Written evidence submitted by the Local Government Association [FLA 005]

About the Local Government Association

1. The Local Government Association (LGA) is the national voice of local government. We are a politically led, cross party membership organisation, representing councils from England and Wales.
2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.

The immediate crisis in local audit and the backlog of unaudited accounts

3. Local audit is in crisis. Councils know this from experience, but it is evidenced by the conclusions of the report from the National Audit Office (NAO) on the timeliness of local auditor reporting. The late delivery of audit opinions is concerning to councils, given the important role that external audit plays in assurance over use of taxpayers' money both centrally and locally. The select committee's current inquiry is welcome and it needs to be recognised that the immediate priority has to be to deal with the current backlog in audited accounts and then resolve the crisis facing local audit.
4. The immediate issue facing local audit is the accounts for 2021/22 and earlier years on which auditors have yet to issue an opinion. Finalising these accounts quickly and addressing the back log should be a priority; the backlog will have a negative impact in the production of 2022/23 accounts and on their audit and finalisation. Since the 2023/24 accounts will be audited under the new contract, in many cases (at least 42 per cent) by new auditors, it is in everyone's interests to ensure that the backlog is as small as possible before we get to that point.
5. The following three measures are suggested by the LGA as a way of making best use of audit time and finance officer time to finalise accounts quickly:
   i. For councils with several years outstanding, concentrate audit effort on the most recent years. Deprioritise and accept balance sheet figures for earlier years that do not have an impact in decision making or council activity and are superseded by 2021/22 figures. This particularly applies to pension valuations and valuations of non-investment assets.
   ii. Amend the requirement on auditors to use "most up to date" figures" for pension valuations as at 31 March 2022 and accept figures used in draft accounts. The point here is that the delay to finalising the 2021/22 accounts means that more

up to date pension valuations could now be available that would not normally have been so had the accounts been audited in time. Auditors may feel they are therefore obliged to insist councils prepare their accounts again using these more up to date figures. If so, this will cause a significant additional delay so it should be prevented.

iii. Deprioritise (and if practical do not produce) a value for money (VFM) statement for any year except the most recent (2021/22). (Earlier years VFM statements will be largely irrelevant now). Normally the auditor will address each VFM audit serially and issue a separate report for each year, one after another. Instead issue a single value for money report which covers 2021/22 and all previous years for which a report has not already been issued, raising matters in relation to previous years only where they remain salient.

6. It is our belief that none of the measures here would increase the risk of local authorities making bad financial decisions or affect the ability of the public or others to hold councils adequately to account.

Background to the crisis in local audit and the Government's response

7. This ongoing crisis follows increasing financial challenge and service pressures on local authorities since 2010, with the recent COVID-19 pandemic and increased audit demands exacerbating long-standing problems in the audit landscape.

8. The LGA recognises there are a number of causes contributing to this crisis including the limited number of firms within the market and a shortage of suitably qualified auditors working for those firms. A survey of councils' experience of local audit undertaken by Public Sector Audit Appointments (PSAA) last year found that the main reason given for delayed audits was resourcing issues on the part of the auditor. While we do not disagree that a shortage of resources and capacity in councils, particularly of suitably qualified staff, will also have had an impact on the timeliness of audit, feedback from our members suggests that long-term causes of delays are more related to the pressures on auditors. It remains the case that a big majority of councils have up until now compiled their draft (unaudited) accounts on time each year, although the delays in audit work alongside the other pressures on finance teams make it harder to meet this deadline.

9. This situation has been made worse by additional work for auditors caused by tighter and stricter regulation of auditors following audit failures in the private sector. In particular, some of the current problems with local audit are perceived to stem from auditors having to spend time on valuations of assets where the value of the asset

plays little or no role in the decision making, finances and financial sustainability, or accountability of the local authority, for example, infrastructure assets such as roads. This does not seem to be good use of scarce audit resources. Furthermore, service demands on local bodies have increased considerably due to the COVID-19 pandemic. Fees have decreased, audit demands increased and the commercial attractiveness of the work for audit firms has declined.

