

# NAO Consultation Response

## Introduction

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This joint response should be taken to be from the three individuals and not from any organisation to which they may be affiliated.

## Code of Audit Practice Chapter One

**Question 1** – *Do you agree with the principles of effective co-operation during the handover period where there is a change in the appointed auditor? (The handover period is defined as the period from the date from which the new auditor's appointment takes effect to the date on which the outgoing auditor certifies completion of their audit).*

We agree that it is essential that there is appropriate co-operation between auditors when there is a change of appointment and that the Code should encourage such co-operation. It is unclear to us how co-operation can be measured or enforced. It will be difficult to define and interpret whether or not the level of co-operation is sufficient. In the present circumstances, at least in England, the incumbent auditor to 2022/23 may walk away as other professional work is more pressing and more profitable. Audit contracts may not be easy to enforce given the changing regulations and environment over recent years. Attempts to enforce such contracts through the courts may further destabilise the local audit market.

It would be helpful for the NAO to provide more detailed guidance on the expectations of auditors and authorities at this stage. A starting point might be the Audit Scotland (2022) Guidance Note on Audit handover. The aim should be to minimise the duplication of effort by the new auditor or the related authority, which will otherwise push up audit fees. ICAS suggests a 'disengagement letter' to set out what has been done and what is still outstanding.

In the present circumstances, it would be useful for those existing auditors which are continuing their local audit work beyond 2022/23 to retain the same local authority audit clients, unless relationships between the auditor and the client have irretrievably broken down. This would avoid, at least temporarily, the creation of unnecessary audit handovers.

## Code of Audit Practice Chapter Two

**Question 2** – *Do you think that the proposed Code requirements in respect of the 'backstop' dates are sufficient to require and enable auditors to report their opinion at the backstop date, apart from in the exceptional circumstances set out?*

*If not, what needs to be added or strengthened?*

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 "an objection that may have a material impact on their opinion on the financial statements" 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<sup>th</sup> September.

## Code of Audit Practice Schedules Three and Four

### Schedule 3

**Question 3** – *Do you agree that the Code should require auditors to perform a reduced scope of work on proper arrangements to secure VFM on a temporary basis for incomplete audits up to and including 2022-23?*

The situation in England has become so desperate that this is the least-worst option. The core issues include (a) the lack of public sector audit capacity due to the closure of District Audit which had been established in 1844; (b) the continuing fragmentation of authority over local audit in England; and (c) the large reductions in central government financial support to local authorities beginning during the 2010 to 2015 government. None of these issues will be solved through these new arrangements. The proposals create a period in which there will be a reduction in accountability of local authorities at a time when many appear to be facing considerable financial risks and uncertainties.

**Question 4** – *Do you have any comments on the proposals for the reduced scope of proper arrangements set out under the reporting criteria that auditors are required to report for incomplete audits up to and including 2022-23?*

The absence of a full-scale VFM opinion until November 2024 at the earliest means that there may be weaknesses that will go undetected and unreported. It is unclear what specific risks will surface during the backlog-clearing period.

It may be appropriate for arrangements to be made to ensure that VFM arrangements are given priority for those local authorities which have higher financial risks, such as being Public Interest Entities, having significant loan covenants or those already having issued section 114 notices. Without such a sector overview, there remains a risk that audit firms may look to provide assurance on a larger number of less risky and/or smaller authorities.

### Schedule 4

**Question 5** – *Do you agree with the approach to enable the auditor to issue a combined commentary as part of a single auditor's annual report for incomplete audits up to and including 2022-23?*

We have indicated above our views of the potential risks and weaknesses of the more limited approach of work in securing arrangements to ensure VFM.

Within those limitations, we think that the approach described in Schedule 4 is reasonable.

