

LONDON BOROUGH OF CAMDEN	WARDS: All
REPORT TITLE: Local Government Audit & Financial Reporting	
REPORT OF: Director of Finance	
FOR SUBMISSION TO: Audit and Corporate Governance Committee	DATE: 21 st September 2023
<p>SUMMARY OF REPORT: This report provides an update on the current status of local government financial reporting and audit following the recent Public Accounts Committee (PAC) enquiry.</p> <p>LOCAL GOVERNMENT ACT 1972 – ACCESS TO INFORMATION: No documents that require listing were used in the production of this report.</p> <p>CONTACT OFFICER: Daniel Omisore Director of Finance 5 Pancras Square London N1C 4AG daniel.omisore@camden.gov.uk</p>	
<p>RECOMMENDATION</p> <p>The Committee is asked to note the contents of the report.</p>	
<p>SIGNED: Signed by the Director of Finance</p> <p>DATE: 8th September 2023</p>	

1. Purpose of the Report

- 1.1 Commencing in March 2023, the Public Accounts Committee interviewed senior officials at the Department for Levelling Up, Housing and Communities (DLUHC), the Department for Business, Energy and Industrial Strategy (BEIS) and the Financial Reporting Council plus a range of other experts and stakeholders to seek their views on the latest picture in local public audit, and progress implementing the findings of the 2019 Redmond Review
- 1.2 These sessions lasted for several months, with the PAC receiving written and verbal evidence from a wide audience including central government, local government, external auditors, Local Government Association (LGA), Chartered Institute of Public Finance & Accountancy (CIPFA), National Audit Office (NAO), Accounting Bodies and standard setters and culminated in the release of a letter to Local Authority Leaders and Chief Officers from Lee Rowley MP, Parliamentary Under-Secretary of State for Local Government and Building Safety.
- 1.3 The letter summarised a series of proposals to clear the backlog and embed timely local audits. An accompanying statement set out early proposals that will be developed in the coming months, with the expectation that amendments to relevant codes and standards can be made for implementation to get underway by December 2023. See Appendix 1/2.
- 1.4 This paper summarises the proposed changes to the system and its implications for local government and the council. The proposals are set out in section 3.

2. Local Audit & Reporting Timeline

- 2.1 Since 2010 the local government audit and financial reporting environment has experienced significant change. From 2010/11 Local authorities were required to prepare financial statements based on IFRS for the first time. This was a major change from the previous standard which was based on UK Generally Accepted Accounting Practices (GAAP). The main drivers behind this adoption were to encourage consistency and comparability in the global economy and to follow private sector best practice. Central Government, Probation Boards and NHS Foundation Trusts made the change one year ahead of Local Government and the transition has enabled the UK to produce an annual set of consolidated Whole Government Accounts (WGA), by combining the financial statements of over 5,500 organisations across the sector. This has arguably provided more complete data to aid in fiscal planning by producing a consolidated set of accounts for government, that are in line with IFRS.
- 2.2 What these changes haven't fully taken account of are a number of unique features to local authority accounting such as Council Tax setting rules or accounting for capital transactions that are driven by UK Parliamentary legislation and does not align with IFRS. Since adoption local government accounts have also become increasingly complex. They have to meet financial reporting standards while also reflecting how local government finance works,

a challenge that increases with the more complex activities that authorities undertake.

