Sixtieth Report of Session 2022-23

Department for Levelling Up, Housing and Communities

Timeliness of local auditor reporting

Introduction from the Committee

Local authorities in England spend around £100 billion each year, delivering many of the services which local taxpayers rely on every day. Following the abolition of the Audit Commission in 2015, financial accounts for the 475 local authorities, police and fire bodies in England are now audited by private firms. Multiple organisations play a part in this system including: the Department for Levelling-Up, Housing and Communities (the Department), which provides legislative oversight of local authority finance and reporting; the Local Authority Code Board, which issues guidance on the required content of local authorities' accounts; Public Sector Audit Appointments Ltd (PSAA), which appoints private sector auditors to local government bodies that have opted into its central procurement scheme; the Comptroller and Auditor General (C&AG) who issues the Code of Audit Practice and guidance; and the Financial Reporting Council (FRC) which regulates the quality of audits provided to major local authorities.

The local audit landscape is set to change again following a government commissioned independent review of the oversight of local audit and the transparency of financial reporting in 2020 (the Redmond Review). In response to the Redmond Review, the Department chose the Audit, Reporting and Governance Authority (ARGA) as the new leader for the local audit system, replacing the FRC. ARGA is due to be established by the Department for Business and Trade, though it will not replace the FRC until 2024 at the earliest. ARGA will assume responsibility for the Code of Audit Practice and guidance, though PSAA will retain its role in appointing auditors to local bodies. The FRC is due to provide a 'shadow' system leadership role from spring 2023 until ARGA takes up its full role. In the meantime, the Department has been the formal system leader and ultimately responsible for the oversight of local audit.

Based on a report by the National Audit Office, the Committee took evidence on Thursday 16 March 2023 from the Department for levelling Up, Housing and Communities. The Committee published its report on 23 June 2023. This is the government's response to the Committee's report.

Relevant reports

- NAO report: Timeliness of local auditor reporting on local government in England – Session 2022-23 (HC 1026)
- PAC report: Timeliness of local auditor reporting – Session 2022-23 (HC 995)

Government response to the Committee

1. PAC conclusion: The backlog of audit opinions for local government bodies remains unacceptably high, and the Department still does not have a plan to reduce it.

1. PAC recommendation: The Department should, as part of its Treasury Minute response, update the Committee on:

- ***What actions it and FRC are taking to increase the proportion of audit opinions for local government bodies that are delivered by the publication deadline for 2022–23;***

- ***What actions it and FRC are taking to clear the backlog of audits from 2021–22 and earlier, and in what timeframe they expect it to clear; and***
- ***What metrics and milestones it and FRC will use to measure progress in improving timeliness of local audit and hold stakeholders to account.***

1.1 The government agrees with the Committee's recommendation.

Target implementation date: December 2023

1.2 In addition to writing to local authorities and auditors on 14 July 2023, Minister Rowley (Minister for local government and building safety) also wrote to the Levelling-Up, Housing and Communities Committee outlining work being led by the Department of Levelling up Housing and Communities (DLUHC (the department)) and the Financial Reporting Council (FRC) to clear the backlog of delayed audits, including commitments from organisations across the local audit system, of which more detail can be found in the letter to the Committee accompanying this Treasury Minute.

1.3 In order to prioritise the production of reliable and up-to-date financial information as quickly as possible, the NAO and the department are proposing to set a series of final deadlines for auditors and local bodies to clear the backlog of delayed audits. Auditors will be required to provide as much assurance as possible for these outstanding years and where necessary, limit their opinion to areas in which they have managed to carry out work. Auditors will still be required to report on value for money, while use of their statutory powers will remain paramount, ensuring residents can remain assured about council expenditure.

1.4 These proposals have the support of the Local Audit Liaison Committee, who will continue to advise on implementation, which the department anticipates should be in train by year end, following a period of engagement over the summer. This builds on work the government has committed to in its response to the Redmond Review and its December 2021 package of measures to improve local audit delays. DLUHC and FRC will measure progress through monitoring the number of audits completed by the new deadlines.

2. PAC conclusion: Delays to the publication of audited accounts for local government bodies increases the risk of governance or financial issues being identified too late and hinders accountability for £100 billion of local government spending.

2. PAC recommendation: The Department should, as part of its Treasury Minute response, explain what it is doing across the local audit sector to mitigate the impact of delays to the audited accounts of local government bodies on:

- ***Accountability for public money spent by these organisations;***
- ***The accounts and audit of central government departments; and***
- ***Significant local audit issues being identified or reported late in the day.***

2.1 The government agrees with the Committee's recommendation.

Recommendation implemented

2.2 As set out above, Minister Rowley has written to the Levelling-Up Committee to update on urgent cross-system work to address the backlog of local audit opinions and mitigate the impact of delays on local bodies going forward. This will help to ensure the system gets back on track which will in turn minimise the negative impact on other government departments and the Whole of Government Accounts.

2.3 The department also wrote to local authority Chief Executives and S151 Officers (Chief Financial Officers) in March 2023 highlighting their critical role in delivering timely, high-quality financial reporting. The letter set out how both the annual auditor's report to the Audit Committee and Full Council and S151 Officers' responsibility to report any concerns on the authority's ability to deliver high-quality draft financial statements by the statutory deadline provide an important accountability mechanism for the taxpayer.

