

# Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England

## Response to call for views

18 December 2019

### 1. About the Local Government Association

- 1.1. The Local Government Association (LGA) is the national voice of local government. We are a politically-led, cross party membership organisation, representing councils from England and Wales.
- 1.2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.
- 1.3. We welcome the opportunity to respond to the call for views of this review and to engage further with the review as its work develops. This response has been cleared by the LGA's Resources Board following initial discussion at the LGA's Leadership Board and Improvement and Innovation Board.

### 2. General comments

- 2.1. Effective external audit and clear and transparent financial reporting are important elements of the governance regime of local councils. As the Call for Views document sets out, there is some evidence that current arrangements are not working as well as they should, but conflicting views about what is going wrong and why.
- 2.2. In the LGA's view the basic external audit arrangements have stood the test of time and are still relevant and appropriate, but there is a need for some changes. Several pieces of work underway at the moment are intended to improve the quality and oversight of councils' finances and the conduct of external audit. These include:
  - 2.2.1. The review of the NAO's Audit Code which is addressing concerns about the value for money audit.

- 2.2.2. A new CIPFA Financial Management Code which will provide new standards against which auditors can assess local financial management.
  - 2.2.3. The creation of a new body, the Audit, Reporting and Governance Authority (ARGA), to be responsible for audit quality.
  - 2.2.4. CIPFA's review of local authority accounting with a view to simplification.
- 2.3. These initiatives will address many of the current issues identified with the audit and reporting regime.
- 2.4. The new organisational arrangements put in place by the Local Audit & Accountability Act should be given time to work before a new sector-wide body, as advocated by the Kingman Review, is considered.  
We do not need to recreate the Audit Commission.
- 2.5. In the LGA's view the most urgent issue is the market for local external audit, reflected in a limited number of firms and a shortage of suitably qualified audit staff. A solution to this will require joined up working between government, sector bodies, the audit profession and the audit firms themselves. While this issue remains unresolved there seems to be little prospect of enhancing or extending the current role of external audit, even if this was desirable.
- 2.6. Better coordination within the current arrangements could be achieved by MHCLG instituting a new local audit board of officials to provide overall system oversight, address emerging issues and coordinate activity. The advantages of this would be:
- 2.5.1. Led by MHCLG, allowing the Ministry to assure itself directly that current arrangements are working well.
  - 2.5.2. Involving all key players within the field of local external audit, including potentially the audit firms and CIPFA in its role as the body responsible for the accounts.
  - 2.5.3. A flexible agenda could respond to issues as they arise.

2.5.4. More cost effective than setting up a new body.

### 3. Specific comments

#### 3.1. Chapter 1 : Definitions of audit and users of the accounts(Questions 1-5)

3.1.1 The LGA believes that the essential form of local government audit - an opinion on the accounts and an evaluation of the arrangements for securing value for money - is the right one.

3.1.2 This approach has persisted largely in this form for several decades and has largely stood the test of time. In recent years this view is backed up by the fact that in a period of unprecedented austerity, only one authority, Northamptonshire County Council, has reached a position in which it has been unable to set a budget within the resources available. Examples can be quoted where auditors already report on issues of financial resilience using existing powers. For example in July 2019, the external auditor Grant Thornton issued a statutory recommendation to a particular Borough Council under section 24 of the Local Audit & Accountability Act having identified findings the auditor wished to have answered in relation to the council's financial resilience.

3.1.3 The published accounts of local authorities need to be as clear as they can be while reflecting a full and factual account of the council's spending and financial position. Residents and taxpayers are the key audience, but also those responsible for governance and decision-makers within the council itself. However most residents and taxpayers are unlikely to get assurance directly from the accounts that public money is being appropriately recorded and used for legitimate purposes. Instead they will need to rely on those responsible for governance and auditors to provide suitable assurance based on their commentary of those accounts. This places increased importance on the audit regime, but also means that audit reporting must be meaningful, intelligible and timely.

3.1.4 We note that CIPFA has been undertaking a project to simplify the accounting code and we welcome this project.

### 3.2. Chapter 2 : The expectation gap (Questions 6-9)

3.2.1 Audit needs to meet the expectations of a wide range of stakeholders, although the most important of these are local residents. However audit cannot do everything.

3.2.2 It is important that the scope of the audit is balanced by questions of risk and proportionality. It is unlikely we will ever have a system that meets the expectations of everybody all the time. For example, external audit cannot and should not get involved in questioning matters of policy, unless there is a question of legality or affordability.

