



Department for Levelling Up,
Housing & Communities

Dame Meg Hillier MP
Chair, Public Accounts Committee
House of Commons
London
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Jeremy Pocklington CB
Permanent Secretary

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Dear Dame Meg,

In our response to the Public Accounts Committee's 11th Report of Session 2021–22 *Timeliness of local auditor reporting on local government in England*, and in the Treasury Minute published on 20 September 2021, the Department for Levelling Up, Housing and Communities (DLUHC) undertook to provide an update to the PAC in September 2021. This letter outlines the department's progress on implementing these recommendations. The recent government reshuffle does mean that the department has new Ministers, and we will be taking their view on the next steps of the work discussed throughout, so this letter is not intended to prejudice their views.

Effective system leadership

The government recognises the importance of establishing a clearly accountable system leader, with overarching responsibility for the local audit framework, including the Code of Audit Practice and the monitoring and review of local audit performance.

The Spring update to the government's initial Redmond Review response set out our intention to establish ARGA, the new regulator being established to replace the FRC, as system leader for local audit within a simplified local audit framework. We committed then to publish a public consultation on the details of how the new system leader will be established in statute, equipped with sufficient expertise on local audit and what the governance and accountability mechanisms will be. The consultation was published in late July and closed on 22 September. Work is now underway to analyse the responses.

BEIS's White Paper *Restoring Trust in Audit and Corporate Governance* proposes overarching statutory objectives and regulatory principles for the new regulator and our summer consultation sets out a proposed discrete statutory objective for ARGAs to act as system leader for local audit.

We have also worked closely with BEIS to determine governance and accountability mechanisms to ensure that as system leader ARGAs will have appropriate regard to the government's policy

aims and priorities for local audit without compromising its operational and regulatory independence.

It is proposed that a remit letter from the DLUHC Secretary of State, to which the new regulator will need to respond, will be issued at least once a parliament and also by exception should circumstances require. The annual report, which ARGA will be required to lay in parliament setting out how it is delivering against its objectives, will include a standing section on local audit.

We will also continue to work closely with BEIS on all related policy development and the establishment of other non-legislative governance architecture such as Ministerial Memoranda of Understanding which will be used to ensure clear accountability between the new system leader and DLUHC.

We also recognise, as the Committee does, that there are urgent problems that cannot wait for ARGA. That is why DLUHC has committed to play a stronger leadership role for local audit in the interim before ARGA is established. This has included establishing and chairing the Liaison Committee, the senior stakeholder forum in the new local audit framework. Since setting up the Liaison Committee in July 2021, DLUHC has convened two meetings to consider key immediate issues, including the forthcoming procurement and ongoing timeliness issues. These have provided a valuable opportunity to ensure alignment of objectives and collaboration on agreed actions. To aid transparency, the minutes of these meetings are being published on gov.uk. This is alongside internal governance that we have established to drive delivery cross-government.

Our summer consultation further announced our intention to establish shadow arrangements from April 2022 for those elements of the new local audit framework which will not require primary legislation to implement. DLUHC is already working closely with the FRC to facilitate these arrangements, which will enable a swifter and smoother transition towards the new local audit framework.

A critical first step in this process will be the appointment of a 'controller for local audit' at the FRC to lead a dedicated local audit unit and be responsible for local audit across the wider organisation. We are liaising with FRC on this role, for which recruitment is expected to begin in October.

Timeliness of audits

The factors that contribute to audit delays are complex and require collective action from government and stakeholders across the sector. In its report into the timeliness of local auditor reporting¹, the National Audit Office identified four key drivers behind audit delays: increasing workload and regulatory requirements; limited availability of staff with relevant qualifications, skills and experience across the sector; how both the work and processes for audit are being managed internally within firms and local authorities; and the impact of COVID-19, both in terms of additional workload and the impact on resource of staff sickness. Through its response to the

¹ <https://www.nao.org.uk/wp-content/uploads/2021/03/Timeliness-of-local-auditor-reporting-on-local-government-in-England-2020-.pdf>

Redmond Review, the government is taking a range of steps that will help to address these issues, identified by Sir Tony Redmond and in the recent National Audit Office and Public Accounts Committee reports.

