

Written evidence submitted by Public Sector Audit Appointments Ltd [FRA 016]

About PSAA

Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association (LGA) in August 2014.

In July 2016 PSAA was specified by the Secretary of State as an appointing person for principal local government and police bodies for audits from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015, which provide the framework for how we operate.

Acting in accordance with this role PSAA is responsible for appointing auditors and setting scales of fees for relevant principal bodies that have chosen to opt into its national scheme, overseeing issues of auditor independence and monitoring compliance by the auditor with the contracts we enter into with the audit firms.

About PSAA's submission

PSAA's submission consists of two parts – a summary of the local audit story, and our analysis of objections.

We have also provided a short Appendix setting out the background to objections for convenience.

PSAA submission to the LUHC Select Committee of Financial Reporting and Audit in Local Authorities

Introduction

Public Sector Audit Appointments Ltd (PSAA) welcomes this Select Committee's review. Our evidence submission is focused on where we believe we can make the most effective contribution to the Committee's review given our unique role. It comprises of a summary of the local audit story, and our analysis of objections since 2015. Please note that our opinions and objections data do not include the small number of bodies that chose to make their own audit appointment for 2018/19 onwards.

Part 1 – Summary of the local audit story

The purpose of local authority audit

The purpose of audit is to provide an independent opinion on the truth and fairness of the financial statements and whether they have been properly prepared, and to report on certain other requirements. In relation to local audit the auditor has a number of distinctive duties including assessing the arrangements in place to deliver value for money, and dealing with electors' objections and considering whether there are matters of importance to be reported in the 'public interest'.

Good quality independent audit is one of the cornerstones of public accountability. It gives assurance that taxpayers' money has been well managed and properly expended and in relation to the organisation's financial position. It helps to inspire trust and confidence in organisations and people responsible for managing public money.

At present too many local government bodies are preparing their budgets and making important business decisions without assurance about their underlying financial position because of the backlog of audit opinions, which has arisen for a combination of reasons. It is vital that local audit is restored as a vital part of the financial management framework by being as relevant and timely as possible.

Local Audit – a brief history, 2017 - now

The audit market was relatively stable when the Local Audit and Accountability Act received Royal Assent in 2014. PSAA's 2017 procurement was on behalf of more than 480 bodies (98% of those eligible to join our national scheme), and attracted very competitive bids from audit firms. We were able to sign long term contracts with five experienced and respected firms and to make auditor appointments to all bodies. PSAA honours all bids in full and so firms effectively set the prices. The firms were confident that they had sufficient people with local audit experience to continue to deliver timely Code of Audit Practice compliant

audits across their refreshed portfolios. As a result, all seemed set fair for an uneventful contract period. However, no-one knew at the time was that this was the calm before a very significant storm that would impact audit across all sectors of the economy, including local audit.

2018 proved to be a very significant turning point for the audit industry. A series of financial crises and high-profile failures in the corporate sector prompted challenging questions about the role of auditors generally, and the purpose and value of their work. The Government commissioned a series of private sector focused reviews covering audit regulation, the audit market, and the quality and effectiveness of audit.

The recommendations of those reviews are at various stages of consideration or implementation by Government. There has been significant change in some areas where new legislation is not required. Notably, the FRC was implemented an urgent drive to deliver rapid, measurable improvements in audit quality ahead of the creation of its successor body, the Audit, Reporting and Governance Authority. This placed increased pressure on firms to take much more extensive and effective steps to ensure compliance with regulatory requirements and expectations in every audit they undertake.

Registered firms conducted local government audits for the first time in 2018/19 with the FRC as statutory regulator, coinciding with its response to the government reviews, particularly the Kingman report. Firms recognised the new regulatory context and instructed their audit teams to undertake additional work to gain higher levels of assurance. However, this additional work required more inputs, posing a threat to firms' ability to complete all of their audits by the target date for publication of audited accounts (then 31 July). In addition, the extra levels of audit challenge caused additional work for finance teams that were often already stretched. The additional audit work required compared to what was expected at the time the contracts were signed comes at a sizeable cost – we estimate that additional audit fees will total more than £75m by the end of those 5-year contracts.

