



National Audit Office

Comptroller and Auditor General

Gareth Davies

The UK's independent public spending
watchdog

Clive Betts MP

By email

Reference GF 2285 24

Date 26 April 2024

Dear Mr Betts,

THE FUTURE OF LOCAL GOVERNMENT IN ENGLAND

Thank you for your letter dated 5 March 2024 on this important topic. You asked me to share my views on the future of the audit of local government with particular reference to the impact of devolution on the assurance available to local people that their money is being well spent.

As your Committee's recent report makes clear, the local audit system is currently in crisis. The NAO is working with DLUHC, the FRC, PSAA, CIPFA, the LGA and the firms responsible for the audits to tackle the unacceptable backlog of local authority audited accounts. This is quite rightly the top immediate priority and must result in the restoration of robust and timely audits of accounts as quickly as possible. In my view the government should aim to have recovered the position within two years. Timely and robust independent local audit is essential in maintaining public trust in how compulsory taxation is used. The consequences of allowing this to slip are potentially extremely serious. We will continue to work intensively with the other organisations with local accounts and audit responsibilities to implement the necessary short-term improvements.

Looking beyond the immediate crisis, I believe that more fundamental changes are required to the local authority accounting and audit system. The diagnosis set out in Sir Tony Redmond's 2020 review remains relevant, although in most respects the position has worsened since he reported:

- we have seen s114 notices issued at Croydon, Slough, Northumberland, Thurrock, Woking, Birmingham and Nottingham councils. Without knowing the detailed background of each of these cases I can't comment in detail, but it is disappointing that in some of them we did not see more timely and robust public reporting by the external auditor.
- only five audits of local authority 2022-23 accounts were completed by the November 2023 deadline – about 1 per cent of the total. The latest published PSAA Ltd monitoring information at the end of February 2024 showed that just ten per cent of 2022-23 opinions had been issued.
- the market for the supply of external audit is extremely fragile. Only seven of the ten audit firms registered to perform local audit opted to take part in the latest PSAA procurement. The contract prices that were necessary to secure the required audit capacity are estimated by PSAA to be, on average, 150 per cent more than the fees for 2022-23.
- firms have responded to a perceived increase in the regulatory risk they face in the local audit market. They are carrying out significantly more work in areas of the financial statements (typically non-investment asset valuations and pension deficit estimates) than was previously considered necessary. Many in the sector feel that this is leading to disproportionate work on areas of the accounts that are lower risk for local authorities than for commercial organisations, resulting in higher costs to the taxpayer.

In my view, these developments make the Redmond review recommendations even more compelling. In particular, I think that Sir Tony was right to recommend a single regulator to oversee local government audit. One organisation (with no other responsibilities) charged with liaising with the sector, specifying the audit

requirement, procuring the audit suppliers, appointing auditors to local bodies, setting fees and holding audit suppliers to account for their performance, would be better placed to avoid a repeat of the current crisis. Despite the commitment and best efforts of all involved, coordinating the activity and risk appetites of at least four organisations, all but one of which have other priorities in addition to local audit, is an inherently ineffective and inefficient approach.

I recognise that the system leader arrangements proposed by the government (and still subject to legislation) will go some way to streamlining complex set of responsibilities currently in place. It would of course be possible to wait to assess the impact of those changes once they have been fully implemented before deciding whether to simplify further in the way I have indicated above.

We also need a fundamental review of the purpose of local authority accounts and the form they should take, within the UK's wider public sector accounting framework. It is vital that local authorities regard their annual report and accounts as a key element in their accountability to local people, and that the governance arrangements in each authority support this effectively. This requires the financial reporting standard setter (CIPFA LASAAC) to work with the sector and other stakeholders to ensure that the financial statements are fit for purpose and meet the needs of users. In turn, this will help ensure that audit effort is directed to areas of genuine interest to users of the accounts and where the risk and consequences of misstatement are significant. The challenge, of course, is achieving this whilst continuing to ensure that local government accounts are accurately reflected in the Whole of Government Accounts (WGA).

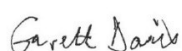
In addition to these fundamental changes, I believe that the developments in devolution in recent Parliaments, and potential further steps in that direction, require a stocktake of the assurance required by local people and central government. Large and increasing amounts of public money are now routed through a range of relatively new devolution arrangements. According to the government, 60 per cent of England's population is now covered by a devolution deal. In 2023, the government announced the 'trailblazer' devolution deals with Greater Manchester and the West Midlands, accompanied by single financial settlements bringing together previously separate central funding streams.

It is open to question whether the current scrutiny and audit arrangements anchored in the Local Audit and Accountability Act 2014 will be adequate as these arrangements develop. In particular, the audit support for scrutiny of sub-regional and combined authority spending is in my opinion not commensurate with the demands of local accountability. A review of how independent audit could best support accountability and scrutiny of regional and sub-regional public spending arrangements would in my view be timely.

Such a review could consider not just the audit arrangements for local authorities (including combined authorities and police and fire services), but also local health spending (both public health and NHS). The current problems with local government audit are also impacting on local NHS audit performance, albeit not yet to the same extreme degree. A fully ambitious scope addressing local accountability for public money might also include the audit arrangements for the academy school and further education sectors.

I hope that these comments are helpful. I would of course be happy to discuss them in more detail.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Gareth Davies', written in a cursive style.

GARETH DAVIES