The government is amending the Local Audit (Appointing Person) Regulations 2015 this Autumn. The changes will enable the appointing person to set fee scales later in the financial year, to standardise the fee variation process where new policy or regulatory changes affect high numbers of local bodies and will remove the requirement to appoint auditors for the whole of the appointing period, introducing more flexibility into the procurement process.

As noted above, an increase in regulatory requirements is one of the key drivers behind delays to audit completion. By reducing the burden on the appointing person, local bodies, and auditors to negotiate fee variations on an individual case-by-case basis, these changes should help to improve the timely completion of audits and lead to fewer fee variations in the long-term. There should also be a reduction in delays which may occur when local bodies which have failed to appoint an auditor decide to opt-in to appointing person's procurement scheme after the deadline.

The proposed legislative changes were strongly welcomed in the government's recent consultation with the clear majority of respondents supporting the government's proposals. While the government is confident these changes will have a positive impact on timeliness, it will of course take time to see the long-term effects of the new legislation.

In addition, the government has already extended the statutory deadline for issuing audit opinions to 30 September for two years and will continue to review whether the deadline should be extended on a longer-term basis. The government has further demonstrated its commitment to the local audit market by providing £15m additional funding for 2021/22 to support local bodies with the anticipated rise in audit fees.

Our summer consultation *Local Audit Framework: a technical consultation* has sought further views on proposals to increase the supply of local auditors through amendments to guidance to facilitate other routes into becoming a Key Audit Partner, as well as other proposals, and we are working with the FRC and other stakeholders to consider the next steps on this.

Through this work, we are taking positive action in response to all of Sir Tony Redmond's recommendations with a focus on improving timeliness. Nonetheless it is clear that while this will have a positive effect in the medium term, a combination of fundamental capacity issues and the impact of COVID-19, will cause delays to worsen in the short-term. As such, the picture for 2020/21 audits is expected to be significantly worse than for 2019/20.

This is of real concern, given the importance of timely audit to both local accountability and DLUHC's stewardship of local government. Earlier this month DLUHC convened a second meeting of the Liaison Committee, where attendees were asked to consider whether additional interventions to improve timeliness were needed, including the case for reducing audit requirements in a targeted way to ease capacity in the short-term. Committee members concluded that audit quality should always be of paramount importance, so any such intervention would need extremely careful consideration as there was a high risk of unintended consequences.

There will be a further discussion of potential actions at the next Liaison Committee meeting in December ahead of which the department will continue to explore options and also take the view of new Ministers.

While we expect that the picture will start to improve from 2022, we do not envisage that it will return to normality at this point, as is expected for other parts of public sector audit affected by COVID-19, given the fact that local audit delays were increasing prior to the pandemic. The timetable for returning to normality will depend on a range of factors, including the outcome of the next procurement exercise. We will continue to work with PSAA and others to monitor the situation.

Next procurement exercise

As detailed in previous correspondence with the Committee, the government has been working closely with PSAA to consider the contingencies in place for their next procurement.

To mitigate the risk of more audit firms leaving the market at the end of their contracts in 2023, PSAA have consulted widely with the sector and the market and incorporated feedback into their recently published updated procurement strategy. PSAA's proposals for seeking to ensure that there is a sufficient range of suppliers include an increased focus on quality in the evaluation methodology to reflect current market expectations, a larger number of lots and so greater flexibility for bidders, as well as a number of initiatives to enable new suppliers to enter the market. In addition, to avoid suppliers who are unsuccessful or unable to bid at the tender stage from being locked out of the market for the entire contract term, PSAA is proposing to establish a Dynamic Purchasing System, from which to procure auditors for any additional audit appointments which arise.

While PSAA is the appointing body, many of the barriers to entry are outside of their control. In recognition of this, further to those actions already being undertaken in response to the Redmond Review, DLUHC has been using the Liaison Committee to provide further support, both through promoting PSAA's scheme and committing to collective action to support the stability of the local audit market more broadly.