The threat of delayed opinions was further accentuated by emerging recruitment and retention issues for audit staff, particularly those with knowledge of the complexity of local government financial statements. Unfortunately, these challenges also arose at a point at which local audits involved increasing levels of technical challenges as bodies explored innovative ways of developing new or enhanced income streams to help fund services for local people.

This risk to the delivery of timely audit opinions first emerged in April 2019 when one of PSAA's contracted firms flagged the possible delayed completion of approximately 20 audits. Less than four months later, all firms were reporting similar difficulties, resulting in 208 (43%) delayed audit opinions. The equilibrium between quality and timeliness that had existed for many years shifted as auditors

responded to the significant pressure to increase audit quality, noting that ultimately there is no statutory deadline for the auditor to give the opinion.

2019/20 audits presented even greater challenges. With Covid-19 in the mix both finance and audit teams found themselves in uncharted waters. Even with the benefit of an extended timetable targeting publication of audited accounts by 30 November, more than 264 (55%) of that year's opinions were outstanding. Worryingly, despite the prioritisation of audit quality over timeliness, the FRC local audit report on its reviews of 2018/19 audits highlighted that there was much more to do if the firms were to meet the required standard.

PSAA was very concerned about developments, and commissioned independent [research](#) published in 2020 that highlighted the fragility of supply. We made this work available to Sir Tony Redmond and his team for their review of local government accounts. Our formal submission of evidence in January 2020 to [the Redmond review](#) called for a regulatory approach tailored to the needs of the sector and systems leadership to join up the various specialist bodies undertaking local audit roles. We also drew attention to tensions and disagreements in relation to the extent of auditors' work and emphasis on valuation of Property, Plant and Equipment where the prioritisation and risk profile assigned by the auditor does not match many preparers' views of the value of assurance.

Sir Tony Redmond's report was issued in September 2020, and many of his recommendations have been taken forward. In the meantime, the audit opinion backlog has grown alarmingly, with 433 (91%) of 2020/21 opinions outstanding at the target date of 30 September 2021. Whilst Covid was deeply unhelpful in terms of adding complexity for all parties, the underlying position was highly concerning. Audit firms were striving to deliver higher levels of quality across the Code of Audit Practice including placing emphasis on areas that many sector voices challenged as being of limited interest/value to them such as assets held long term for operational/service use. However, as local bodies became more vocal about their concerns about the focus of the audit and the implications of delayed opinions, so auditors expressed their concerns about the standard of some of the accounts and working papers which management asserted to be correct.

The [NAO report on local audit timeliness](#) set out the consequences of delayed audit reporting. This includes the fundamental undermining of the usefulness of both the audit view on the financial statements and the Value for Money arrangements commentary that the NAO introduced from 2020/21. PSAA's survey of Audit Chairs in 2022 highlighted the potential for the commentary to give local audit a significant boost subject to audits being completed on a timely basis.

In January 2022 news emerged of the FRC fining Mazars £250,000 for the quality of one of its 2018/19 audits. This first ever fine for a local audit further concentrated firms' approaches on audit quality, coupled with a strongly risk averse approach. An unfortunate consequence was that soon after firms

collectively identified that they could no longer tolerate widespread accounting practices for infrastructure assets that fell below the standards set out in the accounting Code, albeit that they made little or no difference to the financial position of the local bodies themselves. Unpicking this situation took the best part of a year and even then, only to the point of a hard-won temporary solution. This contributed to the outcome that 411 (88%) of 2021/22 opinions were outstanding at 30 November 2022.

PSAA procurement – 2022

PSAA’s role is to secure an auditor for all bodies that opt in to our national scheme. The benefit of bulk purchasing and the state of the market encouraged 99% of eligible bodies to opt in to our 2022 process, covering the audits from 2023/24 to 2027/28. Our new contracts include a range of measures that are designed to reflect the challenges in local audit delivery, and to respond to client feedback [Autumn and Winter webinars – PSAA](#).

