



TIMELINESS OF AUDITOR REPORTING ON LOCAL GOVERNMENT IN ENGLAND

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ICAEW welcomes the opportunity to comment on the inquiry by the Committee of Public Accounts into the timeliness of local auditor reporting on local government in England published on 23 March 2021, a copy of which is available from this [link](#).

Lack of timeliness is a symptom of wider problems in financial reporting and audit:

- Financial statements are critical to decision making and in holding local authorities to account but, in many cases, they are not understandable or sufficiently transparent.
- Better reporting could help prevent issues seen in local authority financial management.
- Local audit relies on a small pool of audit firms to audit hundreds of NHS trusts and local authorities within a short timeframe each year.
- The local audit market is not attractive and there is a risk audit firms could withdraw.
- Sir Tony Redmond stated in his review: *'The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process.'*

The Redmond Review recommendations should be implemented:

- There is a need for a systems leader for local audit with the responsibility for driving improvements in quality in both local authority financial reporting and external audit.
- Investment is needed in local authority finance teams to improve the quality of draft financial statements and supporting working papers provided to external auditors.
- Local authority audit committees need sufficient audit and financial management experience in order to be able to adequately challenge management and auditors.
- The local audit market should be made more attractive to audit firms, including removing unnecessary barriers to entry.

A pragmatic approach is required to deliver audits without incurring excessive costs:

- Local authority financial statements need to be actively reviewed and critiqued by an external body in order to drive better quality and improve understandability.
- Local authorities should publish unaudited financial statements within three months.
- Audit deadlines could be phased to better manage demand on audit resources.

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INTRODUCTION

1. We are responding to the inquiry by Committee of Public Accounts into timeliness of local auditor reporting on local government in England published on 23 March 2021.
2. Our comments are solely intended to support the Committee with its inquiry and in its questioning of officials and others providing evidence.
3. ICAEW is a body whose mission is to promote the public interest and whose members are accountable under a code of ethics. In that context we seek to and want to play a constructive role in supporting the Government and Parliament and would be willing to provide further detail in understanding any of the issues we raise in our submission.
4. We refer in our submission to the report '[Timeliness of local authority reporting on local government in England](#)' dated 16 March 2021 (the 'NAO report') issued by the National Audit Office (the 'NAO').
5. We also refer to the Touchstone Renard report '[The Future Procurement and Market Supply Options Review February 2020](#)' (the 'Market Supply report') commissioned by Public Sector Audit Appointments ('PSAA').
6. The NAO report states that less than half of local councils, local police and local fire bodies' 2019-20 audits were completed by the revised deadline of 30 November 2020, despite this having been pushed back to take account of the impact of the COVID-19 pandemic.
7. While there were significant practical issues facing both local authority finance teams and audit firms because of the pandemic that contributed to this, ICAEW believes that many of the delays experienced are symptomatic of wider problems in the local audit market and in the preparation of local authority finance statements that need to be addressed.
8. As BEIS take forward proposals to strengthen the UK's PIE audit and corporate governance ecosystem, it is essential that MHCLG engage with them to ensure that improvements to local public audit form a coherent package of reform alongside the BEIS audit white paper.

KEY POINTS

Financial statements are critical to decision making and in holding local authorities to account but, in many cases, they are not understandable or sufficiently transparent.

9. The primary responsibility for the quality of annual reports and financial statements sits with the local authority preparing them.
10. The Market Supply report reported: '*Three firms commented that local authority accounts are (a combination of) too long, not user-friendly, 'almost impossible for lay people and even non-specialist auditors to understand' and needed to be simplified.*'
11. Unfortunately, many local authorities treat the preparation of financial statements as a compliance exercise and do not invest the resources that they would put into other major reports that they issue or that equivalent private sector organisations would put into their annual reports.
12. Although external auditors can and do make suggestions for how annual reports and financial statements can be improved, outside of certain material matters that are included in an audit opinion they are not able to require a council to follow best practice or to take steps to ensure reports are more easily understandable to those without financial expertise.

Better reporting could help prevent issues seen in local authority financial management.

