Response ID ANON-729H-D73E-W

Submitted to Addressing the local audit backlog in England
Submitted on 2024-03-06 10:08:56

About this consultation

Introduction

What is your name?

Name:
David Heald on behalf of Lynn Bradley, Ron Hodges and himself. This joint response should be taken to be from the three individuals and not from any organisation to which they may be affiliated.

What is your email address?

Email:
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Are you responding to this consultation as an individual or on behalf of an organisation?

Individual

What organisation are you responding on behalf of? (if applicable)

Not Answered

Name of Organisation:
Not applicable

What is your role in the organisation? (if applicable)

Please specify:
Not applicable

Overview

Phase 1: 'Backstop' proposals for financial years 2015/2016 to 2022/2023

1 Notwithstanding the possibility of exemptions in exceptional circumstances (covered by questions 3 and 4 below), do you agree that Category 1 authorities should be required to have published audited accounts for all financial years up to and including financial year 2022/2023 by 30 September 2024?

agree

Do you have any comments on this issue?:

The situation in England has become so desperate that this is the least-worst option. It should be noted that, though local authorities are under stress throughout the UK, the local audit crisis is an English problem. The core issues are (a) the lack of a public sector audit capacity due to the closure of District Audit which had been established in 1844; and (b) the continuing fragmentation of authority over, and regulation of, local audit in England. This least-worst option is risky, in that (i) the reputation of English local authorities and their auditors will be battered by the likely proliferation of qualified and disclaimed accounts; (ii) there are dangers of the contamination spreading to Scotland, Wales and Northern Ireland from private audit firm market exit; and (iii) the lowering of accounting and auditing standards in order to cope with the backlog might create the impression that high standards are expendable whereas they are vital for transparency and local accountability.
The question should be "'what needs to be done to ensure the timely production of audited accounts for 2023/24 in order to restore proper local accountability?".
As the least-worst options, we identify severe risks that should be mitigated:
(1) that firms take the safe-for-them option of qualifying or disclaiming, especially if they are exiting the local audit market after 2022-23;
(2) that draft accounts quality and audit quality will suffer as efforts concentrate on getting something out for years up to 2022-23 in the absence of FRC and ICAEW audit quality reviews;
(3) that firms entering the market from 2023-24 have not fully appreciated the problems they will inherit;
(4) that local authority finance teams do not have sufficient capacity to deal with their backlog years and deliver high-quality 2023-24 draft accounts;
(5) that none of the multiple actors in the local audit market has the authority to prioritise those audits which bring the largest risks, whether that stems from numerical size, knock-on consequences for other audits, or the nature of particular transactions; and
(6) that the damage to the UK Whole of Government Accounts persists for many years.
As mitigation tactics, we suggest that the following ideas should be explored:
(A) DLUHC and the FRC as incoming system leader need to have a clear idea of what would constitute success at Phase 1. At one extreme would be all currently outstanding audits being qualified or disclaimed for years up to 2022-23 (except where exemptions have been granted), pushing the audit crisis

forward into 2023-24 for which opening balances have to be established. Alternatively, success could be judged not just on the basis of what percentage of audits meet the backstop date of 30 September 2024, irrespective of audit opinion, but on whether systemically important audits avoid disclaimers. Achieving this would require dialogue in order to establish prioritisation that serves the public interest rather than the private interests of key actors.
(B) Where the existing auditor has Public Sector Audit Appointments' contracts for 2023-24 onwards, and there is evidence of satisfactory client-auditor working, then that auditor should be left in place. Normally we would support regular auditor rotation but the first year of an audit engagement is usually the most difficult year. Our proposal would also discourage existing auditors with continuing PSAA contracts from pushing problems into the future for other auditors to deal with.
(C) Exploring the possibility of emergency buying into the local audit market firms not presently in it, perhaps to deal with specific issues such as pensions where delays spillover to central government and other organisations which are part of a pensions scheme. For example, in 2022-23 the Greater Manchester Pension Fund has over 600 contributing bodies.
(D) Exploring the possibility of temporarily dropping, or quickly amending, the Key Audit Partner requirements which lead to reductions in capacity when firms leave the market and existing KAPs either retire or move to non-local audits rather than move to audit firms still in the market.