We managed to secure just enough supply from the limited pool of 10 suppliers (three of whom did not bid) that had gained statutory accreditation to deliver local audits, but only after several rounds of the procurement process. This outcome came with a very significant price increase, with audit costs likely to rise by around 150% for 2023/24 (from c.£50m for 2022/23 to c.£125m for 2023/24) based on the current level of work required. There was limited competition in the process, and crucially there remains no spare supply in the market, and there are now only nine accredited local audit suppliers. This means that the practical restrictions on PSAA’s contractual position remain, and the revised contracts cannot be used to the maximum effect until the situation is addressed that there is no auditor to replace another that is not delivering what is required.

Latest figures on outstanding opinions

There are 545 outstanding opinions as at 31 March 2023 as set out below.

Audit Year	Number	%
2021/22	347	74%
2020/21	145	31%
2019/20	39	8%
2018/19	10	2%
2017/18	2	-
2016/17	1	-
2015/16	1	-

Part 2 – PSAA analysis of objections

Background to objections and our analysis

A unique element of the local government accountability framework is the long-held rights of local electors to inspect accounts and related documents, and to object to auditors about issues of concern. In recent times electors have been able to access far more data and information than when the right to object was originally enacted, because of developments such as transparency reporting and the Freedom of Information Act.

Publicly available information about objections and their outcomes is limited. The work on them is often mainly confidential correspondence between the auditor, the objector and the local body, and the outcome is reported to the body (normally this is a local authority, but the elector rights cover others such as police and fire bodies). Although the auditor's decision and detailed statement of reasons is sometimes reported in the public domain, this is not always the case. To help address that gap PSAA has analysed the outcomes of objections. Appendix 1 provides background to objections within the legal framework of the Local Audit and Accountability Act 2014.

Our analysis is of the 188 completed objections dealt with by appointed firms from April 2015 to March 2023. It covers objections that the auditor has accepted as valid, and so does not cover unsuccessful objection requests, or other matters and questions brought to auditors' attention by electors and others such as journalists, as PSAA does not have the relevant data.

Electors can ask the auditor to issue a public interest report and/or make an application to the court for a declaration that an item of account is contrary to law. Auditors can also make statutory recommendations (under Schedule 7 Local Audit & Accountability Act 2014) and non-statutory recommendations when reporting on what they have found. Auditors also have the power to issue an advisory notice or seek a judicial review, but these two are very rare occurrences, and have not been actioned in any of the objections in our analysis. The auditor may decide that no action is required because the body has already responded to the concern, or because the concern is not valid, or because whilst the elector disagrees with what a body has done or not done body, the body has not done anything that is unlawful.

It is common for electors to raise more than one issue within an objection. The auditor assesses them individually, and so a combination of responses can result.

Main outcome of objections

Our analysis of the main audit outcome of the 188 objections (table 1) shows that three resulted in public interest reports, and that auditors made Schedule 7 recommendations (commonly called statutory recommendations) in 5 other cases. Other written recommendations were made in 69 cases. There were no applications to the courts for a declaration of unlawful expenditure. In the remaining 111 auditors took no action, although in 71 cases the auditor reported that the body had taken steps to address the issues raised (table 2).

Table 1: Outcomes of objections from 1 April 2015 to 31 March 2023

Outcome	Number	%
Public interest report (PIR)	3	2%
Auditor seeks a declaration (Auditors can apply to the court for a declaration that an item of account is contrary to law)	0	0%
Auditor makes Schedule 7 recommendation (Schedule 7 of the 2014 Act allows for the auditor to make written recommendations which place statutory requirements on an audited body)	5	3%
Auditor makes other recommendations (Auditors have a power under section 27 of the 2014 Act to make recommendations that do not place statutory requirements on the body. These may be used where the auditor wishes to bring a matter in respect of an objection to an audited body's attention, but where it may be disproportionate to require the body to put in place additional arrangements, and incur additional cost, to respond to the recommendation)	69	36%
Auditor takes no further action, having considered the objection	111	59%
Number of objections	188	

Source: PSAA analysis of objections April 2015 to June 2019

The reasons why the auditor took no action in 111 objections are set out below (table 2). In most cases more than one reason applied.

