length of statutory accounts that you are alluding to. We also set out in our update that we want the system leader to look at whether we can reduce some of the accounting and audit requirements where those relate to areas of less risk to local bodies.

So proportionality is something that we should look at. But, just to balance that a little bit, I would stress that, as I said earlier, it is not accounting for the sake of it. To give you a very concrete example, a small district authority may have responsibility for a bridge, and understanding how much that costs on a depreciating replacement cost is actually useful information if the bridge were to need to be replaced. That is far more useful to know than for what it was on some historic cost built decades and decades ago—that is frankly not particularly useful information. So it is more than just the Whole of Government Accounts, but I am not downplaying the issue of proportionality.

I do not have a specific response on your idea that we should do something else for the smallest authorities. That is not what Sir Tony recommended. I would be cautious about going too far down that route.

**Craig Mackinlay:** I do share your caution, and that is a broad-brush approach, but we often see emphasis on things as esoteric as the revaluation of heritage assets. Quite frankly, I am not sure anybody cares.

**Chair:** On that point, I am going to go back to Clive Betts.

Q48 **Mr Betts:** I suppose all I am looking for is some reassurance that it will all be better if we have you back in two years' time. Will all the day-to-day problems of local audit be sorted out? Many of these are sticking-plaster measures to get us through. Are we going to be in a better place?



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**Jeremy Pocklington:** I am confident that we are taking a systems-wide approach to look holistically at the challenges facing the local government audit market, and that they will have a beneficial impact. I think, as I said earlier, it will take time. We are looking to see improvement over the next two audit—*[Inaudible.]* We have not set ourselves a specific target—it is too complicated a market for that—but I am absolutely confident that we are taking action. We are taking forward Sir Tony's recommendation. There is the change that we are talking about today, but we are in essence taking forward his work, which has been well received by the sector and other stakeholders as the right sorts of actions to be doing.

Q49 **Mr Betts:** And will value for money be improving? Will you be able to demonstrate that it is?

**Jeremy Pocklington:** I think what we need to see first is the impact of the change from the code of audit practice that was announced last year. I think that is a significant improvement—moving away from a binary statement to a commentary—that will add value and perhaps help address the expectations gap in local government audit. But we will want to evaluate that, and we have said that we will want to undertake a post-implementation review in due course. I am confident that it is the right direction of travel.

Q50 **Mr Betts:** Will we be able to compare how value for money is improving in different authorities?

**Catherine Frances:** Just to come in here, that is not part of the proposals that are set out. I think the answer to your question—I think this is what you're driving at—is that at the heart of this approach is still a system of local accountability and local assessment of value for money, just strengthened through improved transparency and improved audit functioning around that local system. At its heart, there is a locally based system here with a strong market regulation system and a market development situation on the other side, as it were, of the ledger. That, I think, might be the point that you are pushing at. This is within the theme and the approach that was set out in the legislation of 2014, just strengthened, rather than the Ministry or anyone at the centre producing a table that compares A and B between different councils.

Q51 **Mr Betts:** So there would be an ability to look across audits in terms of where risks are occurring and things may be going wrong, but not in terms of value for money comparisons. There is a difference there.

**Catherine Frances:** Viewed as a whole sector, yes. But the caveat I would like to give you is that, in particular areas of business, you may find that there is best practice sector-based work, or a particular Department may say, "We're really interested in regulating quality and reporting on that in a particular part of the sector." We heard just three weeks ago, with the Committee, about proposals for health and social care, where the Government proposal on social will now be inspected on an authority basis by the CQC. That might lead to a different sort of transparency that might be comparable, but that is one particular service tranche within local



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government, rather than everything that is being bought council by council.

**Mr Betts:** It will be interesting to see the further responses to the consultation that is going out and how local government responds to it.

**Chair:** Both this Committee and the HCLG Committee will obviously be working together to look at this closely as it rolls out over the next two years, so you are not off the hook by being at this session today. We will cook something up to keep an eye on it.