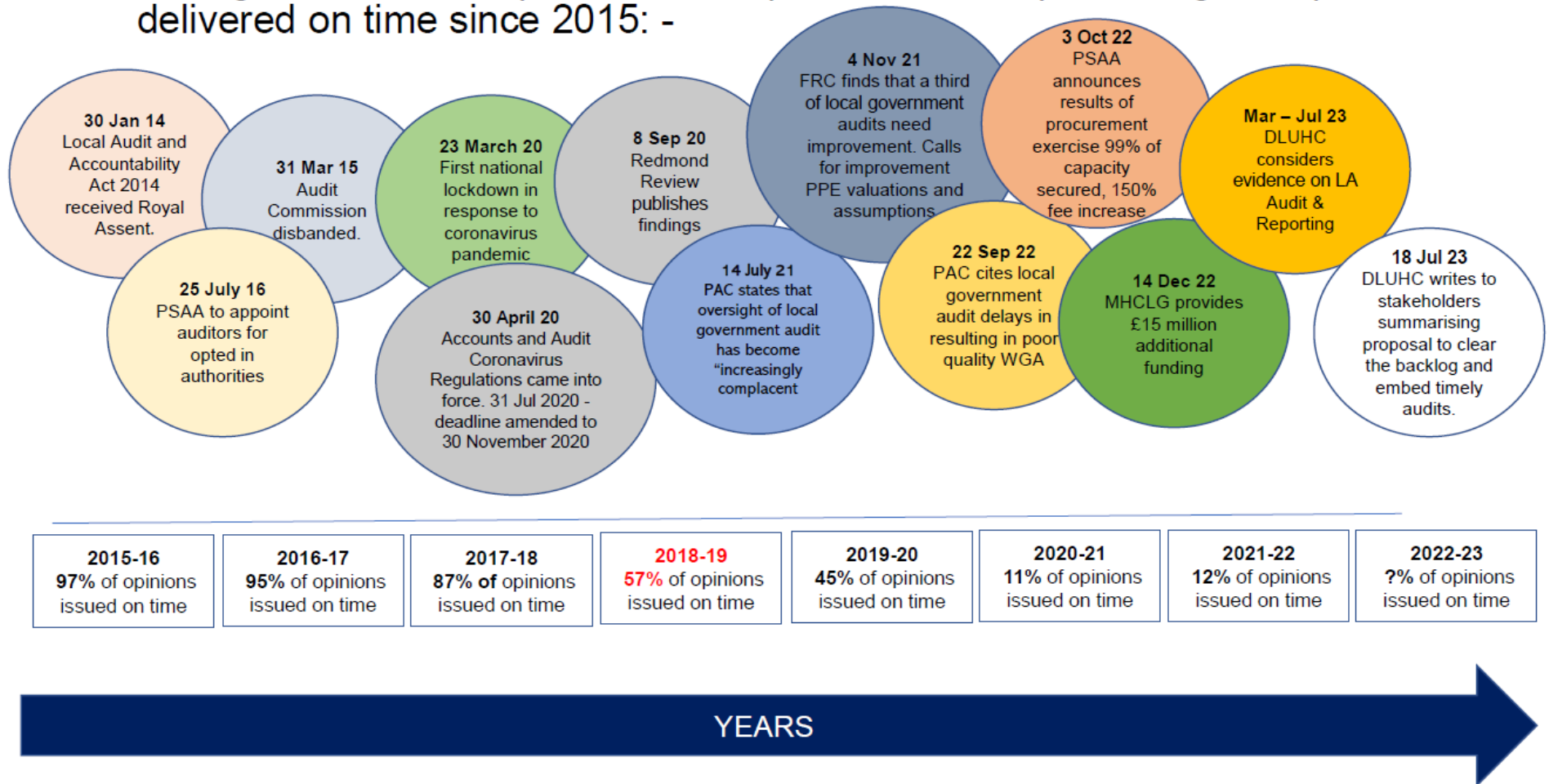
- 2.3 In January 2014 under the conservative and liberal democratic coalition we saw the ratification of the Audit and Accountability Act, closely followed by the disbanding of the Audit Commission. This resulted in a fundamental change in the regulation of local audit.
- 2.4 At the time the Audit Commission had a number of responsibilities for regulating local audit which transferred to other bodies. The National Audit Office took on responsibility for the codes of audit practice and guidance, which set out the way in which auditors are to carry out their functions. The recognised supervisory bodies (accountancy professional bodies) took on responsibility for registering audit firms and auditors and in setting the rules and practices in place that cover the eligibility of firms to be appointed as local auditors and also the qualifications, experience and criteria that individuals will need to have to sign an audit report. They also took on responsibility for monitoring and enforcing audit standards, under supervision by the Financial Reporting Council. This change saw the outsourcing all the Audit Commission's in-house local public audit work to the private sector which initially led a 40% reduction in council audit fees.
- 2.5 The main driver for this change was to reduce inefficiency and wastefulness by reducing the inspection burden and by improving local audit arrangements whilst passing power down to people through more local choice and transparency and as a result saving taxpayers' money.
- 2.6 Following the demise of the Audit Commission new arrangements were required for the appointment of external auditors. The Local Audit and Accountability Act 2014 requires authorities to either opt into the appointing person regime or to establish an auditor panel and conduct their own procurement exercise. As part of closing the Audit Commission the Government novated external audit contracts to (Public Sector Auditor Appointments) PSAA on 1 April 2015. At the time it was expected that the PSAA would secure a number of benefits including timely auditor appointments, manage independence of auditors, secure highly competitive prices, save on procurement costs, save time and effort needed on auditor panels, focus on audit quality and operate on a not-for-profit basis and distribute any surplus funds to scheme members.
- 2.7 The overwhelming majority of councils and other relevant bodies decided to opt into the national scheme for the five-year period from 2018/19 to 2022/23. PSAA completed a procurement of audit services to cover this period starting with the audit of accounts for 2018/19 and were able to pass on significant savings in audit fees to its members.
- 2.8 This then followed a period of relative stability with 93% of audit opinions (between 2015/16 and 2017/18) being completed and issued on time, falling to 57% in 2018/19.

