David Heald's submission to the Ministry of Housing, Communities and Local Government consultation on the proposed Local Audit Office.

Question 1: Do you agree the LAO should become a new point of escalation for auditors with concerns? Yes.

Question 2: Do you agree relevant issues identified should be shared with auditors, government departments and inspectorates? Yes. Consideration should also be given to how significant issues would be reported to Parliament through the Housing, Communities and Local Government Committee. The Public Accounts Committee has a stake in this, not least because of the disclaimer on the 2022-23 Whole of Government Accounts.

Question 3: Should the LAO also take on the appointment and contract management of auditors and for smaller bodies in the longer term? If so, when should responsibilities transfer from SAAA? The LAO should take on both the employment of auditors and the contract management of private auditors. There would have to be separation of functions, as there was at the Audit Commission. It makes sense to have all English local authority auditors appointed by the LAO, so that the market can be properly understood and managed. I would suggest an initial focus on PSAA audits, picking up the SAAA audits later, possibly determined by the timings of existing contracts.

Question 4: Should the LAO oversee a scheme for enforcement cases relating to local body accounts and audit? Yes. There needs to be both early warning systems which identify accounts and audits in difficulty and prompt action to resolve problems.

Question 5: How could statutory reporting and Public Interest Reports be further strengthened to improve effectiveness? There were fewer Public Interest Reports after the abolition of the Audit Commission, even though there was awareness in the sector that problems were mounting. In effect, the Audit Commission had granted implicit insurance to private audit firms undertaking local audits. It is important to understand the dynamics within private audit firms and the vulnerability of their public sector practices when delivery becomes insufficiently profitable due to financial reporting failures and regulatory interventions. The LAO should report on key themes and issues at least annually, and should be able to direct auditors to report on certain matters across the whole sector. This would be important if an issue is identified in one authority but could become pervasive for the sector if left unchecked.

Question 6: Should the scope of Advisory Notices be expanded beyond unlawful expenditure, or actions likely to cause a loss or deficiency, as defined by the Local Audit and Accountability Act, to include other high-risk concerns? No response.

Question 7: Should the LAO own the register of firms qualified to conduct local audits? Qualification to conduct local audits should be separated from employment of auditors and contracting with private firms. Therefore I would favour the Financial Reporting Council (in due course the Audit, Reporting and Governance Authority) owning a UK-wide register of firms qualified to conduct public sector audits, including local audits.

Question 8: Should the LAO hold the power to require local bodies to make changes to their accounts, so that auditors could apply to the LAO for a change to be directed instead of needing to apply to the courts? No response.

Question 9: What are the barriers to progressing accounts reform? My view is that the English local audit crisis stems not from accounts but from audit, through the following chain of events:

1) The Audit Commission is abolished (destroying early warning capacity) and District Audit, established in 1844, is also abolished (removing public sector audit capacity)
2) There is an explicit UK Government objective of reducing the costs of local audit at the very time that private corporate audit fees are rapidly increasing because of complicated new standards and higher perception of financial reporting risks
3) Rather than local audit being a highly profitable business opportunity for private audit firms, this makes local audit unattractive to many private audit firms, and complicates the internal position of their public sector practices
4) The Carillion case, and other corporate audit failures, damages the Financial Reporting Council, which the Kingman Review puts on death row. However, the UK Government does not bring forward primary legislation to set up the successor Audit, Risk and Governance Authority
5) The bruised FRC toughens up its quality reviews of local audits and the Mazars case unnerves private firms with contracts for English local audits. This leads to defensive practices such as hiring their own RICS-qualified surveyors to challenge the valuations of non-investment assets by council-appointed RICS surveyors
6) Influenced by the tougher FRC quality reviews, ICAEW toughens up its own quality reviews, and this spreads to audits in the devolved nations. Private auditors become increasingly nervous and put more pressure on council finance teams which no longer know what the auditor will accept. Changes of auditor have become more difficult than usual. To avoid qualifications, councils accept auditor-requested changes even when they believe these involve a departure from the CIPFA-LASAAC Code
7) Even when councils meet the statutory dates for the publication of draft accounts, the time period between these and the publication of the audited accounts becomes disproportionately long

8) Throughout these developments, local authorities struggle with austerity and the disruptive effects of Covid, and are uncompetitive in the labour market for experienced accountants. IFRS is often blamed for these difficulties.
9) Everyone is unhappy but breaking out of this chain is formidably difficult.