We go now to Sir Geoffrey Clifton-Brown, with his beady eye.

- Q52 **Sir Geoffrey Clifton-Brown:** I want to pick up on one or two points that have come out during the hearing. The first is for you, Ms Frances. There is almost unanimous agreement that these delays need to be picked up on and improved upon for a number of reasons. Part of the reason for the delay is the increasing complexity of local government auditing accounts, as Mr Mackinlay has made clear from his local authority. Do you now have very clear guidance about what local authorities can do in terms of property investment and, even more so—if you followed the hearing on Monday—some of the more exotic things that just a very few local authorities get up to, such as the securitisation of income streams from photovoltaic electricity producers? Is there very clear guidance on all of those things now?

**Catherine Frances:** There is very clear statutory guidance, set out in 2018, about the overarching approach to commercial investment. The Committee has asked us previously whether that is binding on everyone or just guidance; it is guidance. There are then the PWLB reforms that we have alluded to, and CIPFA is looking at revisions to the prudential framework.

I am afraid I am going to have to take away your precise question on the issue of securitisation, because I do not know the answer to that. I am very happy to follow up and give you the information. It may well be that we have not stipulated from the centre what the position is, but there may be best practice guidance somewhere. I just do not know, so I am very happy to get back to you on that.

- Q53 **Sir Geoffrey Clifton-Brown:** It is refreshing to have a witness who says that they do not know the answer. That is perfectly acceptable to this Committee. Could I ask you in relation to that a specific question about valuations? Paragraph 1.11 on page 14 states that a lot of section 151 officers say that the auditing system needs changes relating to valuations. I think that they are indicating that the valuation requirements should be less stringent. If you then go to paragraph 2.27, the audit quality review team says that two of the areas where there are problems with audits are the valuation of property, including investment property, and the valuation of assets supporting pension funds. The two things seem to be going in opposite directions. What is the position on these valuations?



**Catherine Frances:** The position on the valuations is as Jeremy set out earlier: from the Ministry perspective, we hand the questions of the standards that need to be enforced in audit to the regulators of audit. That means that they are bound by the international financial reporting standards, which include very strict stipulations about what you do with the valuation of assets. Interestingly, we are hearing two things. First, exactly as you say, some local government colleagues are saying that that does not feel relevant to them. We are happy to look if there are parts of the system that are in any way a little onerous. We have said that we will ask the FRC, and ARGA in its new form, to consider that question.

Our view, as Jeremy has set out, is that standards are standards, and these things are important in terms of people understanding their asset base. The really key issue in councils that people tell me about is the thing that was picked up in Sir Tony's report, which is that they sometimes feel some work that they really want doing—assessing whether their value for money processes are strong—is a bit simple in how it is described in the audit. It has been a binary statement about that. The audit does not feel quite as relevant to them.

As Jeremy set out, because the NAO changed the code of practice early in 2020, and that change starts to kick in from this year, we hope and expect that the new value for money assessment, which is a descriptive one and not binary, will feel more relevant to local councils and will feel like it is giving them something that they understand. I think that helps to explain why you have a bit of a difference of views there, but it is in an auditing context. The client has to feel that the auditing is relevant, and the code of practice moves there, but the standards that the auditors uphold also have to be extremely high. It is a balance between those things, but we would say that the standard is really **critical**.

- Q54 **Sir Geoffrey Clifton-Brown:** You and Mr Pocklington have put great emphasis this morning, quite rightly, on the code of practice, which hitherto has not been on a statutory basis. You nevertheless say that it will kick in for the accounting year 2020-21, but it is not yet on the statute book. Are there likely to be changes to that when it actually goes on to the statute book, or can we assume that what is being done will be replicated in statute **now**?

**Jeremy Pocklington:** We very much support the changes in the new code of audit practice. We think it is a significant improvement, moving away from the binary decision to a commentary. It is too soon to say whether any further changes will be needed in future: we will carry out a post-implementation review. We cannot, at the moment, see further changes that are the right thing to do, but I do not think any of us would think this should be set in aspic now and it might be possible for there to be further improvements once we have learned from its use, including this year.