10. The LGA recognises that the situation requires a concerted response from a range of stakeholders including the Government, the audit firms, the regulators and the Chartered Institute of Public Finance and Accountancy (CIPFA).

11. Following the recommendations to improve audit delays made in the Redmond Review, the Government responded in December 2020. We largely support the Government's response and the measures proposed in that paper. With the important role that external audit plays in assurance, local audit delays must be a high priority with further measures implemented urgently. Whilst it is acknowledged that some actions have been taken to address delays, we support the NAO's call in its recent report on the timeliness of local auditor reporting (NAO) for the Government to set out a detailed timetable outlining the steps to be taken and when and the time by which it expects to restore timely audited accounts.

12. We also welcome the creation of the Audit Reporting and Governance Authority (ARGA) as system leader as well as the appointment of a new Director of Local Audit to lead it. However, it is unlikely that the ARGA will be fully functioning until 2024 at the earliest; in the meantime, the new Director of Local Audit is acting as system leader (temporarily based in the Financial Reporting Council (FRC)) on behalf of DLUHC. The memorandum of understanding between DLUHC and FRC outlining how this will work has been published but there is a tension between the role of acting as a partner for the local audit system while also being the regulator for the system.

13. We welcome the move of the deadline for published audited local authority accounts to 30 September for six years, until the end of the next appointing period. This was a necessary move to enable the new audit contacts to be procured.

14. We called on DLUHC to also extend the 31 May deadline to 30 June for preparing draft (unaudited) accounts for the 2022/23 year and onwards. For the past two years most councils have been able to finalise their draft accounts by the published deadlines of 31 July but will be under greater pressure to do this for their 2022/23 accounts if the deadline reverts to 31 May 2023. A deadline of 30 June is more realistic. Given the extension of the audit deadline to 30 September it is unlikely that audit work will be

planned to commence soon after 31 May and so reverting to this earlier deadline will cause an unnecessarily tight turnaround for councils. This could also impact on the quality of draft accounts delivered for audit which could, perversely, create more work and actually lead to further delays. However, DLUHC recently announced (link) that the deadline will revert to 31 May for the 2022/23 accounts; this is disappointing.

15. The provision of £15 million additional funding per annum over 3 years totalling £45 million over the Spending Review period, was welcome news in order to support councils to implement changes needed to respond to new audit requirements and Redmond's recommendations. As announced by PSAA, new contracts will apply from the 2023/24 audit following a procurement during 2022. There is a likelihood of a major re-set of audit fees for 2023/24, involving an increase in the order of 150 per cent on the total fees for 2022/23. This represents a potential increase in excess of £50 million per annum. With councils already facing a range of financial pressures, we are calling for this significant increase in fees to be reflected in future allocations of funding and resources to local authorities.

16. The rest of this submission follows the headings outlined in the call for evidence.

Users and uses of local authority accounts and audit

17. The published accounts of local authorities need to be as clear as they can be while reflecting a full and factual account of the council's spending and financial position. Residents and taxpayers are the key audience, but also those responsible for governance and decision-makers within the council itself. However, most residents and taxpayers are unlikely to get assurance directly from the accounts that public money is being appropriately recorded and used for legitimate purposes. Instead, they will need to rely on those responsible for governance (especially statutory officers and elected members) and auditors to provide suitable assurance based on their commentary of those accounts. This places increased importance on the audit regime, but also means that audit reporting must be meaningful, intelligible and timely. There can be no doubt that timeliness has not been achieved recently.

Understandability and accessibility of local authority accounts and audit

18. There have been a number of attempts to simplify local authority accounts in the past. One of the proposals from the Redmond Review is for the production of a simplified statement for users. CIPFA has been undertaking a review aimed at simplifying the accounts (it is one of the measures mentioned in the update paper on local audit that DLUHC published in December 2021), and in 2019 it published a paper "Streamlining the Accounts".