2 Do you agree that the requirement at Regulation 10(2) for Category 1 authorities to publish a delay notice should be disapplied in relation to any outstanding audits covering financial years 2015/2016 to 2022/2023?

disagree

Please explain your response:

In expositions of why local authority accounts are useful, most commentators emphasise the role of councillors and local citizens. National lists of non-compliers are not a substitute for prominent publication on the local authority's website of the years in which there has been a delay in the publication of unaudited accounts (by 31 May after the year-end) and of audited accounts (for which there have been changing administrative and statutory deadlines). We can see why some councils might wish to avoid damaging local publicity about the extent of reporting delays, but that is not an acceptable argument for making local knowledge more difficult.
Moreover, one of the central actors in English local audit regulation should be allocated the responsibility for pulling this information together. Both local publication and central collection and publication are vital to avoid the loss of transparency and historical knowledge about what has gone so badly wrong.

3 Do you think it would be appropriate for Category 1 authorities to be exempt from the statutory backstop date of 30 September in circumstances where the auditor is unable to issue their opinion due to outstanding objections to the accounts that could be material to that opinion?

agree

Please explain your response:

We are unaware of comprehensive public-domain data on objections to local authority accounts in England. Our impression is that the qualifier in the question about "outstanding objections to the accounts that could be material to that opinion" is a tough standard which will not often be met.
The 30-day objection period means that draft accounts, if they miss the 31 May deadline, must be published early enough to allow the auditor to consider the objection without missing the backstop deadline of 30 September.

4 Do you think there would be any other exceptional circumstances which might create conditions in which it would be appropriate for Category 1 authorities to be exempt from the 30 September backstop date?

agree

Please explain your response, including, where relevant, details of exceptional circumstances you consider would justify an exemption.:

Given the failures in regulation of local authority finances (e.g. commercial borrowing) and in co-ordination of the English local audit market, it is unclear what unexpected risks will surface during the backlog-clearing period. It is possible that major actors (e.g. DLUHC, FRC, NAO and CIPFA) and the private audit firms know more internally than they have put in the public domain.
There are three circumstances of which we are aware and we suspect that there may be more. First, 11 councils are Public Interest Entities (PIEs), though there does not appear to be a public-domain list of which councils these are.
Second, councils which are not PIEs may also have borrowings subject to loan covenants. We would hope that councils exposed to such financial risks are fast reporters, though the fact that only 9.6% of audited 2022-23 accounts had been published by 31 December 2024 is worrying. Without knowledge of specifics, it seems possible that, in such cases, the consequences of late unqualified accounts might be less damaging than having qualified or disclaimed accounts.
Third, as well as the difficulties created by delayed local audits, a proliferation of qualified or disclaimed local audits would create further difficulties for other entities, such as central government departments and admitted bodies to pension funds such as housing associations.
In the absence of a central steering capacity to guide prioritisation of audit work, we consider that the above are cases where exemption from the backstop date might be appropriate. However, we re-emphasise that we urge prioritisation to the maximum degree possible.

5 We intend to publish a list of local bodies and audit firms which meet statutory deadlines for the publication of audited accounts and those which do not. Do you think there should be additional consequences for Category 1 authorities or audit firms (excluding an authority or firm covered by an exemption) if they do not comply with the statutory deadline of 30 September 2024?

disagree

Please explain your response and, where relevant, include any suggested consequences:

