

# Eleventh Report of Session 2021-22

## Ministry of Housing, Communities and Local Government

### Local auditor reporting on local government in England

#### Introduction from the Committee

In 2019-20, the 487 local authorities, local police and local fire bodies in England were responsible for approximately £100 billion of net revenue spending. Local authorities are responsible for delivering many of the public services which local taxpayers rely on every day. The Local Audit and Accountability Act 2014 (the 2014 Act) set out the local audit arrangements from 1 April 2015 that apply to local authorities. Multiple organisations play a part in the local audit system, including: the Ministry of Housing, Communities & Local Government (the Department); the National Audit Office (NAO); Public Sector Audit Appointments Ltd (PSAA); the accountancy institutes: the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Institute for Chartered Accountants of England and Wales (ICAEW); the Financial Reporting Council (FRC); and audit firms. The Department has oversight of local authorities and is responsible for maintaining a set of statutory codes and rules for local authorities. The NAO maintains a code of audit practice for audits of local authorities and issues guidance to auditors. PSAA is responsible for securing arrangements for the independent appointment of auditors on behalf of local authorities which opt into its services and for setting audit fees. The external auditors audit the financial statements of local authorities and conclude on whether an authority has made proper arrangements for securing value for money. The FRC monitors and reports on the quality of these audits. The Department for Business, Energy and Industrial Strategy (BEIS) will become the sponsor department for the new Auditing, Reporting and Governance Authority (ARGA), once it is established, but the Department will hold Accounting Officer responsibility for the local government role of ARGA.

Based on a report by the National Audit Office, the Committee took evidence, on 20 May 2021 from the Ministry of Housing, Communities and Local Government. The Committee published its report on 14 July 2021. 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](#), 2020 – Session 2019-21 (HC 1243)
- PAC report: [Local auditor reporting on local government in England](#) – Session 2021-22 (HC 171)

#### Government response to the Committee

**1: PAC conclusion: The marked decline in the timeliness of external audit undermines accountability and hampers effective decision-making.**

**1: PAC recommendation: As a matter of urgency, the Department should write to us by September 2021 with a detailed plan and timetable for getting local audit timeliness back on track.**

1.1 The government agrees with the Committee's recommendation.

## Target implementation date: by end of 2021

1.2 Timely completion of local authority audit is vital in maintaining the transparency and assurance of local authority accounts to taxpayers and supporting effective financial planning within local and central government.

1.3 As part of the [government's response](#) to the Redmond Review, the Ministry for Housing, Communities and Local Government (the department or MHCLG) has taken action to help improve the timeliness of auditor reporting, extending the publication deadline for audited local authority accounts to 30 September for two years, provided an additional £15 million to local bodies to help with the costs of audit and new burdens from the review, and committed to amend regulations to provide the appointing person (Public Sector Audit Appointments Ltd or PSAA) with greater flexibility to agree additional costs.

1.4 The department also welcome the work undertaken by the National Audit Office (NAO) and Financial Reporting Council (FRC) to update Auditor Guidance Notes 03 and 07, and guidance on going concern, to assist delivery of 2020-21 audits, and are working with stakeholders to consider whether there are other steps that could assist timely delivery.

1.5 However, it will take time to get things back on track. The department is currently consulting on broader proposals to strengthen the wider system, including to increase auditor capacity and capability. The department will write to the Committee in September 2021 with an update on plans and timetable for getting timeliness back on track, and then provide a further update on its work to address timeliness issues, as well as the other recommendations from the Committee, as part of the department's response to that consultation, later in 2021. The department has also committed to work with stakeholders and review the audit deadline following the completion of 2021-22 audits.

**2: PAC conclusion: There is a pressing risk of market collapse due to an over reliance on a small number of audit firms and significant barriers to entry.**

**2: PAC recommendation: The Department should write to us by September 2021 explaining what contingencies it has in place should any more audit firms leave the market at the end of their contracts in 2023.**

**3: PAC conclusion: The commercial attractiveness to audit firms of auditing local authorities has declined.**

**3: PAC recommendation: The Department should ensure that PSAA's next procurement exercise, due to begin in 2021, supports a new fee regime for local government audit, which is appropriately funded, and which brings fees into line with the costs of the work.**

3.1 The government agrees with both the Committee's recommendations.

## Target implementation date: September 2021

3.2 The government agrees a decision by firms to withdraw from local audit could pose a risk to the future sustainability of the market. In the [Spring Update](#), the government set out that expanding the number of firms engaged in the market should be a priority for the next procurement and reiterated that Public Sector Audit Appointments Ltd (PSAA) remain best placed to continue acting as appointing body for local audit.

3.3 The government is working closely with PSAA as it designs its procurement strategy. Given the priority attached to this, it was discussed at the inaugural meeting of the Local Audit

Liaison Committee. The PSAA has proposed an increased focus on quality in recent consultations with firms and local bodies, although ultimately prices reflect firms' bids. Additionally, the department is working with PSAA, local audit firms and other key stakeholders to consider what contingencies may be required to support the sustainability of the local audit market.

3.4 As set out above, the government has committed to amend regulations to provide the appointing person (PSAA) with greater flexibility, including to set standardised fee variations across groupings of bodies, and to amend the fee-setting deadline to allow the appointing person to take account of additional information, to make it easier to reflect additional cost pressures from new requirements.