- 2.9 On 23 March 2020 the first national lockdown was announced following the outbreak of the pandemic and in response the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 came into force pushing back the statutory deadline for local audit from 30 July 2020 to the 30 November 2020. Despite the pandemic and the requirement to quickly adopt new ways of working and auditing, as well as significant uncertainty (on property valuations for e.g.) around 45% of audit opinions were issued by the revised November deadline.
- 2.10 In September 2020 in response to concerns regarding the decline in local audit quality and timeliness, Sir Tony Redmond published his long-awaited review of the effectiveness of local audit and the transparency of local authority financial reporting. In the review he sets out a new path for local authorities and their auditors, recommending the creation of a new audit regulator, expanding eligibility for appointment as a local public auditor and an extended deadline for delivering audited financial statements to councils. In December 2020 MHCLG set out their formal response to the review agreeing to some but not all of the 23 recommendations.
- 2.11 In July 2021 the Public Accounts Committee summarised the findings of their investigation into local audit, noting that the Government's oversight of local government audit had become "increasingly complacent" with less than half of local authority audits meeting the deadline for completion in 2019-20, and half of audits examined by the Financial Reporting Council (FRC) needing "more than limited" improvement. The local audit market is "now entirely reliant upon only eight firms, two of which are responsible for up to 70% of local authority audits." A year later in September 2022 the PAC goes on to state that the failures in the local audit market in England and Wales are resulting in poorer quality data for Central Government to use in oversight, and in preparing the Whole of Government Accounts. Noting that the sector was already under strain, with widespread delays to statutory audits and now with additional demands on Local Government from COVID-19 exacerbating the issues.
- 2.12 In November 2021, FRC found that a third of local government audits need improvement. The regulator reviewed 20 major local audits by six of the largest audit firms and said six were below par. Of the firms involved, the work of Grant Thornton UK was scrutinised the most, at nine inspections, as it has the largest share of local authority audits, accounting for 40% of the market. Four Mazars and EY audits were probed, with one each from KPMG, BDO and Deloitte. Key areas requiring action include strengthening the audit testing of expenditure and improving the evaluation and challenge of assumptions used in concluding over investment property valuations. The FRC also wanted to see improvements in the evaluation of assumptions used in property, plant and equipment valuations.
- 2.13 At this time, only 11% of audit opinions for 2020/21 were issued by the statutory deadline.
- 2.14 By October 2022 the PSAA announced the results for the next five-year appointment period, commencing with financial years ending 31 March 2024.

