



National Audit Office



REPORT

Progress update: Timeliness of local auditor reporting on local government in England

Department for Levelling Up, Housing & Communities

SESSION 2022-23
25 JANUARY 2023
HC 1026

Key facts

9%

proportion of local government bodies receiving opinions in time to publish audited accounts for 2020-21 by the extended statutory publication deadline of 30 September, as reported by Public Sector Audit Appointments Ltd

12%

proportion of local government bodies receiving opinions in time to publish audited accounts for 2021-22 by the extended statutory publication deadline of 30 November, as reported by Public Sector Audit Appointments Ltd

632

cumulative number of audit opinions outstanding for all years as at 30 November 2022, as reported by Public Sector Audit Appointments Ltd

35%

proportion of local government bodies who had not received opinions in time to publish 2020-21 audited accounts 12 months after the statutory deadline, as reported by Public Sector Audit Appointments Ltd

5

number of years from 2023-24 for which the government has committed to extend the statutory accounts publication deadline to 30 September from 31 July

1

net increase in the number of firms successful in securing an audit contract from Public Sector Audit Appointments Ltd, following the 2023-24 to 2027-28 procurement

59%

market share by value of the top two audit firms with contracts to audit local government bodies, for the period 2023-24 to 2027-28 (down from 70% in the previous period)

150%

anticipated increase in fees which local government bodies are likely to experience under new contractual arrangements for the period 2023-24 to 2027-28 compared to 2022-23 fees

£60 million

additional funding pledged to local government bodies over four years from 2021-22, to support financial reporting and increased audit costs

2024

earliest expected year for establishment of the Audit, Reporting and Governance Authority, which will act as system leader for local audit

Summary

1 Local government audit provides transparency and accountability to both taxpayers and their local elected representatives. It provides authorities with accurate and reliable financial information with which to plan and manage their services, and finances, effectively. It also provides assurance to the wider public sector, supporting the audit of certain central government departments and the Whole of Government Accounts.¹

2 The arrangements for local audit in England changed significantly following the abolition of the Audit Commission in 2015. From 2018-19, local government bodies appointed private firms to undertake their audits, either directly or through a national scheme. Other responsibilities for regulation and standard setting were spread across multiple organisations. The Department for Levelling Up, Housing & Communities (DLUHC) also sought to compress the timetable for accounts production and audit from 2017-18, to increase public interest in local accounts and encourage more rigorous in-year monitoring.

3 Since 2017-18 there has been a significant decline in the number of local government body accounts including an audit opinion published by the deadlines set by government. We first reported on this in 2021, when 45% of accounts for 2019-20 were published by the deadline, down from 97% in 2015-16. This report provides an update on developments since then, including performance on audit delivery for 2020-21 and 2021-22.

Recent reports on the local audit system

4 Our 2021 report *Timeliness of local auditor reporting on local government in England, 2020* described how the COVID-19 pandemic had a significant impact on the production and audit of accounts for 2019-20.² However, we also noted that the pandemic exacerbated problems which already existed in the local audit landscape, including shortages of experienced staff in both local authority finance teams and audit firms, a relative lack of attractiveness of local government audit as a career, and increasing levels of work for finance and audit staff due to increased focus on audit quality findings.

¹ The Whole of Government Accounts (WGA) consolidates the audited accounts of more than 10,000 organisations across the public sector to produce a comprehensive, accounts-based picture of the financial position of the UK public sector.

² Comptroller and Auditor General, *Timeliness of local auditor reporting on local government in England, 2020*, Session 2019–2021, HC 1243, National Audit Office, March 2021.

5 In July 2021, the Committee of Public Accounts (PAC) published *Local auditor reporting on local government in England*. PAC emphasised a pressing need for system leadership for local public audit but noted that the Audit, Reporting and Governance Authority (ARGA),³ the body due to replace the Financial Reporting Council (FRC) and which DLUHC proposed as local audit's future system leader, would not be set up until 2023 at the earliest. PAC emphasised that DLUHC had to take urgent steps to address problems that could not wait for ARGA to be in place.