The Treasury and the Financial Reporting Advisory Board will not go back on the 2009 decision to implement IFRS across the UK public sector. My view is that if governments impose IFRS on the private sector they should take the medicine themselves, albeit with appropriate modification and/or interpretation for the public sector. Local authorities are increasingly complex bodies, with group structures and financing mechanisms such as sale and leaseback between group entities. Moreover, smallness does not guarantee simplicity in accounting, as can be seen in those English district councils whose financial sustainability has been damaged by risky commercial ventures.

The stresses and strains of the English local audit crisis have held back developments in local authority accounting. CIPFA-LASAAC has been under-resourced and preoccupied with firefighting, with less time for topics such as infrastructure accounting and the timely implementation of new standards, working out how to separate IFRS-based accounts from the statutory overrides, and how to develop Redmond-style pilots of simplified reporting to citizens consistent with the audited accounts.

Question 10: Are there structural or governance barriers to accounts reform that need to be addressed? Much of the complexity of local authority accounts stems from statutory overrides, most of which are designed to protect council taxpayers. With less pressure on the system it should be possible to produce two statements at the same time, one which is the IFRS-based financial report and the other showing the adjustments necessary to reach the financial aggregate relevant to council tax setting. However regrettable some of these statutory adjustments are because they make councils' financial reports unintelligible to most citizens, the motivations for many of them still apply. Contrary to the Minister's preface to the Consultation document ("Local government is the foundation of the state"), no UK nation has decided what role it wishes local authorities to play.

Question 11: Should any action to reform be prioritised ahead of the establishment of the LAO? Annex A of the consultation document sets milestones, with the final one being:

> "LAO fully resourced and begins contract management with other elements of its oversight, as set out in the transition plan to give the market clarity and time to adjust: By 2027/28."

This is a long period to wait, especially as UK governments do not have a good record in progressing audit legislation, as evidenced by delays to primary legislation to establish the Audit, Regulation and Governance Authority. There are useful steps that could be taken in the meantime, including:

(a) Increasing the resourcing of CIPFA-LASAAC so it can, inter alia, catch up the Financial Reporting Manual and make Code modifications which allow early adoption of new standards by those local authorities with the capacity to do that
(b) Encouraging, and possibly funding, early adoption of new standards, particularly those which might be difficult to implement in local authorities. Edinburgh City Council and Crawley Borough Council were early adopters of IFRS 16, a step which will have clarified issues for other councils.

Question 12: Are there particular areas of accounts which are disproportionately burdensome for the value added to the accounts? The obvious retort to this question is "value added to whom?", as government financial reports are aimed at multiple audiences. The main areas of recent difficulty appear to have been pensions disclosures and non-investment assets. The CIPFA-LASAAC 2025-26 Code Consultation proposes changes to accounting for non-investment assets consistent with the Treasury Thematic Review. Part of the motivation for such changes, which include the use of indexes, is to address the problem that auditors focus excessive attention on the valuation of assets which the local authority has no intention of selling, an example of how the regulatory system has made auditors nervous.

Question 13: Do you agree that the current exemption to the usual accounting treatment of local authority infrastructure assets should be extended and if so, when should it expire? Extension of the exemption is inevitable in the present circumstances, though I would strongly argue in favour of aligning with central government in the use of current values when capacity exists to do so.

If I were a local authority Chief Financial Officer, I would be tempted to offer to be a pilot for current values for infrastructure assets if that were permitted by the Code. But then I would retreat for two reasons. First, in the present situation as described in the response to Question 9, I would not wish to expose my council to an audit qualification. I would not know what methodology auditors would find acceptable, given that the configuration of local authority infrastructure assets is quite different from those in central government (think of the complexity of local streets versus relatively standardised motorways). Second, I would wonder why, given that much historic cost data has been lost during successive local government reorganisations, my authority has never had an audit qualification on local authority roads. One of the effects of the chain of events described in my answer to Question 9 is that previously accepted practice has been challenged by auditors. I would reflect on the false messages that historic cost data on infrastructure are conveying, given that new spend at current prices makes it look as if the infrastructure asset base is increasing when the physical deterioration is visible to all who want to look.