13. The process of preparing financial statements is an essential part of the financial control system in any organisation. It is at this point that checks are carried out to ensure that financial data is complete, that revenues, expenditures, assets, liabilities and reserves have been correctly recorded, and that key accounting judgements are made or confirmed.

14. Annual reports and financial statements are also a key tool in ensuring local authorities are accountable to councillors and residents, by providing them with a comprehensive account of how a council's resources have been applied to serve their local communities.
15. Recent public interest reports have highlighted how important financial understanding is to effective decision-making and oversight by councils. Better quality financial reporting, together with other improvements in the financial information provided to councillors, could have helped avoid some of these problems.

Local audit relies on a small pool of audit firms to audit hundreds of NHS trusts and local authorities within a short timeframe each year.

16. Only eight audit firms are currently accredited to operate in the local audit market.
17. The period between the end of the financial year (31 March in all cases) and the deadline for completing audits is particularly intensive as the same audit teams are used to audit NHS bodies and central government bodies contracted out to them by the NAO.
18. Audit firms can struggle to find sufficient qualified and experienced individuals to deliver local authority audits. Low margins limit the ability to offer higher pay, and career paths are less attractive. The pressure put on audit staff to work intensely over such a short period of time exacerbates the issues in attracting staff and increases staff turnover, with some choosing to leave the audit profession altogether.
19. For these reasons, amongst others, many auditors feel that the current deadlines for completing audited financial statements for several hundred local authorities is unrealistic in the context of the resources available.

The local audit market is not attractive and there is a risk audit firms could withdraw.

20. The risk profile of many councils has increased in recent years as reserves have declined and balance sheets have weakened, with many councils borrowing to invest in commercial activities. The impact of the coronavirus pandemic has damaged the financial position of councils even further.
21. Higher risks from local audits in recent years, both financial and reputational, have not been matched by a commensurate rise in audit fees, making the local audit market less attractive to audit firms.
22. Audit firms are also seeing higher costs as they address more intensive regulation of local audits by the FRC and deal with operational separation of audit within firms, putting pressure on already relatively low margins.
23. An additional £15m provided this year by the Ministry of Housing, Communities and Local Government ('MHCLG') to local authorities for finance teams and audits was welcomed by them and audit firms but does not address the more fundamental drivers of higher risks and higher costs in the assessment of firms as to whether they should continue to participate in the local audit market.

Sir Tony Redmond stated in his review: *'The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process.'*

24. The systems of local audit in England are not overseen by any one body or individual with responsibilities for accounting, financial reporting and audit of local authorities in England spread over multiple bodies including the local authorities themselves, MHCLG, CIPFA, CIPFA LASAAC, PSAA, ICAEW, the FRC, and the NAO.
25. The disparate nature of responsibilities makes it difficult to co-ordinate on systemic issues, such as effectively managing demands on local audit.

There is a need for a systems leader for local audit with the responsibility for driving improvements in the quality of both local authority financial reporting and external audit.

26. ICAEW concurs with the recommendation in the Redmond Review that there should be a systems leader for local audit.
27. ICAEW believes that a systems leader should be responsible for driving improvements in the quality of local authority financial reporting and external audit, and for leading on resolving issues such as the timeliness of local audit reporting, the subject of this PAC inquiry.

Investment is needed in local authority finance teams to improve the quality of financial statements and supporting working papers provided to external auditors.

28. ICAEW also concurs with the recommendation in the Redmond Review that improvements are needed in the quality of financial statements and supporting working papers provided to external auditors.
29. Recent public interest reports have shown how public money can be wasted when decision-makers and councillors overseeing those decisions do not have sufficient understanding of financial risk. High-quality financial statements that explain the financial position of a local authority and the risks to which it is exposed in an understandable way are important contributors to improved decision-making and accountability.
30. Local audit firms report that provision of inadequate supporting working papers and evidence is a significant contributor to delays in audits and audit firms not always meeting target dates.
31. This will require investment in local authority finance teams and in making the local authority finance profession an attractive career choice.
32. It will also require local authorities to place a higher priority on the importance of producing high-quality financial statements that meet best practice and how doing so can increase financial understanding amongst both officers and councillors.
33. Success in this area would also benefit local taxpayers understanding of, and ability to scrutinise, spending decisions of local authorities, improving accountability and transparency.