6 In a subsequent report on local government finance, PAC concluded that DLUHC had not acted with sufficient urgency, nor had it set out an overarching plan and timetable, to address severe and pressing problems with the local government audit market. PAC highlighted that DLUHC's oversight of local government finance relied on a system of local accountability, which was being hampered by "shockingly late" audit opinions.

About this report

7 This report provides a factual update on local auditor reporting since our March 2021 report. We set out:

- an up-to-date position on the timeliness of audit opinions issued on local government bodies in England (local authorities, local police bodies, local fire bodies) and other bodies (combined authorities, functional bodies, local transport, national parks authorities, pensions authorities and waste disposal authorities);
- an assessment of the impact of delays to local government audit opinions; and
- the steps government and others have taken to address concerns reflected in PAC's 2021 and 2022 recommendations (see Appendix Two). These concerns covered the need to:
 - support the local audit market;
 - increase the supply of qualified auditors; and
 - reform the local audit system.

³ The Audit, Reporting and Governance Authority is the proposed audit regulator to replace the Financial Reporting Council and to become system leader for local audit.

8 Our report draws on published evidence and data, from DLUHC, the FRC and Public Sector Audit Appointments Ltd (PSAA).^{4,5} We have not undertaken new research in the preparation of this report and, while this report provides an update on actions taken since 2021, it does not evaluate the sufficiency or effectiveness of them. While PSAA data allow us to show the number of audit opinions issued on time, we have no published information that allows us to comment on the performance of local government bodies themselves in publishing draft accounts to the timetables expected by DLUHC, or comment on the quality of those draft accounts as submitted for audit. Our study methods are described in full in Appendix One.

Key findings

Timeliness of audits

9 The timely completion of local audits fell to 9% for 2020-21. Nine per cent of local government bodies received opinions in time to publish audited 2020-21 financial statements by the 30 September deadline. This was a significant reduction from 45% for 2019-20, even allowing for the tighter publication deadlines compared with the previous year. DLUHC effectively provided a two-month window for completion of audit opinion work on 2020-21 draft accounts, rather than three for 2019-20. In November 2021, PAC expressed its “shock and concern” at this performance (paragraphs 2.6 and 2.7).

10 Performance on timely completion of 2021-22 audits was 12% and the backlog of outstanding audit opinions grew to 632. Only 12% of local government bodies received opinions in time to publish audited 2021-22 financial statements by the deadline, despite a further extension of the publication deadline to 30 November 2022. This allowed a potential four months for auditors to complete their opinion work on the draft financial statements. By the November deadline, PSAA reported the number of delayed audit opinions to be 632. Some 35% of local government bodies had not received opinions in time to publish audited accounts for 2020-21, one year after their original deadline (paragraphs 2.8 and 2.9).

4 The Financial Reporting Council monitors the quality of major local audits in England and recognises accountancy institutes as Recognised Supervisory Bodies with which audit firms must register before being appointed by local bodies.

5 Public Sector Audit Appointments Ltd is responsible for securing efficient and effective arrangements for the independent appointment of auditors and setting fees on behalf of local bodies who opt into their national scheme.

11 Delays to local government audit opinions continue to have impacts elsewhere in the public audit system. In turn, delays in one sector disrupt audit firms' planning and delivery for the other sectors. Issues include:

