

Written evidence submitted by Ernst & Young LLP [FRA 023]

Introduction

Understanding the purpose, accessibility and value of financial reporting and audit is paramount to establishing an effective framework that reassures taxpayers they are receiving value for money public services and supports the resilience of local authorities. Ernst & Young LLP (EY) audits a significant number of local authority (LA) reports and welcomes the opportunity to contribute to this inquiry.

The Committee should note that we recently provided oral and written evidence to the Public Accounts Committee Inquiry on Timeliness of Local Auditor Reporting, which will prove relevant in the context of your current work.

This inquiry on Financial Reporting and Audit in Local Authorities is correctly focused on LA's financial stability and sustainability and we welcome the opportunity to offer further insights and opinions on these important and complex matters

Key points

- **We welcome the inquiry's focus on the purpose, accessibility and value of financial reporting, as well as the important role it plays in ensuring the financial sustainability and resilience of a local authority (LA).**
- **LA's accounts are long and complex to the detriment of their accessibility and understanding, and we recommend this is reviewed.**
- **We recommend developing a clear set of measures defining financial performance and financial resilience, that are derived from information within the LA accounts. This would assist their interpretation and comparability by the user.**
- **This is an opportunity to assess the effectiveness of International Financial Reporting Standards (IFRS) in the context of public sector financial reporting, including whether it remains the appropriate reporting framework; the consequences of a move to another set of reporting standards (e.g., FRS102); or if all elements of IFRS need to be adopted in full by LAs.**
- **We do not believe auditing standards should be modified to provide less challenge to items of LA accounts compared to the same items reported in private sector accounts, providing less assurance and creating two tiers of auditing. If such assurance is not required, then we believe a better solution would be to remove those items from the accounts requirements.**

Users and uses of local authority accounts and audit

Length and complexity of LA accounts

We agree with the Committee that one of the key elements to consider is what purpose are LA accounts meant to serve. Clarity on the objectives and on the users would help to ensure the information provided is both clear and understandable to LA representatives making relevant financial decisions, the individuals charged with their governance and to members of the public in the communities they serve.

The length and complexity of LA accounts makes them difficult to navigate. LA accounts often exceed 100 pages, far longer than other organisations, and it remains unclear whether, or to what extent, they are read and understood by the public. Due to the variety of regulatory requirements they must comply with, LA accounts are far more elaborate than those of other public bodies, including the NHS. For example, they must include information such as explanations of how an authority reconciles the *accounting basis* to the *funding basis*. In addition, commonly accepted measures for interpreting a set of private sector accounts, such as EBITDA (earnings before interest, taxes, depreciation, and amortization), are either absent or have no meaningful equivalence in the public sector. Therefore, they

lack a clear framework of commonly accepted and comparable measures to interpret a LA's financial performance.

We believe there is the potential for the development of a clear set of measures, perhaps an EBITDA-public sector equivalent. Defining these measures would be a clarification of what LA accounts need to contain with a corresponding improvement in the scrutiny of those accounts, because those charged with governance will know 'what to look out for' and be more able to 'call things out' when there are omissions or instances of misreporting.

Reporting standards

This inquiry provides an opportunity to assess IFRS in the context of public sector financial reporting and consider whether it remains the appropriate reporting framework for this sector. It would be worth exploring the move to another set of standards (e.g., FRS102), or perhaps whether all elements of IFRS need to be adopted in full. The Committee should note that other parts of the public sector adopt IFRS, with exclusions or adaptations, and more of these could be used to remove extraneous information currently required in LA accounts that we believe do not add value to the user.

Auditing standards

Firms conducting LA audits follow the National Audit Office's Code of Audit Practice 2020 (the 2020 CoAP) which defines the scope of these audits. Auditors work within the scope of the 2020 CoAP by applying International Standards of Auditing (UK) whilst also taking account of public sector guidance and interpretation of those standards. The standards ensure that we robustly challenge the local authority and their compliance with the relevant accounting framework, which is the CIPFA/LASAAC Code on Local Authority Accounting in the United Kingdom (the CIPFA Code).

We have heard the view expressed that the auditing standards should be modified for the public sector, to provide less assurance in certain areas. We do not agree with this view. Our concern is that this would create a two-tier level of auditing between the public and private sector.

The public sector is obviously funded by the taxpayer, who does not have a direct day-to-day say on how and where their taxes are *invested* in public services, nor where or from whom those services are provided. Therefore, we do not believe the taxpayer should also receive lesser assurance on local authority accounts.

Taxpayers, or any other user, should be assured that all items within LA accounts are audited to the same high-quality standards as company accounts. They should not have to understand which items within the accounts are audited, and to what level or extent they are independently attested. Therefore, if it is determined that the taxpayer does not need assurance on a specific item in the accounts, then it is our view that those items should be removed from the accounts by modifying the requirement within the CIPFA Code.

Reporting and auditing value for money

Auditors have a responsibility, under the aegis of the 2020 CoAP, to assess an LA's Value for Money (VfM). The Committee should note that this underlying information is not found within the accounts, rather, it's drawn from a number of sources and processes with varying degrees of accessibility from within the LA. The 2020 CoAP instigated a requirement for auditors to provide a commentary on the sufficiency of an LA's VfM, alongside the auditor's judgement and commentary on the accounts. Having worked with this requirement since 2020, we question why there is not a clearer responsibility on behalf of the LA itself to document and describe the adequacy of its VfM framework in one accessible place. It can be argued that one of the purposes of the narrative report, statement of accounts and/or annual governance statement, is to do just that. However, these disclosures are completed to variable standards by LAs and we believe they are therefore unreliable sources for VfM information.

Understandability and accessibility of local authority accounts and audit

We believe that the length and complexity of LA accounts, in addition to the lack of a defined and comparable model of interpretation and comparison, inhibits the ability of the user to obtain a clear picture of an LA's financial sustainability, resilience or performance.

The picture on local authority reserves is available within its accounts. The balance on the General Fund is clearly set out within the Movement in Reserves Statement (MIRS), as is the total of earmarked revenue reserves, those reserves set aside for ringfenced capital purposes, and the unusable reserves. However, the level of detail of explanation regarding these reserves is variable across LAs. An informed

reader, with knowledge of the financial framework, would have the ability to locate and interpret this information. However, less informed users would struggle to locate and interpret the information included in the Statement and its supporting notes. Therefore, without further contextual information, while the position is set out, the usefulness is limited.

This supports the key theme in our response that this is the time and opportunity for a fundamental review of the purpose and content of LA accounts.

Meeting the needs of users with better LA accounts

In summary, we believe it is imperative that the form, function and content of LA accounts is carefully reconsidered to define what needs to be included (and excluded) to ensure they are fit for purpose and to improve their understandability and meaning for the end user.

In this regard, the role of the Local Audit System Leader is highly important, as a means to convene all relevant stakeholders and drive an effective debate on this important subject. We recommend this work should progress alongside other aspects the System Leader is reviewing such as workforce capacity, skills, and barriers to Key Audit Partner status.

To this end, we encourage the System Leader to engage with all stakeholders that influence the financial reporting framework, as part of the overall debate on the sustainable future of LA public audits.

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