They managed to secure sufficient capacity to assign an auditor to the 99% of English local authority, police, fire and other local public bodies that opted into their procurement programme. However, this followed a supplementary procurement round after PSAA only secured 96.5% of the required capacity in the initial procurement. At the same time the PSAA warn of 150% increase in audit fees as both Deloitte and BDO exit the local audit market.

- 2.15 In December 2022 MHCLG provides £15 million additional funding to local bodies for 2021/22 and 2022/23 to support with the implementation of recommendations following the Redmond Review and additional costs resulting from new audit requirements, including the new value for money reporting arrangements. Camden's share of this allocation is £55k for the main accounts plus a further £7k to support the Pension Fund accounts.
- 2.16 In July 2023 DLUHC writes to stakeholders summarising proposal to clear the backlog and embed timely audits. At the time of writing this letter only 27% of local audits had been completed for the financial year 2021-22 with the combined total of outstanding local audits dating back to 2015-16 at over 500.

Changes to accounts publication requirements and percentage of opinions delivered on time since 2015: -



3. Proposals for addressing the outstanding audits

- 3.1 The ministerial statement (Appendix 1 and 2) sets out early proposals that will be developed in the coming months, with the expectation that amendments to relevant codes and standards can be made for implementation to get underway by December 2023. They can be grouped across two broad themes.

Addressing the Backlog

- 3.2 The NAO and DLUHC intend to set a series of statutory deadlines for accounts preparers and auditors. Auditors would be required to provide as much assurance for a particular year by the relevant date and report using the usual process. There will therefore be substantial scope for audit qualifications and disclaimers where information in the statement of accounts cannot be supported by sufficient, appropriate evidence gathered before the deadline. (No indicative dates are provided in the statement).
- 3.3 This reflects a recognition that when outstanding audits are eventually signed off, they will offer little assurance about an authority's current financial position. Reports on value for money arrangements and their statutory audit powers will continue remain a high priority.

The various system members are expected to contribute to the following areas:

- **NAO** – consideration of a replacement Audit Code
- **DLUHC** – consideration of need for legislation to effect statutory deadlines and manage knock-on effects.
- **CIPFA** – provision of guidance for accounts preparers following any amended regulations for statutory deadlines, and for section 151 officers certifying accounts in light of potential qualifications or disclaimers.
- **FRC** – guidance on its regulatory approach to local audits, articulating the importance of timeliness and compliance with statutory deadlines as an additional measure of audit quality; use of supervisory role to ensure commitment from audit firm leaders and to escalate any pervasive concerns about an audit firm's resilience, risk management and ability to deliver timely audits; suspension of plans for audit quality reviews for 2021/22.
- **PSAA** – reassessment of fees for historical audits (including full compensation for audit work carried out in good faith before the introduction of statutory deadlines and/or reimbursement of prepayments for work that will not now be done)
- **Audit firms** – work with other system members to secure professional commitment to the proposals.
- **Chief Executives, section 151 officers and Audit Committees** – working co-operatively to approve the accounts by the statutory deadline.

- **LGA** – support for councils to understand their role in relation to external audit and that of auditors and help to communicate those messages to members and officers.