- delays to the certification of central government accounts that have material pensions valuations. The Ministry of Justice (MOJ) and the Department for Digital, Culture, Media & Sport (DCMS) both have a number of agencies or arm's-length bodies with material Local Government Pension Scheme liabilities. The National Audit Office (NAO) requires local auditor assurances over these liabilities in order to certify these organisations' accounts and the departmental accounts they feed into. Delays to these local auditor assurances contributed to MOJ and DCMS accounts for 2021-22 being certified between four and five months after the Parliamentary summer recess;
- delays in publication and risks of reduced quality for the Whole of Government Accounts. Local audit delays were one of several factors affecting the 2019-20 Whole of Government Accounts, which were certified 26 months after the year end and five months later than the statutory deadline. PAC reported in 2022 how local government data that were unaudited or missing, due to local audit delays, risk adversely affecting the quality of the accounts and any insights based on them; and
- adverse impacts on NHS bodies which rely on the same audit market as local government bodies. NHS bodies have reported growing concerns about the capacity of their external auditors, resulting in the auditors carrying out fewer interim audits, which puts pressure on the audit of final accounts. They also report concerns around the attractiveness of the market to audit providers and the capacity of NHS finance staff to meet accounts preparation timetables (paragraphs 2.10 to 2.14).

12 DLUHC and other bodies in the local audit system have made a range of interventions intended to support timeliness in the near term. We temporarily relaxed our Code of Audit Practice requirements about the timing of audit reporting on value-for-money arrangements to allow auditors to focus on accounts opinion work. HM Treasury raised the threshold above which local government bodies are required to submit audited data returns for Whole of Government Accounts. DLUHC and the Local Authority Code Board have also deferred the requirement for local government to adopt new statements and accounting standards while resource pressures continue to affect performance (paragraph 2.15).

13 DLUHC has not yet set out a comprehensive timetable for restoring timely audited accounts, but it has said it will retain extended accounts publication deadlines for another five years. PAC requested that DLUHC produce a detailed timetable by which it expects to restore timely audited accounts. DLUHC has previously explained that local audits would take longer to get back on track than other public sector and corporate audits because the issues affecting local audit pre-dated the COVID-19 pandemic and had a wide range of causes. In December 2021, DLUHC announced that the deadlines for publication of audited accounts would continue to be extended to 30 September to 2027-28. DLUHC has since provided dates for the expected delivery of a range of elements designed to help address the delays in local audit (paragraph 2.16).

Action to tackle the challenges in local audit

Supporting the local audit market

14 A new procurement in 2022 to appoint local auditors for the 2023-24 to 2027-28 period provided an opportunity to increase the commercial attractiveness of local audit. Responding to market and sector feedback about concerns over supply and performance, PSAA selected contract award criteria that prioritised quality over price. Price considerations represented only 20% of bid scoring in 2022 compared with 50% in its previous procurement (paragraphs 3.2 and 3.3).

15 Following its procurement, PSAA has advised local government bodies to expect fee increases of 150% dependent on the level of work in the first year of the new contracts. DLUHC had already announced funding totalling £60 million for local government to help with the costs of strengthening financial reporting and increased auditing requirements. This comprised £15 million for 2021-22 and £45 million over the following three years. PSAA requested in October 2022 that central government consider providing further support to local government bodies to help fund this expected increase in audit fees (paragraph 3.4).

16 PSAA intended its 2022 procurement to encourage new audit suppliers to enter the market. In 2021, PAC highlighted that two firms shared 70% of the market by value, with the risk of a “fundamental capacity gap” developing should any one firm exit the market. PSAA’s procurement strategy was structured to broaden supplier participation by: allowing opportunities for firms not yet registered as local auditors to participate; including ‘development lots’ to allow new entrants to bid for smaller packages of work; and setting a target of 34% maximum market share for any single provider (paragraphs 3.5 to 3.7).

17 The 2022 procurement reduced the market share of the largest providers and brought new firms into the market. The overall number of providers increased from five to six, as three firms entered the market and two exited. At 36%, the market share of the largest provider was higher than the intended maximum. The share represented by the top two firms in the market reduced from 70% to 59% and one of the top two firms by market share changed. In total, PSAA awarded contracts covering 96.5% of the work it originally tendered for. Following a rapid supplementary procurement process in August 2022, PSAA secured 99.5% of this capacity, a figure it judged sufficient following confirmation of the impact of local government reorganisations (paragraph 3.8).