19. Such attempts at simplification, while valiant, do not appear to have borne fruit yet. One reason for this is that local government finance and the statutory framework within which it operates is inherently complex. The effort involved in producing and auditing the accounts has increased enormously over the years and continues to do so. There is a view that this added workload neither adds value to councils nor provides useful information to users of the accounts. In its submission of evidence to the Redmond review one firm of auditors drew attention to the increase in length and complexity of accounts by citing an example of a council where the length of the 2018/19 statement of accounts was 219 pages compared to 91 pages ten years earlier and the audit opinion was 12 pages compared to 3 pages ten years earlier. Since then, accounts, if they have been finalised at all, have become longer rather than shorter.

20. The accounts do hold good financial information that can allow assessment of important issues such as use of reserves, financial resilience and capital health, however, to get to these, users firstly need access to timely audited statements and secondly, they need to find what they are looking for amongst pages of what may appear to be (particularly to users who are not specialist professionals) relatively meaningless detail.

21. There is a need to explore alternative approaches and the LGA is ready to play its part in taking these forward with Government and other stakeholders. There needs to be a conversation involving all interested parties that concentrates on finding solutions to improve the quality and relevance of the accounts.

Making local authority accounts meet the needs of users better

22. Local authority accounts need to follow a set of recognised standards but the balance between compliance with International Financial Reporting Standards (IFRS) and the purpose of the accounts to report transparently on the use and stewardship of public resources appears to be wrong. International standards can be subject to statutory override. These overrides are sometimes driven by technical considerations but sometimes by expediency. One area to explore is whether there is there a case for wider use of overrides in the interests of clearer reporting.

23. Adherence to IFRS renders the accounts more complex, and it also means that every change in IFRS needs to be reflected by a further change in the local authority accounting code, which usually creates extra work for hard pressed accounting teams and auditors.

24. Local authority accounts have unique features that distinguish them from those laid down by international standards. One example is the separation of revenue and capital. This applies nowhere else and requires councils to account differently for each. There

is a strong case for special treatment for local authority accounts to distinguish them from those laid down by international standards in the light of this.

25. An alternative to the use of statutory overrides would be for the inclusion of IFRS considerations in the local authority accounting codes to be on an as needed basis., Adherence to the standard would no longer be by default. Instead IFRS would only be applied to the codes when it clearly improves the quality of financial information to aid decision making and makes a significant contribution to consistent reporting through whole of government accounts (WGA).

26. Responsibility for producing the accounting codes sits with CIPFA, which is at least partly funded by the sale of the finished codes to users. Although adherence to the codes is mandatory, the codes themselves are only available for a fee.

Addressing findings in audits and sharing best practice

27. The LGA believes that the essential form of local government audit - an opinion on the accounts and an evaluation of the arrangements for securing value for money - is the right one. This approach has persisted largely in this form for several decades and has largely stood the test of time. The recent crisis shows failure to deliver such opinions in a timely manner, it does not mean that the idea of delivering the opinion is the wrong one.

28. It is justifiable to ask whether anything has fallen short in the local audit system that has contributed to statutory reports and interventions in a small number of councils. However, it is important to point out that while audit is intended to give a measure of assurance to councils and to citizens, it cannot replace other accountabilities and other checks and balances within the system*.* We are concerned that if auditors are pushed too much in this direction they may find themselves straying into areas that are matters for local democratic accountability, such as seeming to give guidance on levels of taxation or spending*.*

29. The absence of multi-year funding settlements is a big issue for local authorities. The Spending Review 2021 and Autumn Statement 2022 provided some welcome assurances on future funding levels at a national level for the next two years, but significant uncertainty remains at the local level and nationally beyond 2024/25, which continues to hamper councils' financial planning and financial sustainability. Councils need a multi-year settlement which provides sufficient funding for statutory services. This is crucial for councils to plan budgets effectively, manage future risk, and improve the financial resilience of local government.

April 2023