- Q55 **Sir Geoffrey Clifton-Brown:** **My** final category of questions comes back to the questions I asked at the beginning, and which the Chair followed up, about the number of firms that are involved in these local audits. Mr



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Crawley, I warmly welcome what you said about possible new arrangements for consortia and so on and so forth, but—as the Chair has already indicated—the complexity of these audits is clearly going to put more pressure on the key auditing partners, and they are becoming fewer and fewer, as we heard on Monday, because more and more of them are getting to an age where they need to retire. Clearly, training of new entrants into the profession to do this local auditing is important. Is it solely a matter for the individual auditing firms themselves to take care of this training of new entrants, or do the Government have a role in this?

**Tony Crawley:** In response to Sir Tony's report, there are discussions between the Department and CIPFA about what could be done in terms of training. The firms do carry out extensive training programmes for their own staff, so it is about ensuring that the training that is given includes the unusual aspects of local government so that people start to understand those unusual aspects, as referred to on Monday, and the knowledge you build up about how local government works and about the extra responsibilities that local government staff have. It is already being looked at by the working parties that are going on in response to Sir Tony's report about what options there might be in terms of additional training being made available to existing—but also aspirant—firms.

**Q56 Sir Geoffrey Clifton-Brown:** The point is that people progress through the profession to become key auditing partners, but the basic, larger amount of the groundwork is done by new entrants coming into the profession, and that does seem to be a problem. How are new entrants going to be encouraged to come into this profession unless the fees are such that more firms are encouraged to do this work, and therefore want to recruit more people to do this public auditing work? How is it going to work?

**Tony Crawley:** It might be worth dwelling for a second on how the fees are set. We put out the lots and the procurement process. The firms put in their bids; the winning bids are totted up; all the winning bids are honoured in full; and then the fees are set as a result of totting up the winning bids and adding the PSAA's small cost on top of that. Effectively, the market has set the price. The PSAA is a not-for-profit organisation, so—

**Q57 Sir Geoffrey Clifton-Brown:** Forgive me for interrupting, Mr Crawley, but surely there is a much more fundamental problem with that? These firms, particularly two or three of the big four, are not bidding at all, so isn't there a really serious problem here?

**Tony Crawley:** One of the big four did not bid last time; three did. Obviously, it is their decision whether they bid or not, but if they think it is an attractive enough matter, they will bid. It is a private sector-driven market: each winning firm's bid is honoured in full, and then there is a mechanism to recompense the firms for additional work through the statutory appointed person regulations. In terms of fees, it is very much market-driven, and then once the fees have been set, additional work is



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paid for through the appointed person regulation stipulation that additional work can result in an additional fee.

- Q58 **Sir Geoffrey Clifton-Brown:** Mr Pocklington, you have heard Mr Crawley's optimism, but what is the contingency if one or two of the major firms actually drop out? What is the contingency to make sure that we continue to have a robust local auditing system?

**Jeremy Pocklington:** As we have discussed in this hearing, we are taking action quickly to provide the confidence that this market needs in order to ensure that there is sufficient capacity in the market. It is the additional resources, the additional changes to the fee-setting regulations to enable fees to be set closer to the audit work, for fees to be varied accordingly, clarity about the future direction of system leadership—these are the actions that we are taking, designed to ensure that there is sufficient capacity and confidence in the market for firms to invest. Of course we will need to maintain the very close watch, the very close monitoring of the situation in order to ensure that audit firms are participating and are providing the capacity that we need to see.

- Q59 **Sir Geoffrey Clifton-Brown:** But what happens if all those measures don't work—what then?

