

QUALITY ASSURANCE

How did local audit performance sink so far?

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Audit should play an important part in boosting confidence, and not many aspects of modern Britain are as desperate for a confidence boost as local government.

England's local audit system, however, is in a catastrophic state. Missed deadlines, arguments over how to value assets that will never be sold and firms leaving the market entirely all led to an audit backlog that peaked at around 1,000 individual years' accounts.

Anyone with any doubt as to the scale of the crisis need only watch a recent Public Accounts Committee meeting, nominally about the Whole of Government Accounts. The session soon found its narrow focus on the "parlous state" (as Treasury permanent secretary James Bowler described it) of local audit. The sheer amount of unaudited financial information left by the crisis had led to the 2022-23 WGA receiving a disclaimed opinion for the first time ever. A session on the whole of government spent almost all of its time talking about local government accounts. It's a massive issue.

Local audit performance had begun to slip already, but it reached crisis levels amid the disruption of Covid-19. More than half of 2019-20 opinions, and more than 90% of 2020-21 opinions, missed (extended) deadlines. By 2021-22, just 12% were completed on time,



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Independent review by Sir Tony Redmond, 2020



and the following year, 2022-23, just five met the deadline – not 5%; five accounts.

In September 2020, Sir Tony Redmond published a review into the local audit system and found: “For local audit to be wholly effective it must provide a service which is robust, relevant and timely; it must demonstrate the right balance between price and quality; and be transparent to public scrutiny. The evidence is compelling to suggest that the current audit service does not meet those standards.”

The previous government, albeit belatedly, recognised how bad the situation had become. Former local government minister Lee Rowley began working on a solution in spring 2023, but legislation was introduced too late to pass before the 2024 general election.

Current local government minister Jim McMahon continued the work, quickly reviving a planned series of ‘backstops’ – deadlines by which audited

accounts for each outstanding year would be published, even if assurance work is not finished and auditors need to disclaim or qualify their opinions.

Accounts up to and including 2022-23 had a backstop of 13 December last year, and 2023-24 had 28 February this year, with deadlines now set until the 2027-28 accounts (November 2028), by which time the government hopes to have meaningfully ‘reset’ the sector.

Disclaimed opinions

Half of the 467 bodies whose audits are contracted by Public Sector Audit Appointments, a non-profit company set up by the Local Government Association to oversee local audit procurement and contract monitoring, either had their 2022-23 accounts disclaimed or missed the deadline.

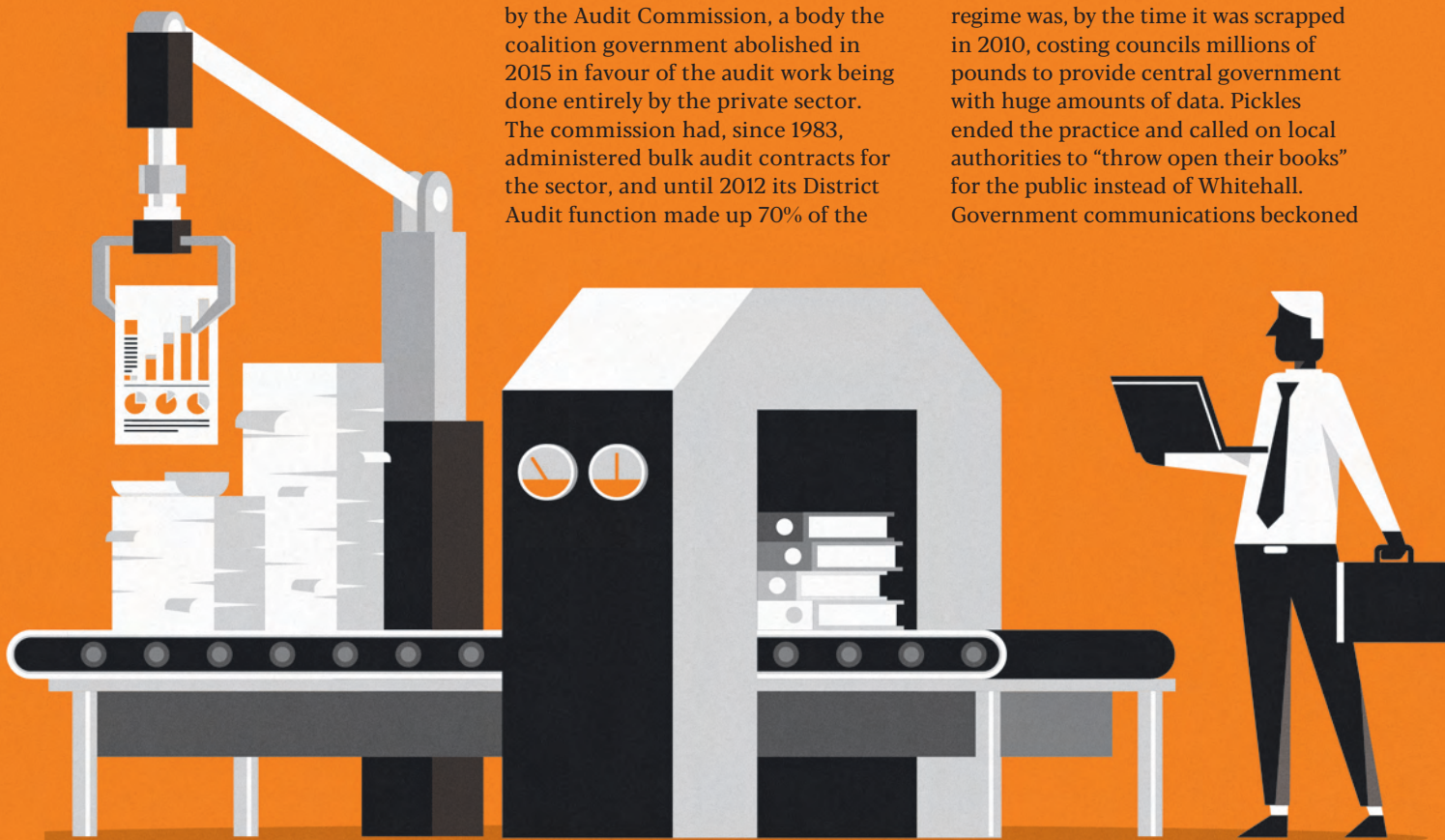
But how did the system reach this point? It clearly wasn’t always this bad. For decades, the audit of local government accounts was overseen by the Audit Commission, a body the coalition government abolished in 2015 in favour of the audit work being done entirely by the private sector. The commission had, since 1983, administered bulk audit contracts for the sector, and until 2012 its District Audit function made up 70% of the