3.2.3 As the Call for Views points out, there are other checks, balances and controls bearing upon local government which together comprise a regime that probably provides local government with the most transparent, robust and comprehensive system of governance of any sector. The roles of statutory officers, for example, means that auditors do not have to assess the legality of every decision and every item of expenditure as they once did. Audit should not be about duplicating controls that already exist and auditors need to take a risk based approach to the level of work required.

3.2.4 Looking at the whole system of governance together our view is there is no obvious argument for extending the role of the external auditor much beyond its current scope, even if this was capable of being resourced.

### 3.3. Chapter 3 : Audit and wider assurance (Questions 10 & 11)

3.3.1. The LGA does not support inspection as an appropriate or cost effective way of getting local authorities to improve. We note that when the Comprehensive Area Assessment was abolished in 2010, the government of the day considered it to be 'bureaucratic' and to have 'stopped councils focusing on residents' main concerns'. We agreed with that assessment. Indeed, the experience of the first decade of this century underlines the danger of regulating so much that councils spend time and money on compliance that would be better spent meeting the needs of local people. In contrast, the sector led improvement model favoured and implemented by the LGA with the support of MHCLG and councils is flexible, good

value for money and gets councils focused on their own improvement rather than an ultimately unproductive tick box exercise.

3.3.2. It has been estimated that before the abolition of the Audit Commission, the total annual cost of monitoring local government, including external audit and inspection, was close to £2 billion a year.

3.3.3. We support the NAO's conclusion from its recent consultation on the code of audit practice that that the "overall approach to work in this area [ie value for money] is seen as proportionate and focuses attention on key areas of risk", and we are supportive of the changes proposed by the NAO to the code of practice (a copy of our submission to that consultation is available on our website).

3.4. Chapter 4 : The governance framework for the audit system (Questions 12-15)

3.4.1. The LGA lobbied for the Local Audit & Accountability Act to provide the option of a national procurement arrangement and it was the LGA that set up Public Sector Audit Appointments Ltd (PSAA). Ninety-eight percent of councils opted in to the PSAA arrangement.

3.4.2. We continue to believe that there are value for money, independence and oversight benefits that flow from this arrangement. Contrary to some reports, in awarding the first contracts under the new Act which began with the 2018/19 financial year, PSAA increased the quality weighting used in the Audit Commission's last tendering exercise.

3.4.3. 2018/19 is the first year of the new contracts, so it is difficult to judge the success of the process on relatively short experience. However the target deadline for completing local government audits was not met in 2019 in 40% of cases. This is unacceptable, and PSAA is working with the sector and the audit firms to address the issue. A major factor in so many deadlines not being met was additional quality criteria and due diligence that audit firms were required to apply as a result of the FRC increasing its quality criteria. There are lessons here for future regulators.

- 3.4.4. This year is also only the second year of the new timetable for the completion of audits. The LGA expressed concerns about this timetable from the start and has called for the deadline to be put back to the end of September.
- 3.4.5. It is clear is that the current local external audit market is in need of urgent attention. There are too few participants in the market and a growing shortage of qualified local audit staff with the necessary skills and experience which has exacerbated issues in meeting the earlier deadline. The solutions to this are not easy to see and will not be quick to implement but the LGA wants to work with external auditors and other stakeholders to devise a solution.
- 3.4.6. We do not think that the suggested solution of the Independent Review of the Financial Reporting Council (“the Kingman review”), which is to set up a single body to oversee quality, standards and audit appointments is likely to address this fundamental problem. Any solution will require action by audit firms and professional bodies and quite possibly by government, with the cooperation of councils. Not all of these stakeholders would come within the purview of a new single body. Such an all-encompassing body would also need to be large and complex, probably with Chinese Walls within it, to manage such a wide range of functions. A single body would look a lot like the Audit Commission and would therefore be just as likely to be bureaucratic and expensive.
- 3.4.7. The LGA’s suggested solution to the future coordination of the local audit system, including addressing the issues apparent in the market, is to set up a single high level board overseen and chaired by MHCLG and incorporating all the key stakeholders including PSAA, the audit firms, CIPFA, ARGAs, the National Association of Local Councils and the LGA. This would be a simple and inexpensive way of coordinating activity and would ensure that MHCLG has an oversight role over the whole system, which it needs, without taking responsibility for delivering any part of it. All the right organisations, including those with the capacity to act and influence, would be in the room. The terms of reference could be subject to regular review and agenda would be flexible, so that the most pressing issues were dealt with. It would also leave open the option of creating an

over-arching body later on if the government identified a need, although we do not believe this would be necessary or foresee that it would ever be desirable.