The department is also amending regulations to enable the appointing person to appoint auditors for the period they consider most appropriate, rather than being restricted to appointing for the whole of the compulsory appointing period.

Further to these mitigating actions, PSAA's Board has been considering a range of contingency options. Some of these are commercially sensitive, and PSAA have advised that it would not be appropriate to raise publicly at this stage. Their procurement strategy has highlighted, however, that PSAA holds in reserve the option at its sole discretion to extend one or more of the existing audit services contracts for up to two years if required, in the event that the next procurement fails to attract sufficient capacity to enable auditor appointments to every opted-in body. This fallback option should be viewed as a last resort as PSAA's stated preference is to enter into new long-term contracts. However, it provides an important contingency to mitigate the risk of a significant reduction in auditor capacity in the short-term.

DLUHC have also been considering broader contingencies that may be needed, were the ongoing procurement exercise to attract insufficient bids. This includes working with the Crown Commercial Service, who recently published their new *Audit and Assurance Framework*, to consider how this could provide an alternative route for local bodies to procure auditors.

To mitigate the risk that local bodies who decide not to opt in to the next procurement are themselves unable to appoint an auditor, given the broader market fragility, PSAA is implementing a detailed plan of proactive and frequent communications to promote the scheme to eligible bodies. In addition, PSAA's new Dynamic Purchasing System will, subject to market interest, provide an option for PSAA to procure a local auditor at a later date for bodies who initially opt-out but who subsequently fail to make an auditor appointment.

Accounting and audit requirements

Government recognises the importance of having local authority accounts and audits focused on areas of greatest risk and concern to citizens, that are transparent and accessible, while also being mindful of the need to ensure that they inform Whole of Government Accounts requirements.

Local Authority Financial Reporting requirements

Government is working with CIPFA LASAAC on improving the presentation of local authority accounts.

A key driver of the complexity of LA accounts is that they must comply with both IFRS and statutory accounting principles, effectively presenting two different forms of reporting in one set of accounts which can be confusing to non-specialists. This project will look at how the presentation can be clearer. The project brief was agreed in June 2021 with consultation proposed on accounting code changes to be carried out from May to September 2022.

The government is also working with CIPFA to develop a standardised statement, to be published alongside local authorities' statements of accounts. The standardised statement will provide a short, clear, and transparent summary of the authority's financial performance.

While this new statement will help to improve the useability of local authority accounts, we also need to be mindful of placing new burdens on local bodies and their auditors at a time when these services are stretched. Consequently, we want to take time to make sure that we get these new requirements right, also by updating new Ministers and seeking their views on how to proceed.

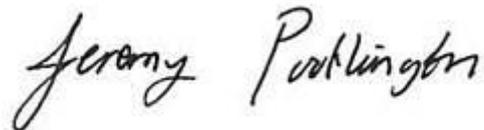
Local Authority Auditing requirements

The department is in discussion with Financial Reporting Council (FRC), sector representatives, auditors, and the National Audit Office (NAO) to review the focus of local audit to make sure that it addresses the areas of most risk to local authorities, and whether it may be possible for auditors to reduce the level of work on certain valuations.

The government is mindful, however, that audit in the UK is necessarily conducted to a high standard in accordance with *International Standards on Auditing*, and to inform the Whole of Government Accounts, and any changes to the local government audit regime must be carefully considered to make sure the quality of audit is not unintentionally affected. Further, audits are conducted independently, and it remains for auditors to assess the work needed to provide the appropriate level of assurance. The government is working with the relevant stakeholders to understand whether changes to audit would reduce resource pressures and produce more timely accounts, and what changes to the system would be needed to facilitate this, although as the Liaison Committee has cautioned, this would need to avoid unintended consequences.

The department will set out further detail on its thinking and next steps, as part of the broader response to the recent consultation that closed on 22 September, before the end of this year.

Yours sincerely,

A handwritten signature in black ink that reads "Jeremy Pocklington". The signature is written in a cursive, flowing style.

JEREMY POCKLINGTON