These are dangerous waters.
We support the publication of lists of local authorities and audit firms which meet the statutory deadlines for the publication of audited accounts and those that do not. Such a list should also tabulate the date on which the unaudited accounts were published and presented to the auditor for audit. The abolition of the Audit Commission led to the collapse of early warning systems and such a public source will provide ex-post evidence of performance.
We have no systematic evidence with which to differentiate (a) declining capability in local council finance departments, leading to late and unsatisfactory draft accounts; and (b) auditor performance. However, knowledgeable actors have told us that both these factors apply. We have also heard about draft accounts being prepared by the 31 May 2023 deadline but that the auditor is pre-occupied with other audit work. We expect that there will be a lot of blame shifting: the auditor saying the draft accounts were inadequate and the council saying that the auditor was pre-occupied elsewhere.
Clearly, if the auditor has not performed all the contracted work on the audit, they should not be paid for the missing components of that work. Given that the experience of the Covid-19 pandemic has led to more off-site working, there might be difficulties in securing agreement on how much audit work has actually been done. Where an audit requires more work in order to achieve a better audit outcome (e.g. unqualified rather than modified), there should be a mechanism for quickly authorising further work.
In answer to the direct question, we do not think that there should be “additional consequences”, whatever that means in practice, for councils and auditors that miss the backstop dates. First, there will be reputational damage to both. Second, this is a system-wide crisis which is bigger than any council or audit firm, and there is no cost-effective way of calculating relative blame. Third, Public Sector Audit Appointments just managed to find enough audit capacity for the 2023-24 to 2027-28 appointments period. Two large firms will exit after the completion of 2022-23 audits, having no contracts in the new period. Market exit during the new contract period would severely disrupt the three-phase recovery plan. We can envisage conversations within the audit firms about whether it is worth being part of the local audit market.
Although there are too many central actors, it seems that none of them has the capacity or powers to prioritise which audits should take precedence. There seem to be contractual and ethical standards obstacles to prioritisation. From a public policy perspective, the backlog clearance which is most urgent relates to large authorities, those with spillovers to other entities, and those which are known to have risky transactions. However, these are likely to be the most time-consuming, so we speculate that auditors might concentrate resources on simpler audits to maximise their percentage performance against the backstops. Moreover, it is well known that audit firms often use the same teams for National Health Service audits on which we understand them to be very busy during the April-June period, which takes out a large chunk of time before the 30 September 2024 backstop date.
The level of public understanding of local audit is generally low. However, councillors and the public take some assurance from their council having a clean audit opinion, to which they have become accustomed. Our expectation is that there will be a lot of qualified and disclaimed opinions, and that it will be extraordinarily difficult to communicate effectively that most are not a reflection of poor financial management by the council but a consequence of the backstop dates interacting with their auditor’s other workload. Relationships between clients and auditors will become strained.

Phase 2: ‘Backstop’ proposals for the recovery period, financial years 2023/2024 to 2027/2028

6 Notwithstanding the possibility of exemptions in exceptional circumstances (covered by questions 7 and 8 below), do you agree that Category 1 local authorities should be required to publish audited accounts for financial years 2023/2024 to 2027/2028 by the following dates?2023/24: 31 May 2025,2024/25: 31 March 2026,2025/26: 31 January 2027,2026/27: 30 November 2027,2027/28: 30 November 2028

agree

Do you have any comments on these dates?:

Whether these deadlines are achievable depends critically on (a) how Phase 1 works, and (b) keeping the contracted firms in the local audit market.
We assume that these dates have already been discussed with local authorities and their representative bodies and with the audit firms.

7 Do you think it would be appropriate for Category 1 authorities to be exempt from the statutory backstop dates for Phase 2 in circumstances where the auditor is unable to issue their opinion due to outstanding objections to the accounts that could be material to that opinion?

agree

Please explain your response:

For convenience of response analysis, we repeat here our response to Question 3.
We are unaware of comprehensive public-domain data on objections to local authority accounts in England. Our impression is that the qualifier in the question about “outstanding objections to the accounts that could be material to that opinion” is a tough standard which will not often be met.
The 30-day objection period means that draft accounts, if they miss the 31 May deadline, must be published early enough to allow the auditor to consider the objection without missing the backstop deadline of 30 September.

8 Do you think there would be any other exceptional circumstances which might create conditions in which it would appropriate for Category 1 authorities to be exempt from the backstop dates for Phase 2?

agree

Please explain your response, including, where relevant, details of exceptional circumstances you consider would justify an exemption:

For convenience of response analysis, we repeat here our response to Question 4.
Given the failures in regulation of local authority finances (e.g. commercial borrowing) and in co-ordination of the English local audit market, it is unclear what unexpected risks will surface during the backlog-clearing period. It is possible that major actors (e.g. DLUHC, FRC, NAO and CIPFA) and the private audit firms know more internally than they have put in the public domain.
There are three circumstances of which we are aware and we suspect that there may be more. First, 11 councils are Public Interest Entities (PIEs), though there does not appear to be a public-domain list of which councils these are.
Second, councils which are not PIEs may also have borrowings subject to loan covenants. We would hope that councils exposed to such financial risks are

fast reporters, though the fact that only 9.6% of audited 2022-23 accounts had been published by 31 December 2024 is worrying. Without knowledge of specifics, it seems possible that, in such cases, the consequences of late unqualified accounts might be less damaging than having qualified or disclaimed accounts.
Third, as well as the difficulties created by delayed local audits, a proliferation of qualified or disclaimed local audits would create further difficulties for other entities, such as central government departments and admitted bodies to pension funds such as housing associations.
In the absence of a central steering capacity to guide prioritisation of audit work, we consider that the above are cases where exemption from the backstop date might be appropriate. However, we re-emphasise that we urge prioritisation to the maximum degree possible.