Local authority audit committees need sufficient audit and financial management expertise in order to be able to adequately challenge management and auditors.

34. ICAEW concurs with the recommendation that local authority audit committees should appoint at least one independent member with audit and financial management expertise and experience to support elected representatives in overseeing financial control and audit in what can be large and complex organisations.

The local audit market should be made more attractive to audit firms, including removing unnecessary barriers to entry.

35. The Market Supply report commented in February 2020, before the pandemic: *'All the firms believe that fees are now too low across the board and do not offer adequate rewards to compensate for the risks that they perceive they are taking. Although they acknowledge that the current fees are based on bids that they themselves have made, they feel that the audit environment has now changed – especially as regards regulatory expectations and technical complexity. PSAA's contracts allow firms to submit fee variations in respect of new regulatory expectations and new (auditing or accounting) technical requirements. We understand from PSAA that a significantly increased number of variation requests are currently being evaluated or are anticipated.'*
36. One barrier to entry that should be reconsidered by the FRC is the requirement that the audit partner must qualify as a Key Audit Partner (KAP) in addition to being a registered auditor, a requirement specific to the local audit market and not applicable to other sectors requiring equal or much greater sector-specific knowledge and expertise.
37. Our understanding is that the requirement to qualify as a KAP acts as a barrier to new entrants considering whether they might want to enter the local audit market, even where

they have audit partners with experience that would make them eligible to apply. The limited number of KAPs in each individual firm also makes it more difficult to achieve audit deadlines.

38. Existing regulations and professional standards for registered auditors already require audit partners and their audit teams to have appropriate expertise and experience in a sector including familiarity with the sector-specific regulations and the common risks that organisations face.
39. Another potential barrier to entry that should be considered is the approach adopted by the PSAA in allocating audit contracts. Our understanding is that this can act as a deterrent to new market entrants and additionally potentially add to the costs of audit if the location of the allotted audits is not geographically near to the location of the audit firm's team specialising in local audit.

Local authority financial statements need to be actively reviewed and critiqued by an external body in order to drive better quality and improve understandability.

40. ICAEW believes that the quality of local authority financial statements needs to be improved and that a systems leader could help to achieve this by actively engaging with local authorities and their finance teams to demand and encourage improvements.
41. Local authorities should expect to be held to high standards in how they utilise public money, and they should expect to adopt best practice in reporting on how they have done so.

Local authorities should publish unaudited financial statements within three months.

42. Absent a national crisis such as the pandemic, a well organised and adequately resourced finance team of any organisation should be able to prepare good quality unaudited financial statements within three months of their year-end, if not much sooner.
43. ICAEW therefore believes that there is no need to adjust the deadline for preparing and publishing unaudited financial statements on an ongoing basis.
44. In the circumstances of the pandemic, there should be accommodation for local authorities who have particular issues in achieving the deadline this year.

Audit deadlines could be phased to better manage demand on audit resources.

45. One option to resolving the issue of timeliness in issuing audit opinions would be to spend more in order to devote greater resources to audits in a shorter period of time and bring in more market supply. However, this might not be the most sensible use of public funds given that there is less time-sensitivity than in private sector equivalently sized listed companies that typically issue audited financial statements within two to three months of their year-ends.
46. ICAEW believes there is merit in replacing the formal deadline for local authorities with a series of deadlines across the summer to be determined by a system leader for local audit in agreement with the local authorities and the audit firms concerned.
47. There may be merit in permitting some local authorities to complete their audits by the end of October rather than by the existing deadline of September.
48. Given that many local authorities are individually immaterial to the national public finances we do not believe phasing local authority audit deadlines in this way would hamper the preparation of the Whole of Government Accounts or the National Accounts, provided that unaudited financial statements are prepared and submitted by all local authorities by the end of June.