2.4 DLUHC does not rely entirely on audit for the assessment of risk; audit is only one part of the local control framework. The department regularly monitors the financial health of local authorities using a wide range of data including income and expenditure data and reserves levels, as well as through extensive direct engagement with councils. Minister Rowley's letter to the Levelling-Up Committee also emphasises that auditors must continue to meet their statutory duty to report on value for money (VfM) arrangements in addition to using the existing statutory powers at their disposal to highlight concerns at an early stage.

3. PAC conclusion: Long-term market and workforce development are essential if the Department is to resolve the current problems with local auditor reporting and create a more resilient system for the future.

3. PAC recommendation: The Department should, alongside its Treasury Minute response, write to us to set out how it and FRC will ensure the market and workforce for local audit develops as needed to address existing issues, and the metrics and milestones that they will use to measure progress and hold stakeholders to account.

3.1 The government agrees with the Committee's recommendation.

Recommendation implemented

3.2 The Permanent Secretary has written to the Committee alongside this Treasury Minute setting out FRC's plans to progress the Local Audit Workforce Strategy and will write again before the end of 2023 setting out the actions the FRC, working collaboratively with system partners, has determined are necessary across the local audit system.

4. PAC conclusion: Delays to establishing the Audit, Reporting and Governance Authority (ARGA) and handing over responsibilities for leading local audit to the FRC, risk performance deteriorating further.

4. PAC recommendation: The Department should, as part of its Treasury Minute response, set out its contingency plans should the legislative programme not allow for ARGA's establishment during this Parliament.

4.1 The government agrees with the Committee's recommendation.

Recommendation implemented

4.2 The government response to the *Local audit framework technical consultation* in May 2022 set out that, before the Audit, Reporting and Governance Authority (ARGA) is established, shadow system leader arrangements would also be established at the FRC. Shadow arrangements will cover all the planned system leader responsibilities ARGA will have except setting the Code of Audit Practice (the Code), as primary legislation is needed to transfer the Code from the NAO to a different organisation. As such, shadow arrangements constitute the government's contingency plan for legislative delay.

4.3 The FRC appointed the first director of local audit in September 2022. A memorandum of understanding (MOU) setting out shadow system leader responsibilities was published in March 2023.

4.4 Full shadow arrangements are anticipated to start later in 2023 once the department and the FRC complete overall readiness assurance. During the shadow period the NAO will continue to set the Code, working closely with the FRC to plan a seamless transfer once a legislative timetable for ARGA establishment is determined. Planned statutory governance and accountability mechanisms (e.g., issuing of a remit letter) will be adhered to during the shadow period.

4.5 ARGA will clearly deliver benefits across the wider audit system as a new regulator; ahead of its establishment, shadow system leader arrangements at the FRC will provide an effective contingency for the local audit system, enabling a seamless transfer once legislation can be brought forward. The government is committed to legislating on the establishment of ARGA when Parliamentary time allows.

5. PAC conclusion: There are no consequences for local government bodies or local auditors failing to deliver audited accounts on time.

5. PAC recommendation: The Department should write to us by October 2023 setting out how it will address the lack of incentives or sanctions around timeliness of auditor reporting, based on its more detailed review of the causes of delays and where lessons can be learned.

5.1 The government agrees with the Committee's recommendation.

Target implementation date: October 2023

5.2 The department will write to the Committee in October 2023 with its approach.

5.3 The government recognises the potential role incentives and sanctions can play in a well-balanced system. Incentives and sanctions, however, can also result in unforeseen behavioural impacts. Given the range of issues the government is trying to address across the local audit market, any work in this area would require very careful consideration.

5.4 As stated by Minister Rowley on 17 July 2023 in his evidence given to the Levelling Up, Housing and Communities Committee inquiry into local financial reporting, the government is currently prioritising clearing the backlog of delayed local audits. The government, however, has committed to explore how greater transparency around audit delays could influence behaviour and believes the wider system of consequences is a vital area to consider for the longer term once the urgent issue concerning the backlog has been resolved.

6. PAC conclusion: Government, local bodies and standard setters still lack a shared view of how to ensure that local public accounts, and the audit of them, are fit for purpose.

6. PAC recommendation: The Department should set out as a matter of urgency, alongside its Treasury Minute response if not before, how it will work with HM Treasury, the FRC and others to agree permanent and proportionate measures to address the most complex parts of local bodies' accounts and the subsequent audit of them.

6.1 The government agrees with the Committee's recommendation**.**

Recommendation implemented

6.2 On 17 July 2023, Minister Rowley, gave evidence to the Levelling Up, Housing and Communities Committee inquiry into local financial reporting and audit. This followed his letter to the Committee of 14 July 2023 which updated on early work to deliver reforms across the system, including reviewing the most complex areas of local authority accounting, with a particular focus on the valuation of non-investment assets and pensions and associated auditing requirements.

6.3 The Permanent Secretary has written to the Committee alongside the publication of this Treasury Minute to summarise this work. The Committee will be provided with a further update after the summer once this work has progressed further.