9 We intend to publish a list of local bodies and audit firms which meet statutory deadlines for the publication of audited accounts and those which do not. Do you think there should be additional consequences for Category 1 authorities or audit firms (excluding an authority or firm covered by an exemption) if they do not comply with the statutory deadlines for Phase 2?

agree

Please explain your response and, where relevant, include any suggested consequences:

For convenience of response analysis, we repeat here our response to Question 5.
These are dangerous waters.
We support the publication of lists of local authorities and audit firms which meet the statutory deadlines for the publication of audited accounts and those that do not. Such a list should also tabulate the date on which the unaudited accounts were published and presented to the auditor for audit. The abolition of the Audit Commission led to the collapse of early warning systems and such a public source will provide ex-post evidence of performance.
We have no systematic evidence with which to differentiate (a) declining capability in local council finance departments, leading to late and unsatisfactory draft accounts; and (b) auditor performance. However, knowledgeable actors have told us that both these factors apply. We have also heard about draft accounts being prepared by the 31 May 2023 deadline but that the auditor is pre-occupied with other audit work. We expect that there will be a lot of blame shifting: the auditor saying the draft accounts were inadequate and the council saying that the auditor was pre-occupied elsewhere.
Clearly, if the auditor has not performed all the contracted work on the audit, they should not be paid for the missing components of that work. Given that the experience of the Covid-19 pandemic has led to more off-site working, there might be difficulties in securing agreement on how much audit work has actually been done. Where an audit requires more work in order to achieve a better audit outcome (e.g. unqualified rather than modified), there should be a mechanism for quickly authorising further work.
In answer to the direct question, we do not think that there should be “additional consequences”, whatever that means in practice, for councils and auditors that miss the backstop dates. First, there will be reputational damage to both. Second, this is a system-wide crisis which is bigger than any council or audit firm, and there is no cost-effective way of calculating relative blame. Third, Public Sector Audit Appointments just managed to find enough audit capacity for the 2023-24 to 2027-28 appointments period. Two large firms will exit after the completion of 2022-23 audits, having no contracts in the new period. Market exit during the new contract period would severely disrupt the three-phase recovery plan. We can envisage conversations within the audit firms about whether it is worth being part of the local audit market.
Although there are too many central actors, it seems that none of them has the capacity or powers to prioritise which audits should take precedence. There seem to be contractual and ethical standards obstacles to prioritisation. From a public policy perspective, the backlog clearance which is most urgent relates to large authorities, those with spillovers to other entities, and those which are known to have risky transactions. However, these are likely to be the most time-consuming, so we speculate that auditors might concentrate resources on simpler audits to maximise their percentage performance against the backstops. Moreover, it is well known that audit firms often use the same teams for National Health Service audits on which we understand them to be very busy during the April-June period, which takes out a large chunk of time before the 30 September 2024 backstop date.
The level of public understanding of local audit is generally low. However, councillors and the public take some assurance from their council having a clean audit opinion, to which they have become accustomed. Our expectation is that there will be a lot of qualified and disclaimed opinions, and that it will be extraordinarily difficult to communicate effectively that most are not a reflection of poor financial management by the council but a consequence of the backstop dates interacting with their auditor’s other workload. Relationships between clients and auditors will become strained.

10 The Accounts and Audit Regulations 2015 (regulation 15(1)(a)) currently requires Category 1 local authorities to publish unaudited accounts by the 31 May following the end of the financial year. In light of the proposed deadlines for the publication of audited accounts, do you think the 31 May deadline remains appropriate for financial years 2024/2025 to 2027/2028?

agree

Please explain your response:

Moving the deadline from 31 May to a later date would give a bad signal during Phase 2. Provided that there is a system for centrally collecting data on which unaudited accounts have met this deadline, this will provide early warning to the system leader of where future difficulties in meeting the audited accounts backstop date might arise.