Longer term systemic change and sustainability

- 3.4 There will be an escalated reporting framework for audit firms and local bodies to resolve issues ahead of statutory deadlines. DLUHC will look to publish a list of local bodies and audit firms that did not meet statutory deadlines.
- 3.5 The FRC will produce a workforce strategy by the end of the 2023 calendar year, which will identify gaps and barriers across the local audit system that are hindering the development of future capacity and agree actions and solutions to unblock them.
- 3.6 All system participants will consider whether the level of work required for the current reporting and disclosures obligations on account preparers, and the level of audit and oversight, is proportionate to its value to the user of the accounts, given the potential financial or governance risks are relatively low. In the coming months, an assessment will be made whether this work is proportionate to risk and a wise use of taxpayers' money (particularly for non-investment assets).
- 3.7 The Comptroller & Auditor General is considering changes to the Audit Code relating to certain (unspecified) balances in the accounts while a broader solution is sought.
- 3.8 CIPFA is exploring changes to the Accounting Code for the medium term, in order to enable a more proportionate approach to the accounting requirements for non-investment assets and pension valuations for a local authority context. This work will be advised by the HM Treasury thematic review of the valuation of non-investment assets.
- 3.9 The FRC has committed to set out annually its planned regulatory programme, areas of focus and how its inspection activity serves the public interest through alignment with the significant financial, accounting and governance risks facing local bodies. In particular, it will set out how it will review auditors' work on operational assets and pensions valuation, the rationale for doing so and examples of good practice.

Risks

- 3.10 Discussions are ongoing alongside the main system members noted above. The list below captures some of the main risks and concerns members will be working to resolve on the coming months.
 - 3.10.1 Risk of diminished incentive for auditors to clear backlogs before the new statutory deadlines. Concern that auditors could rely on the backstop dates rather than progress challenging audits.

- 3.10.2 The risk of a wave of adverse opinions due to audit capacity rather than quality or information issues.
- 3.10.3 Concerns that this is being seen as a local government finance issue, when in reality this is more nuanced with various moving parts and key players i.e. audit capacity, market issue, regulator, procurement, accounting standards etc.
- 3.10.4 Impact on the opening balances of the statement of accounts for subsequent years. What this means for account authorisers duty to confirm accounts as reflecting a true and fair view.
- 3.10.5 Reputational risk for the sector. Importance that any disclaimers are appropriately worded, and that broader issues with local government audits are well understood outside the sector.
- 3.10.6 Importance of avoiding a repeat of the current backlog.
- 3.10.7 Potential unintended consequences of disclaimers such as higher utility rate costs, increased borrowing costs.
- 3.10.8 Proper review and implementation of a workforce strategy to strengthen resilience in the sector.
- 3,10.9 Risk that members are unable to agree on and clarify the purpose/priority of local audit.

Camden Statement of Accounts Progress

- 3.11 The current status and target dates for completing outstanding audits at Camden are shown below. However, it is not yet known what impact the DLUHC proposals will have on the timetable.

2019-20

- 3.12 Draft Accounts prepared and published. Final Audited Accounts (along with updated Annual Governance Statement) and draft Audit Completion Report approved at ACG Committee 15 June 2023. Final review checks to be completed by Mazars technical team. Given the auditor staffing challenges and the summer holiday period likely to conclude final accounts in **September 2023**.

2020-21

- 3.13 Draft Accounts prepared and published. Camden's audit recommenced in late July following Mazars completion of NHS audits. Fieldwork is close to completion. Targeting **September 2023** ACG meeting for presentation and approval of final accounts.

2021-22

- 3.14 Targeting early **October 2023** for drafts accounts. Timing of audit still TBC with Mazars once draft accounts finalised.

2022-23

- 3.15 Preliminary work started. Discussions ongoing at a national level with government and other key stakeholders with a view to clear the audit backlog.

4. Finance Comments of the Executive Director Corporate Services

- 4.1 This is a report of the Director of Finance, whose financial comments are incorporated into this report.

5. Legal Comments of the Borough Solicitor

- 5.1 The Borough Solicitor has been consulted and has no comments to add.

6. Environmental Implications

- 6.1 There are no environmental impacts arising from this report.

7. Appendices

1. Letter from Lee Rowley MP to Local Authority Chief Executives, Leaders, Chief Financial Officers and Local Audit Firm Partners.
2. Cross sectoral statement outlining proposed approach to resolving these reporting and audit backlog issues.

REPORT ENDS