market. In its later years, however, its popularity had waned.

“It wasn’t always seen as the villain of the piece – in fact, it was a very respected organisation, but it came to be seen a bit as Big Brother telling people what to do,” says Laurence Ferry, professor in accounting for democracy at Durham University Business School. “The big change was the global financial crisis, leading to the Conservative-led coalition government, which pursued localism – particularly [the coalition’s communities secretary] Eric Pickles.”

Lord Pickles’ opinion on the body remains unchanged, despite the lessons of the past few years. Speaking with *PF* in 2022, he said: “I do not mean to be unkind, but they were completely useless. All the big scandals that we had, the Audit Commission did not pick them up.” Ouch.

The Audit Commission’s costly top-down ‘comprehensive area assessment’ regime was, by the time it was scrapped in 2010, costing councils millions of pounds to provide central government with huge amounts of data. Pickles ended the practice and called on local authorities to “throw open their books” for the public instead of Whitehall. Government communications beckoned



an “army of armchair auditors”, empowered by newly transparent council finances, to contribute to the sector’s financial assurance.

“The Audit Commission had lost a lot of support, but the government threw the baby out with the bathwater by ending District Audit as well,” Ferry says. “Nobody expected them to get rid of the whole thing. As a result, public provision disappeared and they expected the private sector to pick it up.”

“Private audit firms thought they were going to make a lot of money from the abolition of the Audit Commission, but the other part of the government’s policy was to cut audit fees just as private audit fees were going up,” says David Heald, emeritus professor at the Adam Smith Business School, University of Glasgow. “If you look at the extent to which firms have come in and out of the market, it’s clear that’s where the policy mistake was.”

PSAA has managed on each round to appoint auditors for all 470 bodies, but it has not been easy. Some suppliers, despite being registered to undertake local audits in England, choose not to participate at all.

“The delays we have seen in audited accounts are [the result of] myriad issues across the sector,” says Paul Dossett, head of local government at Grant Thornton, the firm that currently undertakes the most local audit work. “Capacity in the local audit sector has been an ongoing challenge, and there are currently six firms providing external audit to local government.”

A small number of firms and a shortage of qualified auditors have combined with relatively low fees (which some have blamed for the sector becoming unattractive to finance professionals) to leave it unable to deal with the work. In 2023, a senior civil servant told the Public Accounts Committee there were fewer than 100 key audit partners (staff qualified to sign off accounts) in the market, most of whom were over 50 years old. But that’s just one side of the coin.

“Local authorities have also been facing their own resource challenges,

while some have been stymied in their production of accounts by contested accounting judgments, which require both external accounting and legal advice,” Dossett explains.

Sanction score

External auditors were “frightened”, says Heald, by a 2022 sanction on Mazars by the Financial Reporting Council over “insufficient and undocumented” challenge on the valuation of refurbishment costs in a local authority audit. The £250,000 fine was because, the FRC said, Mazars “fell far short of the applicable standards and regulations”. (Mazars said at the time that it accepted the sanction, and worked closely with the FRC throughout the process.)