Table 2: Cases where the auditor determined no further action was required

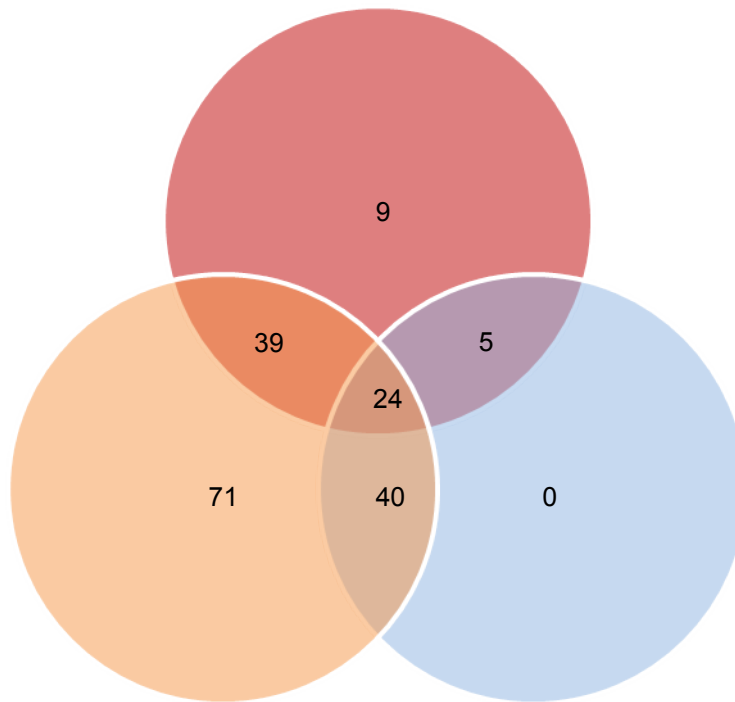
Outcome	Number
Auditor takes no action as body action lawful and appropriate	173
Auditor takes no action as while expenditure may be unlawful discretion exercised not to apply to Court ¹	34
Auditor takes no action as matter not considered to require a PIR ²	97
Auditor takes no action as while law is unclear it is not the role of the auditor to clarify	9
Matter is beyond the auditor's jurisdiction (outside auditor's remit)	27
Body has responded satisfactorily to the relevant issue or part of issue	40

Source: PSAA analysis of objections April 2015 to March 2023

^{1,2} - See Appendix 1 for notes to tables

As referenced above, electors often raise more than one issue within their objections. Auditors consider each of them, and this means that often they report that multiple actions have been taken on the issues, whether this be by the body or by themselves. The combinations of the outcomes of the 188 objections are illustrated below (Figure 1).

Figure 1: Objections often result in more than one action



Auditor takes no action	PIR, court declaration, S7 recommendations, or other recommendations	Body takes action on the issue or part of issue
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Source: PSAA analysis of objections April 2015 to March 2023

The analysis above illustrates that in respect of 117 of the 188 objections (62%), there has been some form of action taken in response to the objectors' concerns, whether it has been taken by the auditor and/or by the body responding as appropriate to the issue raised. In 71 cases, as illustrated by the area shown in orange, the objection raised has resulted in no action being taken by either the auditor or the body.

Objection topics

The range of issues covered by the objections in this analysis is set out below (table 3). The 25 'other' objections tend to relate to specific local issues.

Table 3: Subject matter of objections

Category	Number
Investments	2
Administration of Council Tax Benefit	2
Environment/Waste/Incinerator	9
General Expenditure issues	20
Governance	16
Harbour expenditure	9
Housing	5
Legal costs	6
Lender Option Borrower Option (LOBO) arrangements	33
Parking	17
PFI and contracts	18
Planning	10
Severance and remuneration payments	6
Taxi licences	3
Transport matters	7
Other	25
Total	188

Types of bodies receiving objections

Objections have been made at various types of bodies as shown in Table 4.