Increasing the supply of qualified auditors

18 DLUHC consulted on a number of measures, including those to increase the supply of qualified local auditors. In 2021, PAC raised concerns about a “missing generation” of auditors with the required experience for local audit, with most key audit partners over 50 years old.⁶ PAC recommended that DLUHC work with the FRC and the accountancy institutions to accelerate the supply of qualified auditors. DLUHC opened a consultation in July 2021 and published the results in May 2022 (paragraph 3.9).

19 DLUHC and other bodies have set out a range of approaches to increase auditor supply, although some will not take effect until later in 2023. The approaches include:

- creating new routes for becoming a key audit partner. The FRC published updated guidance in June 2022 outlining changes to the categories of experience the Institute of Chartered Accountants in England and Wales (ICAEW) may consider in assessing applications for key audit partners, and a new training route for those with less local audit experience;
- developing a new qualification for local auditors, which DLUHC expects to launch in spring 2023;
- developing a new technical advisory service to support firms with specialist advice on complex local audit issues, which DLUHC expects to launch in summer 2023; and
- announcing a workforce strategy for local audit, led by the FRC. DLUHC intends to work with the FRC, and subsequently ARGAs, along with a small number of firms, on a strategy expected to consider the pipeline for the development of future auditors.

Since spring 2021 the number of key audit partners listed on the ICAEW register has increased slightly from 98 to 99, with 20 new registrations since April 2021 (paragraph 3.10).

⁶ Key audit partners are staff responsible for key decisions or judgements on significant matters, with respect to the audit of financial statements on which the firm will express an opinion.

Reforming local audit

20 DLUHC has taken steps towards creating a new system leader for local audit, although it understands ARGA will not be established until 2024 at the earliest.

In July 2021 PAC expressed its concern that DLUHC's plans to place responsibility for system leadership with ARGA would not meet the "pressing need" for system leadership now. Since then, developments have included:

- DLUHC's establishment of the Local Audit Liaison Committee, intended to bring together sector expertise and develop a joined-up response to the problems in local audit. The committee, chaired by DLUHC, met for the first time in July 2021 and had met six times by the end of 2022;
- DLUHC updating PAC on developments to the plans for governance and accountability arrangements for ARGA. DLUHC first set out plans in May 2021, including a remit letter that the Secretary of State for Levelling Up, Housing and Communities would issue each Parliament to set out government's priorities for local audit. DLUHC intends relations between ARGA and itself to be governed by a memorandum of understanding; and
- the FRC appointing a new director of local audit, who took up post in September 2022. The new director will lead on FRC's shadow system leader arrangements for local audit until ARGA is established. DLUHC and FRC intend to publish a memorandum of understanding in January 2023 setting out the shadow roles FRC will take on.

In May 2022, the Department for Business, Energy & Industrial Strategy (BEIS) told the Local Audit Liaison Committee that ARGA would not be established before 2024 at the earliest (paragraphs 3.11 to 3.17).⁷

21 DLUHC has reported progress in reforming local government accounts. In 2021 PAC expressed its concern that local government accounts were impenetrable to many stakeholders, which did not aid accountability. PAC also described how complex valuation arrangements around property investments in particular generated levels of audit work disproportionate to the risks faced by authorities. Since then, DLUHC has reported developments including:

- working with the Chartered Institute of Public Finance and Accountancy (CIPFA) to develop a standardised statement providing short, clear and transparent information on financial performance. In 2021 DLUHC deferred the requirement for local government bodies to adopt these new statements to relieve pressure on the audit system; and
- reviews under way by HM Treasury and CIPFA looking at accounting requirements for complex areas, such as non-investment property, plant and equipment valuations (for example, council offices, public swimming pools or social housing) and infrastructure assets (for example, roads, street lighting and flood or coastal defences) (paragraphs 3.18 to 3.20).

⁷ The Department for Business, Energy & Industrial Strategy is the department leading on the creation of ARGA.