**Jeremy Pocklington:** We are confident that we are undertaking the right actions, as recommended by Sir Tony in his report. Mr Crawley can talk a little bit more about the details of how the procurement works, and the legal obligations on PSAA as well in order to ensure that there is sufficient capacity, and that authorities do have access to auditors. That is the ultimate backstop, but the actions that we are taking that we have been talking about today are designed to provide confidence in the market and more resources, and tackle the inflexibilities that have been challenging over the last couple of years.

- Q60 **Sir Geoffrey Clifton-Brown:** In order for you to have confidence in what you are saying, are you directly talking, particularly to the big four, and particularly to those who are not bidding at the moment, to ask them whether they think these measures would encourage them to come back into the market?

**Jeremy Pocklington:** We are in regular dialogue with the auditors. Ms Frances meets with the auditors regularly. I have had my own discussions as well. So it is something that of course the Department does; we recognise the importance of this market. Now, it is Government policy that it is a locally led approach and it is a market-based approach. What we are doing is strengthening the market so that it works better.

- Q61 **Sir Geoffrey Clifton-Brown:** Ms Frances, do you have anything to add? This is an existential threat to the entire local government auditing system, so it is a really serious matter.

**Catherine Frances:** I agree it is a really serious matter, but as Jeremy said, it is a market. We need to make sure that colleagues who are working in that market, both on the procurement side and on the provider side, understand the future direction of travel. Auditors have told us that



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they need system leadership, they need clarity on direction of travel, they need to know what they are auditing and to what standard, and I think those standards are set out, and the future is set out there; and then, once those specifications are in place, it is the job of PSAA and Tony Crawley and his colleagues to procure within that framework. Hopefully the modifications that we are consulting on at the moment, which will allow PSAA freedoms and flexibilities to respond to a changing market, will give PSAA colleagues the tools that they need to successfully procure in that market.

- Q62 **Chair:** A couple of questions from me, one of which is actually to Mr Crawley. Your role does not include procurement for national health service audit, but the private firms see all public audit as one. First, Mr Crawley, is there an issue there? Do you talk to counterparts? I want to ask the same of either Mr Pocklington or Ms Frances—you can decide which of you will answer—but Mr Crawley first.

**Tony Crawley:** I am sorry, do we talk to—

**Chair:** Do you liaise with colleagues on the NHS side on the issue about the markets? The public audit work of the firms that you are procuring will include the NHS, even though you are not procuring that.

**Tony Crawley:** Yes, we do; we keep a close eye on the NHS market. In fact, you will have seen that I contributed to a Health Service Modelling Associates paper on the state of audit markets that came out relatively recently. The challenge is to have public sector teams that are viable. Obviously, external audit of local government does not take the whole year in normal circumstances, so it is about co-ordinating. We are not able to offer our contracts to the NHS at the moment; that is the position. What we are able to do, though, is speak to the other procurers of those teams. So we talk to the NAO, Audit Scotland, the NHS bodies and NHS England and so on. So we get a lot of market intelligence about what is going on in terms of the audit world.

- Q63 **Chair:** Okay, but the people you are procuring, and are struggling to get to do the work at the moment, are doing NHS bodies, so there is obviously some difference there. What are the key lessons?

**Tony Crawley:** The NHS market and, as has been referred to, the audit market itself are struggling across a number of sectors. There is only a finite amount of resource, so what we are looking to do in conjunction with the Ministry is to get more flexibility around how we can work things through and how we can procure. Hopefully that will provide that more secure market. We are totally realistic about how tough and difficult the current position is. We have ideas about how we can attract people in, and how we can make it more attractive in terms of bidding. We also have a safety net that we can extend the current contracts for two years, but that would only buy breathing space. We want to have long-term viable contracts with the firms.

- Q64 **Chair:** Which we have gone through. On the issue of extending as a safety net, do the private companies that you are procuring have to



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extend if you request that? They can presumably walk away at the end of their normal contract if they choose to do that.

**Tony Crawley:** We can extend that contract for up to two years.

Q65 **Chair:** Yes, but do they have to adhere to that request for an extension?