Question 14a: Should the LAO adopt responsibility for CIPFA's Code of Practice on Local Authority Accounting? No. The LAO will be an English body and, given that public sector accounting consistency across the UK is not only desirable but will be insisted upon by the Treasury, that responsibility should be held by a UK body, whether a government entity or a UK-wide professional body.

The title page of the consultation document states "Applies to England", when the proposals have consequences for Scotland, Wales and Northern Ireland.

First, with England being dominant in terms of size, there is a risk that UK Government Departments with responsibilities for England forget the devolution settlements of 1999 and propose arrangements that go against the spirit of devolved government. The LAO proposals have profound implications, particularly in terms of taking the Local Authority Accounting Code from CIPFA-LASAAC (in which the devolved nations participate) and moving it to the LAO. Since the adoption of accruals accounting in government in the early 2000s and the devolution settlements of 1999, the policy objective has been to make government accounting as consistent as possible across the four nations and tiers of government. This objective, which I support, has been subscribed to by HM Treasury and the Financial Reporting Advisory Board. If the LAO took control of the Local Authority Accounting Code from CIPFA-LASAAC, there are likely to be conflicts with FRAB and the devolved nations, threatening consistency across the UK public sector. For these reasons, responsibility for the Local Authority Code must be kept at the UK level.

Second, there are independence issues regarding the setting of accounting standards, setting of auditing standards, quality assessment of financial reports and audits, direct provision of auditing services and contracting for auditing services. How these are separated or bundled together will influence both costs and perceptions of independence. With the LAO being given responsibility for the appointment and contracting of local auditors and for identifying and summarising developments in local government financial reporting, it is essential to retain separation from the development of the Code of Local Authority Accounting which should be retained by CIPFA-LASAAC. The LAO should take over responsibility from the NAO for the Audit Code for English local government while the devolved nations' public audit agencies retain their existing responsibilities for their national codes. As the relevant private firms are UK-wide, there are strong arguments for co-ordination. Audit quality should continue to be assessed by the FRC (ARGA) and ICAEW within a framework which establishes what is proportionate in the local authority sector.

Question 14b: Are there other options relating to responsibility of CIPFA's Code of Practice? A new UK body could be created but the disruption from doing that is not justified. Restructurings run the severe risk of capacity being damaged as people move from organisations that will be abolished into roles in the new structure.

Question 15: Should the Accounting Code be freely available if it is not transferred to the LAO? Yes. It is indefensible that the Code by which UK local authorities must account is behind a toll. As a matter of principle it should be freely available to all users, including those citizens who wish to use their statutory power of objection. The costs involved in its preparation should be met either by grants from the UK and devolved governments or by a levy on UK local authorities. Implementing the former would be less complex as such a levy might involve passing primary legislation in four legislatures. The total cost would be minimal relative to the £210.753 billion total expenditure of UK local authorities in 2022-23.

Question 16: What additional support should be provided to finance teams, audit committees and elected members to develop and strengthen financial governance? The most important requirement is the injection of stability, which is more likely to be secured if the dysfunctional chain of events set out in my response to Question 9 can be broken.

Question 17: How should KAP eligibility be extended further, should some categories of local audit be signed off by suitably experienced RIs (and if so, which)? No response.

Question 18: Should the market include an element of public provision? Yes. I opposed the abolition of District Audit and have always believed it was a catastrophic policy error. This has been confirmed by the fact that the local audit crisis is an English problem. However, establishing a public sector provider will take time to add incremental capacity as it is likely to be initially staffed by people already in the system, whether in private audit firms, the National Audit Office or the devolved audit agencies. Such job moves would themselves bring a degree of disruption, so arrangements to attract auditors into local audit are imperative. Remuneration and career prospects would have to be addressed.

Question 19: If yes, should public provision be a function of the LAO? Yes, in relation to England.