11 The existing annual deadline for the publication of unaudited accounts is 31 May. As set out above, we are proposing a backstop date for the publication of audited accounts for the financial year 2023/2024 of 31 May 2025. This would mean that 31 May 2025 would be the statutory deadline for both the publication of audited accounts for financial year 2023/2024 and unaudited accounts for financial year 2024/2025. Do you expect this would create any significant issues?

disagree

Please explain your response:

There are capacity problems in local authority finance departments but the coincidence of these deadlines should not of itself be a significant problem. The extent of catching up some councils have to achieve means that bottlenecks at some dates are inevitable. However, forward knowledge of these dates should assist workload planning.

12 The government anticipates that the Phase 1 backstop proposals will result in modified or disclaimed opinions. A modified or disclaimed opinion at the end of Phase 1 would require auditors to subsequently rebuild assurance. The Phase 2 backstop dates are intended to enable this work to be spread across multiple years. Given this additional work, and noting the further explanation at paragraphs 15 to 46 of the Joint Statement, do you have any views on the feasibility of audited accounts being published by the proposed statutory backstop dates for Phase 2?

Please respond in the free text box below:

Achieving these dates will clearly be difficult but the reputation of councils, auditors and regulators will be at stake. When the situation is a mess, digging out of it is inevitably difficult. The local audit crisis has contributed to the decline of public trust in government.
There is a risk to which attention should be drawn. If 10% of audits are late, that is embarrassing for those councils and their auditors. If 90% of audits are late (the 2022-23 situation), then the reputational effects are likely to be less severe. It is possible that some people will argue that the absence of consequences from financial reporting and audit failures mean that local authority accounts have no audience and that no one cares. This interpretation would be mistaken as the knock-on effects, such as compromising other entities and damaging the UK Whole of Government Accounts, are severe.

Publication of an audit letter

13 Do you agree that it would be beneficial for the 2015 Regulations be amended so that Category 1 bodies would be under a duty to consider and publish audit letters received from the local auditor whenever they are issued, rather than, as is currently the case, only following the completion of the audit?

agree

Do you have any comments on this issue?:

If this proposal had been in place during the years of the audit crisis, remedial action might well have come earlier by attracting greater public attention. Having the audit letter delayed by the non-publication of audited accounts has been damaging.

Equality impacts

14 Do you have any comments on whether any of the proposals outlined in this consultation could have a disproportionate impact, either positively or negatively, on people with protected characteristics or wish to highlight any other potential equality impacts?

Please add any comments in the free text box below:

We are aware of no equality impacts, other than that those with protected characteristics may be more vulnerable to the deterioration in the quality of public services which may have accompanied the failures in local authority financial and value-for-money reporting.

Further feedback

15 Finally, do you have any further comments on the proposed changes to the 2015 Regulations not covered by the questions so far, including relating to any unintended consequences?

Where possible, please limit your response to 500 words:

This episode reflects badly on the governance of English local authorities. When the Audit Commission was abolished, the requirements were (a) continuation of a public sector audit capacity in a hived-off District Audit, and (b) the early warning functions of the Audit Commission being taken over by DLUHC's predecessors. Instead, the focus was on driving down audit costs at a time when public expenditure reductions were stressing local authorities, a few of which then engaged in reckless ventures. England is too large a country to run on informal knowledge and the audit crisis has now enveloped most local authorities.
The exceptionalism of England is demonstrated by the fact that the local audit crisis is contained there. We are concerned about spillover effects of these proposals to Scotland, Wales and Northern Ireland. Either the devolved nations will be held to higher standards than England (which we favour but might be politically difficult), or there will be divergences in accounting and auditing requirements between them and England (creating further problems for the Treasury's Whole of Government Accounts). We are puzzled that the Draft Statutory Instrument published by DLUHC for this consultation states that it applies to Wales whereas we believe that it should not.
Our journal article (available at https://www.davidheald.com/publications/PMM local audit crisis 2023.pdf) on the English local audit crisis supported the Redmond Review proposal for an Office for Local Audit Regulation, but that has been rejected by the UK Government. There are too many actors in play for the decisive action that could have prevented the situation getting so bad. "Shortage of parliamentary time" for the Audit, Reporting and Governance Authority legislation is unconvincing. We are puzzled about how OFLOG fits into the picture and would have expected it to be part of this consultation package.
Subject to the caveats that we have entered in response to the Consultation Questions, we support most of the proposals. We have explained the risks that we foresee. What the system needs is decisive prioritisation of local audits, as is possible in the devolved countries, but it is difficult to see how such prioritisation can be achieved in a fully outsourced local audit system because of the wording of contracts and of ethical standards protecting auditor independence.
6 March 2024