3.5 The government will write to the Committee in September 2021, explaining the contingencies that are in place to support the procurement of the next round of audit contracts, although being mindful of not wanting to undermine PSAA's ongoing opt-in and procurement processes.

**4: PAC conclusion: The rapidly diminishing pool of suitably qualified and experienced staff increases the risks to the timely completion of quality audits.**

**4: PAC recommendation: The Department should work with the FRC and the accountancy institutions to implement accelerated training and accreditation to increase the supply of qualified auditors quickly, and to build attractive career paths in local audit.**

4.1 The government agrees with the Committee's recommendation.

**Target implementation date: by end of 2021**

4.2 The government agrees that a ready availability of skilled and appropriately trained auditors is crucial to ensuring both the long-term sustainability of the local audit market and good quality, timely audit. As Sir Tony Redmond has noted in his review, the local audit market is currently dependent on a few big suppliers and more needs to be done to encourage other firms into the market to support long-term sustainability.

4.3 The department committed in its December 2020 [response](#) to working with the Chartered Institute of Public Finance and Accountancy (CIPFA), the Financial Reporting Council (FRC), the Institute of Chartered Accountants in England (ICAEW) and Wales and other stakeholders on both improving auditor training and reviewing the entry requirements for Key Audit Partners and to strike an appropriate balance between ensuring audit quality and market sustainability. The [public consultation](#) published on 28 July 2021 sets out proposals from a sector lead working group for delivering this, including to amend Key Audit Partner guidance to facilitate additional routes, as well as proposals to develop a new training offer, and the department is seeking views on whether these activities, or further action, are required to support the pipeline of future auditors, and support new entrants into the market. Alongside this, the Department for Business, Energy and Industrial Strategy (BEIS) is also considering responses to the consultation on its White Paper that includes proposals for increasing competition in the wider audit market.

4.4 The department will continue to work with FRC, ICAEW, CIPFA, PSAA, and others as the working group develops its proposals and the department considers responses to the consultation and will provide an update on this work in the broader consultation response before the end of 2021.

**5: PAC conclusion: We are not convinced that the recently announced new local audit arrangements will meet the pressing need for effective system leadership now.**

**5: PAC recommendation: The Department should write to us by September 2021 and outline:**

- **how it will address the need for strong system leadership now, while ARGA is being set up and established; and**
- **how it will work with BEIS to set up ARGA, the accountability and governance arrangements, and how its performance will be monitored and evaluated.**

5.1 The government agrees with the Committee's recommendation.

**Target implementation date: by end of 2021**

5.2 The government recognises the need for effective system leadership now. The department's [Spring Update](#) set out the responsibilities the Audit, Reporting and Governance Authority (ARGA) will have as system leader for local audit and the governance mechanisms which BEIS has been consulting on for the new regulator. The department committed then to publish a [public consultation](#) on the details for Summer 2021 recess and signalled that MHCLG would assume a stronger leadership role in the interim before ARGA is established.

5.3 MHCLG has already established the Liaison Committee, a senior stakeholder forum – as recommended by Sir Tony Redmond to consider systemic issues – with MHCLG as chair while ARGA is being established. An inaugural meeting was held on 29 July 2021 to discuss the develop of the next procurement strategy, and meeting minutes will be published in due course, with a further meeting in September 2021.

5.4 The department's summer consultation reflects further work MHCLG has already conducted with BEIS and FRC on governance and delivery. It has been agreed with BEIS that MHCLG's Secretary of State will send a discrete Remit letter to ARGA and that ARGA's annual report will have a standing, distinct local audit section – the government is consulting on the scope of this. This also outlines that FRC will establish interim arrangements from April 2022 to ensure a smooth and timely implementation. Finally, NAO has been liaising with FRC on the range of activities it conducts around the Code of Local Audit to assist with planning for the transfer of the Code to ARGA as system leader.

5.5 Given views are currently being sought from stakeholders on the proposals ahead of a consultation deadline of 22 September 2021, it is proposed to provide a high-level update in September 2021 and will also consider these points as the department develops its response to that consultation later in the year.

**6: PAC conclusion: Unless local authority accounts are useful, relevant and understandable they will not aid accountability.**

**6: PAC recommendation: The Department should write to us by September 2021 with its detailed plans for agreeing with stakeholders ways to focus local authority accounts and audits on areas of greatest risk and concern to citizens.**

6.1 The government agrees with the Committee's recommendation.

**Target implementation date: September 2021**

6.2 The government agrees and is clear that local accountability must be at the heart of local government financial reporting. To deliver on this work will require a collaborative effort across the local audit system. The department is currently developing a plan to deliver Sir

Tony Redmond's recommendation for each authority to prepare a standardised statement to be presented alongside the statutory accounts with the aim of providing greater transparency of financial reporting.

6.3 In its [Spring Update 2021](#), the department also set out its intention to work with stakeholders to identify opportunities to reduce some of the accounting and audit requirements where these relate to areas of less risk to local bodies. This includes working with CIPFA to progress their project to improve the presentation of local authority accounts with the short term aims to review the statutory disclosures and materiality and the longer term review of the more complex disclosures that increase the time to prepare for- and audit in- the statement of accounts.

6.4 The Local Audit Liaison Committee that is now in place to cover the transition period until the new local audit system leader is established at ARGA and will provide a strategic steer to drive progress of the proposed changes aimed at improving the understanding and accountability of local authority reporting. MHCLG is happy to write to the Committee in September 2021 with a plan for how work will be progressed.