### 3.5. Chapter 5: Audit Product and Quality (Questions 16-24)

3.5.1. External audit staff do need to be sufficiently experienced and qualified to effectively audit local authorities, which have unique accounting and governance arrangements. The issue of the allocation of resources to audits is dealt with in the section above.

3.5.2. The current scope of audit coverage and the guidance relating to it seems to us to be about right. Other than the current issues relating to the delivery of external audits to deadline, we do not perceive serious shortcomings in the regime, as evidenced by the fact that most councils have responded to many years of cuts, the majority remain robust and resilient despite this and the system responds adequately to identify and support councils that are at risk of financial failure. Only one council in ten years of austerity has so far found itself in a position where it was unable to set a budget. Most of the main financial resilience issues faced by councils would be addressed most effectively by additional funding for services rather than by additional audit.

### 3.6. Chapter 6 Auditor reporting (Questions 25-31)

3.6.1. As the Call for Views sets out, external auditors currently have a wide range of powers to investigate and report and on the whole auditors seem to be using these relatively effectively. As mentioned above our formal response to the NAO's review of the audit code is available on our website, but in general we are comfortable with its proposals and direction of travel.

3.6.2. We do think that questions raised by electors can take a long time to resolve, which is frustrating for councils and electors alike, and we would like to see these dealt with more quickly, although this of course would have resource implications for auditors.

### 3.7. Chapter 7 The Framework for Responding to Audit Findings (Questions 32-34)

3.7.1. In the context of a council, elected members are 'those responsible for governance' and therefore it is appropriate that they should form the core of the Audit Committee.

3.7.2. The LGA supports Audit Committees being allowed to co-opt independent members who offer expertise and insight and where independent voices may be considered important.

3.7.3. The role of audit committee chair needs to be valued more. In partnership with PSAA and CIPFA we are supporting Chairs of Audit Committees in their roles. There is a lot of good practice for audit committees available which perhaps needs to be signposted better and made more freely available and we will look at how this can be done with the owners of that content.

3.7.4. The Comptroller & Auditor General has pointed out that some audit reports can be obscure in their language, leaving it unclear to those responsible for governance how they should respond, and we support measures in the revised NAO audit code to address this issue.

3.7.5. There would not seem to be a need for a separate body to track action in response to auditor reports. The external auditors can do this and have the powers to follow up. Reports and responses are freely available on council websites.

### 3.8. Chapter 8 The Financial Reporting Framework (Questions 36-39)

3.8.1. Much of the information required to assess a council's financial position is contained within its financial accounts. Local authority accounts need to be sufficiently robust and detailed enough to enable this assessment to be made.

3.8.2. But the standard set of accounts is difficult to read even for experts and although some councils have put in considerable effort to make the accounts clearer, this is a time-consuming process and the results are still often difficult to understand. It should be noted that a key purpose of

external audit is to give assurance to citizens that experts have looked at the accounts and found them to be of adequate standard.

- 3.8.3. The LGA supports efforts by CIPFA to simplify and clarify the accounts. Simplification needs to involve a risk assessment to ensure that the interpretive value of elements of the accounts is worth the resource commitment involved in deriving and auditing them. The example of fixed asset valuations is sometimes mentioned, and the LGA would agree that there is little to be gained in spending a lot of time annually valuing assets that are never likely to be sold.
- 3.8.4. It is good practice to provide performance information alongside financial results. Data engines such as the LGA's LG Inform data tool could be used to produce standardised reports that could be 'lifted and shifted' into the accounts and populated by councils themselves with the latest data.

### 3.9. Other Issues (Questions 40-43)

- 3.9.1. Subject to the points made elsewhere in this response, it does seem to the LGA that the current regime provides adequate information for residents to hold councils to account. In this regard it is important to set the external regime alongside other standards and requirements applying to councils including the rules of access to council meetings, the transparency code and freedom of information among other things.
- 3.9.2. Local government has always been an innovative sector. Local councils under resource constraints have to find new ways of doing things and local audit has to respond to this. Government policy over many years has accepted that councils need to be empowered to deliver outcomes for local communities. It is the role of external auditors to comment on whether councils are acting within the law
- 3.9.3. However, some of the issues that have attracted comment, such as councils owning and investing in commercial property and using complex financial instruments to manage risk within their treasury management portfolios are not, in fact, new.

3.9.4. It is a concern if the market no longer provides the capacity to audit these arrangements at local level and this is the issue that needs to be addressed as a matter of urgency. It would be perverse to stop councils using their local powers to support their communities because they were unable to be audited.

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