## Question 2: Code of Audit Practice Chapters 3 and 4

### Chapter Three

**Question 6** – *Do you agree that auditors should be required to return to the full scope of VFM arrangements work under the three reporting criteria set out under paragraph 3.11 of Chapter Three of the Code from audit year 2023-24 (the year of which the new audit appointments contracts under PSAA's national scheme start)?*

We agree with this approach in general terms. However, if the first date for full scope reporting is November 2024 for the 2023/24 financial year, these seems like a huge challenge for many

authorities and auditors in the present circumstances. We accept that deferring this date is far from ideal. The regulators, including the NAO, need to consider the impact on the sector as a whole of a significant number of authorities and auditors, quite possibly a majority, failing to meet this deadline.

**Question 7 – not applicable.**

## Chapter Four

**Question 8 - Do you agree that the Code should specify the 30 November as the date by which auditors should issue their auditor's annual report based on the work they have completed so far rather than wait for the audit to be fully completed?**

This proposal raises a number of issues, which cause us to be unconvinced regarding its feasibility. First, what happens if something serious emerges between 30<sup>th</sup> November and the date of the final audit report on the annual accounts? If this causes a discrepancy between the findings at 30<sup>th</sup> November and the later opinion, there is a risk that this brings both the authority and its auditor into disrepute. Second, we think it likely that the risk to the auditor described above, will cause a large proportion of these 'draft final' reports to be disclaimed. We do not think that this will help to provide assurance to councillors or the public at large regarding the sustainability, governance or VFM arrangements of their local authorities.

## General Comments

**Question 9 - Are there any other comments you wish to make?**

We believe that there are a number of issues, giving rise to risks to the sector as a whole and therefore to the role and effectiveness of the Department that need to be considered.

First, we worry about the impact of the pausing of audit quality reviews. This raises the risk of sub-standard audit work, and consequentially errors in financial statements or inadequate arrangements over VFM, going undetected.

Second, we think that the communication difficulties to councillors, the media and citizens have been understated. It will be difficult for these parties to understand the difference between the alternative forms of modified opinions (such as those indicated in Chapter 5, paragraph 5.5) and whether these are caused by the temporary relaxation of standards and regulation or something more serious, long-term and specific to an individual local authority.

Third, the NAO may wish to consider the impact of these changes on other parts of the public sector. For example, what impact does the relaxation of accounting, VFM and audit obligations of local authorities have upon public sector pension schemes and other departments, notably Health and Social Care and Education?

Fourth, we think it most likely that disclaimers of opinion will dominate during the catch-up period, because this would be the least risky approach for audit firms. The NAO should consider the possible effect of this on perceptions of governance and accountability across the whole sector. A disclaimer essentially means that there will be no assurance over any aspect of the annual accounts and could be interpreted as being worse than having no audit opinion at all. What would the NAO expect the DLUHC to do in these circumstances? Furthermore, what will be the resulting impact on the whole-of-government accounts? Presumably it is likely to add the existing audit qualifications on the WGA or at least make the existing ones more severe.

Fifth, we are concerned about the spillover effects of these proposals to Scotland, Northern Ireland and Wales. Either the devolved nations will be held to higher standards than England (which we

favour, but might be politically difficult), or the devolved nations will be allowed to lower their standards to those of England, even though they have not experienced the crisis position reflected in England. We are puzzled that the consultation papers refer specifically to England, but the Draft Statutory Instrument published by DLUHC also includes Wales.

Our journal article (Bradley, L., Heald, D. and Hodges, R., (2023), 'Causes, consequences and possible resolution of the local authority audit crisis in England', *Public Money & Management*, vol. 43(3), pp. 259-267) supported the Redmond Review proposal for an Office for Local Audit Regulation, but that has been rejected by the UK Government. We are puzzled about how OFLOG fits into the picture and would have expected it to be part of this consultation package.

## **Equality Impacts**

**Question 10** - *Do you have any comments on whether any of the proposals outlined above could have a disproportionate impact, either positively or negatively, on people with protected characteristics or wish to highlight any other potential equality impacts?*

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.