Table 4: Bodies receiving objections

Type	Number of objections
London Borough	60
Unitary Authority	44
District Council	34
County Council	25
Metropolitan Council	19
Fire and Rescue Authority	2
Combined Authority	2
National Park Authority	1
Chief Constable	1

There were 43 bodies that had received more than one objection (eight objections was the highest), and 70 bodies had received a single objection.

Objections currently under investigation

There were 40 objections under investigation at 31 March 2023 (Table 5).

Table 5: Analysis of Objections as at 31 March 2023 by audit year

Audit Year	Number of objections being investigated
2015/16	4
2016/17	4
2017/18	2
2018/19	3
2019/20	5
2020/21	15
2021/22	7
Total	40

Source: PSAA objections data

Appendix 1- Background to objections

Legal framework

The requirements of the current local audit framework in relation to objections from local government electors took effect from 1 April 2015, with the introduction of the Local Audit and Accountability Act 2014 (the 2014 Act).

Section 27 of the 2014 Act allows for local government electors to make objections to the local auditor, subject to satisfying some conditions. The auditor must consider whether the objection is valid by complying with legal requirements, whether to accept it for consideration, and what action to take in response. Schedule 7 of the 2014 Act sets out further requirements in relation to public interest reports and statutory recommendations, which are potential outcomes from objections.

The appointed auditor's role on objections

In considering the objections they receive, local auditors must exercise professional judgement, and have regard to the Code of Audit Practice (the Code) and auditor guidance issued by the National Audit Office (NAO). Auditor Guidance Note AGN04 covers auditors' additional powers and duties and AGN07 covers reporting requirements.

While the auditor may need to take legal advice on aspects of the subject matter of an objection, the auditor remains responsible for the decisions and judgements made in determining the objection. This principle applies for all aspects of work performed under the 2015 Code.

The Local Audit and Accountability Act 2014 Section 27 - Right to make objections at audit

- (1) This section applies if, at an audit of accounts under this Act a local government elector for an area to which the accounts relate makes an objection to the local auditor which meets the requirements in subsection (2) and which;
 - concerns a matter in respect of which the auditor could make a public interest report, or
 - concerns a matter in respect of which the auditor could apply for a declaration under section 28.
- (2) The requirements are that;
 - the objection is made in writing, and
 - a copy of the objection is sent to the relevant authority whose accounts are being audited.
- (3) The local auditor must decide;
 - whether to consider the objection, and
 - if the auditor does so, whether to take action within subsection (1) in response.

- (4) The local auditor may decide not to consider the objection if, in particular, the auditor thinks that;
- the objection is frivolous or vexatious,
 - the cost of the auditor considering the objection would be disproportionate to the sums to which the objection relates, or
 - the objection repeats an objection already considered—
- (i) under this section by a local auditor of the authority’s accounts, or
(ii) under section 16 of the Audit Commission Act 1998 by an auditor appointed under that Act in relation to those accounts.
- (5) Subsection (4)(b) does not entitle the local auditor to refuse to consider an objection which the auditor thinks might disclose serious concerns about how the relevant authority is managed or led.
- (6) If the local auditor decides not to take action within subsection (1), the auditor may recommend that the relevant authority should instead take action in response to the objection.

Notes to Table 2

1	<p>The auditor may exercise discretion and not take further action where one or more of the following applies:</p> <ul style="list-style-type: none"> a) the law has changed since the objection; b) limited significance of the subject matter; c) limited wider public interest in the issues raised; d) the substance of the matter has been considered previously by the body’s auditor; e) the substance of the matter falls within the scope of work conducted by an inspectorate or other body; and f) the costs of dealing with the matter are disproportionate to i) size of authority or ii) amounts involved.
2	<p>The auditor may take no further action if the matter is not considered to require a PIR or other formal action provided for in the legislation. The circumstances in which this is permitted are where one or more of the following applies:</p> <ul style="list-style-type: none"> a) limited significance of the subject matter; b) limited wider public interest in the issues raised; c) there is sufficient information already in the public domain; d) the substance of the matter has been considered previously by the body’s auditor; e) the substance of the matter falls within the scope of work conducted by an inspectorate or other body; f) the costs of dealing with the matter are disproportionate to i) size of authority or ii) amounts involved.