Question 20: What should the initial aim be in relation to proportion of public and private provision? In an ideal world, I would argue for circa 70% public and 30% private but the experience of the devolved audit agencies is that this can only be achieved if there is sufficient interest from private audit firms with the appropriate skills and capacity. I have long argued for mixed procurement but recognise that it has to be (a) profitable and stable for private audit firms, and (b) attractive to those private audit firms from which the public audit agencies can learn.

Question 21: Should the Secretary of State, in consultation with the LAO and for defined periods, set an envelope within which the body could determine the appropriate proportion of public provision for the market? No. A long-term commitment to mixed procurement should be explicitly stated but there should be no formal target for proportions. Resolving the difficulties of English local audit would make bidding for local audit work more attractive to the private firms upon whom the dysfunctionalities of this market have rebounded. If there were a formal target, that is likely to affect the bidding behaviour of private audit firms, probably increasing audit fees because of the lack of competition and the knowledge that outsourced contracts would be be issued whether or not these were value-for-money.

Question 22: Do you think that the Chair of an audit committee should be an independent member? If the Question means "not a member of ruling party or governing coalition", then 'Yes'. If it means "not an elected councillor", then "No". The first interpretation brings a measure of independence from the current administration while recognising the democratic mandate. On grounds of protecting democratic legitimacy the Chair of the Audit Committee should not be an unelected person. However, there are strong arguments for appointing some persons with specialist accounting and auditing knowledge to the Audit Committee, not least because they could help elected members to navigate between council officials and auditors. Experience of internal audit as well as of external audit would be useful. I would make this arrangement permissive rather than a statutory requirement, at least until the availability of suitable candidates is established. External members require some knowledge of IFRS and of local authority activities, as well as being perceived to be independent by councillors and preferably having some connection to the local area. My expectation that the distribution of persons with such attributes and experience will vary geographically.

Question 23: Do you have views on the need for a local public accounts committees or similar model, to be introduced in combined authority areas across England? I am not sufficiently familiar with the institutional structure to have a view.

Question 24: Would such a model generate more oversight of spending public money locally? I am not sufficiently familiar with the institutional structure to have a view.

Question 25: How would the creation of such a model impact the local audit system and the work of local auditors? Local authority audits have a Bannerman clause, restricting the audience to which the audit certificate is addressed. Any new mechanism would have to consider the potential effects on (a) auditor workload and (b) the willingness of private auditors to be subject to such a regime.

Question 26: Do you agree that the MLA threshold should be increased? My general assumption is that thresholds should be periodically increased in light of inflation, otherwise more entities than originally intended will go over the threshold.

Question 27: Do you agree that some local bodies should be declared exempt from the regulatory focus of an MLA? For example, should Integrated Care Boards be exempt? No response.

Question 28: Do you agree that smaller authorities' thresholds should be increased? My general assumption is that regulatory thresholds should be periodically increased in light of inflation, otherwise more entities than originally intended will go over the threshold.

Question 29: Do you agree that the lower audit threshold of £25,000 should be increased broadly in line with inflation? My general assumption is that thresholds should be periodically increased in light of inflation, otherwise more entities than originally intended will go over the threshold.

Question 30: Are there other changes that would improve the accounting and limited assurance regime for smaller authorities? No response.

Question 31: What additional support, guidance or advice do local bodies and/or auditors need for future statutory deadlines (including backstop dates) for the publication of audited accounts? The most important requirement is to re-establish certainty so that local entities can confidently plan. Explicit guidance is required on asset valuations and on what is proportionate auditing, so that finance teams know what auditors will accept and auditors know how quality assessors will score. Until the backlog is cleared, the system should prioritise entities with listed debt or with high-risk profiles.

Question 32: Do you think that financial reporting and/or auditing requirements should be amended for a limited period after the backlog has been cleared and as assurance is being rebuilt, to ensure workload and cost are proportionate? This question is too unspecific about what relaxations are being contemplated. My position is that one has to be very careful about temporary relaxations which might then become permanent. The 2022-23 UK Whole of Government Accounts were disclaimed by the Comptroller and Auditor General due to the English local audit backlog, with the Treasury hoping that the reset programme of backstops will lead to a future removal of the disclaimer. Supposedly temporary abatements to financial reporting standards and/or auditing requirements might open up a new set of obstacles to removing the WGA disclaimer.

Glasgow, 29 January 2025