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LGA consultation submission

Since then, auditors and councils have clashed over valuation of certain assets, including some property that will never be sold. Heald says: “Auditors appoint RICS qualified surveyors essentially to have arguments with RICS qualified surveyors appointed by the councils. You see a lot of time and money spent – and that’s the kind of defensive measure that auditors are taking to avoid being criticised by the regulators. Councils don’t know what the auditor will accept, and that’s a problem.”

Whereas, before, auditors would weigh up quality and timeliness when doing their work, the balance has clearly shifted – quality is being prioritised at the total expense of timeliness.

Many blame complex local authority accounts. Dossett names the

Accounting Code, written by CIPFA and derived from International Financial Reporting Standards, and new standards introduced in the past decade as complicated aspects that have added to the workload. Council accounts can now stretch into hundreds of pages. One audit firm pointed the Redmond review to a particular council’s 2018-19 accounts being 219 pages, compared with 91 pages 10 years earlier, with a corresponding audit opinion of 12 pages, compared with just three a decade before.

There is another big question at the heart of this issue – what are local authority accounts for? The LGA, in its submission to the recent consultation, said: “It is accepted that local authority accounts need to follow

a set of recognised standards, but the balance between compliance with IFRS and the purpose of the accounts to report transparently on the use and stewardship of public resources appears to be wrong.”

Meaningless detail?

It added: “The accounts 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 among pages of what may appear to be (particularly to users who are not specialist professionals) relatively meaningless detail.”

In order to empower Pickles' "army of armchair auditors", some aspects of the accounts would probably need to be simplified. But simplification is not universally seen as the cure to what ails the local audit system.

"It's a question of expertise," says Ferry. "The problem was never with the accounts; it's that they got rid of the people who understood them. Approaching this problem by simplifying local authority accounts is putting the cart before the horse. Could they be simplified? Of course. But that's not going to solve the problem."

Overloaded with overrides

"Local authorities undertake complicated activities," says Heald. "Some people in local government want to blame IFRS, but it's all the overrides that complicate the understandability of the accounts."

Heald believes accessibility is not the main issue. "I don't expect a council tax payer to actually go looking at their local authority accounts. However, a council tax payer would expect that their local authority accounts have been prepared to proper accounting standards and to have been subject to proper assurance."

A further question then follows – what is local audit for? The shifts have seen a far greater focus being put on assessing financial statements, at the expense of value-for-money work. Auditors seem to want this to change under the incoming regime.

"We believe there is a strong need for a single systems leader, responsible for sector-wide issues," says Dossett.

"We would expect such a body to highlight the vital importance of value-for-money and the appropriate use of auditor powers. The new system leader should also identify the areas it believes are critical to stakeholders, and direct local auditors to focus their work in those areas." This would, Dossett says, shift the focus away from property valuation, towards income, expenditure and reserves.

But, for now, local authority accounts are complex, and they are produced

and audited in a complex system. Private firms conduct the audits, with key audit partners registered with the Institute of Chartered Accountants in England and Wales, with contracts arranged by PSAA, on accounts prepared to standards set by CIPFA, to an audit code of practice set by the NAO, under supervision of the FRC, and with ultimate policy responsibility held by the Ministry of Housing, Communities & Local Government.

This complexity is one reason why the government, following a recommendation in the Redmond review, wants to introduce a single body overseeing the sector. Sound familiar? Have we come full circle back to the Audit Commission?

The government would say no – and it would say it strongly. When proposing the Local Audit Office in a recent consultation, it stressed that the move was "not a return to a

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Laurence Ferry, Durham University Business School

bloated Audit Commission. Lessons will be learnt, and the LAO will be proportionate and operate within its strategic objectives and the principles of this strategy."

However, the LAO is planned to oversee the market, take control of some of the functions split up between the various system partners and possibly deliver some audit work directly.

"Politically, the government can't say it's bringing back the Audit Commission, but I see the LAO very much as the 'Audit Commission part one', doing the very basic stuff," says Ferry. "Financial audit, getting through the backlog and doing very slight value-for-money work – not what it became, which people didn't like."

Establishing the LAO alone will not be enough to fix the crisis in audit capacity. If it does not involve training new auditors, even re-establishing public provision will only succeed in moving capacity around the system – leading either to very marginal gains or none at all.

Ferry believes that building up public provision could "realistically" be achieved within three or five years at a minimum. The benefits, he says, include re-establishing the "culture" of District Audit, with people seeing their careers in the sector, enabling it to retain expertise.

Things must change

There appears to be a split between the weight people place on simplification and on simply building capacity and experience, but all parts of the system agree that things cannot stay the same. The stakes are too high for the LAO to be set up without ambition.

"Local authorities are an important part of British society and a big economic actor, and it's vitally important that the sector runs smoothly," Heald says.

"Life for local authorities is very tough, and it doesn't help when the regulatory system fails in this way. But it's a lot easier to smash up a system than [it is] to put it back together again." 