**Tony Crawley:** The contract is at our discretion, so it is not a safety net that is attractive, but it does at least give us a breathing space if—

Q66 **Chair:** Just to be absolutely clear, if I were running an audit of a company and I was doing audits for local government and was minded to withdraw, and PSAA said, “You have to extend by two years,” I would have to extend by two years.

**Tony Crawley:** That is the contractual position, yes.

Q67 **Chair:** Fine. That is really helpful. So that is the contingency that Sir Geoffrey was pushing at. Mr Pocklington, do you want to comment on what you are doing to link up with colleagues in, I suppose, the Department of Health and Social Care to make sure that public audit as a whole is a healthy sector, not just the local government element of it? Or does Ms Frances want to come in on that?

**Catherine Frances:** As we talked about earlier, the NHS is in some ways a bit different and in some ways very similar. The difference, the auditors tell us, and we understand why, is that the bodies in some ways are very large scale. They are simpler in some respects in terms of their structure. The critical thing for the Committee to understand, I suppose, is that NHS bodies are consolidated into the NHS account, then DHSC’s account and then through to Whole of Government accounts. It exerts a slightly different pressure in the system actually, about standardisation and so on and so forth.

That said, the auditors do both markets, and we have worked closely with the NHS and DHSC on the proposals yesterday. The NHS is regulated by the code of practice, which is set by the NAO, and our proposals are to move to ARGA. They will continue to have that code of practice defined by ARGA with local government as it moves. So the NHS moves with that system, and the quality of their audit is regulated at the moment with everybody else’s and will also be with that system with ARGA. The big difference for the NHS is simply that they procure directly themselves, rather than by a central body.

We are talking to them closely. It is hard to manage the interface between the two big systems. It is very practical work, but so far we are, as it were, broadly speaking aligned. It is just that for any auditor it is a very busy year, moving from one to the other.

Q68 **Chair:** That brings me finally to the point that I still cannot quite get hold of in my mind. This is for Mr Pocklington or Ms Frances, on the relative balance on ARGA between the public and private sectors. Where are the levers for the Department to make sure that ARGA doesn’t become a body that is dealing with the regulation of private sector audit, with a



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little tiny adjunct of public sector, perhaps not as well understood? There are issues both ways. It could be that the public sector stuff really merges as a very big, almost separate, subset of it, but there is a risk as well that it just gets swallowed up under private audit. How are you going to guard against that, Mr Pocklington? You talk about Government having one voice, which was a lovely phrase with great hopefulness, but that is not how it often seems to us here.

**Jeremy Pocklington:** This will be the subject of further consultation in the summer. It is important that we get the balance right here. I assure the Committee that we are working very closely with BEIS and with the FRC, which will become ARGA, as we get the details.

Q69 **Chair:** Those are nice phrases—"working very closely with" and "lots of collaboration"—but realistically, if push came to shove, what powers will you have over ARGA to make sure that the public sector audit is a healthy set-up?

**Jeremy Pocklington:** ARGA will be a public body, and the proposed governance is set out in the BEIS consultation. The non-executives will be appointed by the Government.

Q70 **Chair:** Sorry—that is the Government, but it is your Department that oversees local government audit. I just want to know where your levers will be.

**Jeremy Pocklington:** We will establish a written relationship with BEIS as to how we will oversee that together. We will then input into the statutory remit for the new body. ARGA, of course, will be accountable to the BEIS Secretary of State and to Parliament. It will produce the annual report on local government audit. We will have a direct relationship with ARGA, as I am sure this Committee, or Parliament, will as well. It is an important issue. It is recognised by ARGA. The chief executive of the FRC, who will be the chief executive of ARGA, is a former section 151 officer who understands the specific needs of local government, and we will set out further details before the summer.

**Chair:** As I have hinted, both our Committees will be looking closely at this. Of course, the NAO will have a key role too. Thank you very much indeed for your time. The transcript, as ever, will go up on the website uncorrected, and we will be putting out a report at some point after the forthcoming recess.