ICAEW
REPRESENTATION 34/24

ADDRESSING THE LOCAL AUDIT BACKLOG IN ENGLAND: CIPFA LASAAC ACCOUNTING CODE OF PRACTICE

Issued 28 March 2024

ICAEW welcomes the opportunity to comment on the consultation on short-term changes in England to the **Code of Practice on Local Authority Accounting in the United Kingdom**, published by **CIPFA LASAAC** on 29 February 2024, a copy of which is available from this link.

These limited proposals will help a little, but not by much

- We do not believe the proposals will significantly reduce workloads of preparers and auditors, nor address the backlog of unsigned audit opinions.
- There is a balance between ensuring high quality financial reporting and reducing the burden on accounts' preparers and auditors.

Prioritising a more proportionate approach to the valuation of operational property

- We believe that the current approach to the audit of operational property is disproportionate to the level of risk in the public sector.
- The temporary proposals should be the recommended valuation method for 2024/25 financial statements but should only be used in 2023/24 where valuations do not already exist.
- A long-term solution to simplify the valuation of operational property is vital.
- We would welcome future consultations on simplifying reporting requirements.

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INTRODUCTION

1. This response has been prepared by ICAEW's Public Sector team in consultation with ICAEW's Public Sector Advisory Group. ICAEW's Public Sector team supports members working in and with the public sector to deliver public priorities and sustainable public finances, including over 13,000 in ICAEW's Public Sector Community. ICAEW engages with policy makers, public servants, and others to promote the need for effective financial management, audit and assurance, financial reporting and governance and ethics across the public sector to ensure public money is spent wisely.
2. ICAEW welcomes this consultation on proposed temporary amendments to the Code of Practice on Local Authority Accounting in the United Kingdom, for 2023/24 and 2024/25.
3. We understand the unenviable task that CIPFA LASAAC have encountered in trying to identify measures that will help preparers and auditors address the local audit backlog in England, while at the same time, ensuring that financial statements still accurately reflect the financial results and position of local authorities.
4. The local audit crisis is undermining public trust in local authority finances, with only 1% of English councils publishing audited financial statements by the 30 September 2023 target date for 2022/23 financial statements. There was a backlog of 771 overdue audits as of 31 December 2023.
5. Local authority accounts must be a credible public record which enables stakeholders to hold local authorities to account. This is only possible when audited financial statements are published on a timely basis, and when accounts are understandable to key stakeholders.
6. In 2023, ICAEW published its vision for local audit on how to bring confidence to the finances of local public bodies. Our vision makes the case for better financial reporting, high quality and more timely audits, stronger financial management and governance, and a thriving profession that is highly valued.
7. We submitted evidence on 17 April 2023 to the House of Commons Levelling Up, Housing and Communities Committee setting out how we believe financial reporting and audit in local authorities can be improved.
8. We submitted evidence on 18 May 2023 to the HM Treasury thematic review of non-investment asset valuation for financial reporting purposes.
9. We submitted evidence on 15 August 2023 to the DLUHC consultation on statutory guidance on the Best Value Duty for local authorities in England.
10. We submitted evidence on 17 October 2023 to CIPFA LASAAC on how we believe the Local Authority Accounting Code can be improved.
11. We submitted evidence on 7 March 2024 to the DLUHC consultation on proposed regulatory changes to address the local audit backlog in England.
12. We submitted evidence on 7 March 2024 to the NAO consultation on proposed changes to the Code of Audit Practice.
13. For questions on this submission please contact our Public Sector team at representations@icaew.com quoting REP 34/24.

KEY POINTS

THESE LIMITED PROPOSALS HELP A LITTLE, BUT NOT BY MUCH

14. While the proposals are welcome, we do not believe that the changes will have a sufficiently significant impact on the workloads of auditors and accounts' preparers, nor will the changes make local authority accounts more understandable to key stakeholders and users of accounts.
15. We consider that for the proposals to have significant benefits in helping progress the recovery period for local authority financial reporting and audit, further amendments to the Code would have to be introduced.

16. We note from the invitation to comment that several short-term changes to the Code were considered, including reducing the level of disclosures required on many transactions and balances, disapplying the requirement to carry out impairment reviews, removing the requirement to produce group accounts and removing the requirement for prior-period adjustments.
17. While we concur with CIPFA LASAAC in not supporting the majority of the above suggestions, we do believe that there are several areas in local authority financial reporting where reduced disclosures on transactions and balances would help streamline financial statements and reduce the burden on both preparers and auditors. Within our response to CIPFA LASAAC regarding the 2024/25 Code consultation, we highlighted the importance of limiting divergences away from IFRS as being a way to ease the burden on the local audit and accounts preparation system.
18. We appreciate that there is a balance to be struck between ensuring high-quality reporting, aligning Code requirements with IFRS as far as possible, and reducing the level of work required for both accounts' preparers and auditors alike. However, audited accounts which are published well after the period to which they relate, have a reduced benefit for users of local authority financial statements and become a threat to high-quality financial reporting.

PRIORITISING A MORE PROPORTIONATE APPROACH TO THE VALUATION OF OPERATIONAL PROPERTY

19. ICAEW has previously called for a more proportionate approach to operational property valuations within the public sector, in the context of a much lower level of risk to the finances of public bodies funded by national or local taxation. This contrasts with private sector entities where valuations provide important information to readers of accounts concerning the income-generating ability of the assets concerned.
20. Remeasurements of operational property are, in most cases, not linked to the revenue that a local authority receives or affect its expenditure directly, in contrast with investment properties or other non-current assets held for their ability to generate income. As a consequence, they typically do not impact outturn against budget, are of relatively limited use for decision-making and are of less interest to users of accounts.
21. Despite that, it is still important that operational properties are recognised in local authority financial statements in accordance with accounting standards, and that disclosures provide sufficient information to users to understand how they are measured in the balance sheet.
22. We therefore welcome the proposal to use a standard centrally determined index to update asset values in future financial statements. This should reduce the burden on both preparers and auditors, while still providing sufficiently relevant information to users.
23. However, these proposals come too late to be effective for 2023/24, as many local authorities will have already commissioned valuations of their portfolio.
24. We would therefore recommend restricting the use of this option in financial statements to 2024/25, where no valuations have been prepared, or for use in 2023/24 where no valuation has been commissioned. This would avoid any need for preparers to justify and auditors to assess, their choice between valuation or indexed values. This could add to, rather than alleviate, the burden placed on both preparers and auditors.
25. We believe that a long-term solution is needed in how operational property is measured in local authority financial statements, which more appropriately reflects the level of risk. Any solution must understand the needs of primary and other users of local authority accounts, and how asset values affect accountability, governance, and decision-making. We welcome the plan to consult on proposals to further explore simplifying requirements for the measurement of operational property in the 2025/26 Code.

ANSWERS TO SPECIFIC QUESTIONS

Question 1

Do you agree with the proposal that, for local authorities in England only and for the 2023/24 and 2024/25 reporting periods, the application of the requirements of the Code should be amended so that asset values in the financial statements may be based on the most recent valuation which has been subject to audit, adjusted for depreciation, and updated by a standard centrally determined index?

If not, why not? Please provide reasons for your view.

26. Yes, we agree with the proposal that asset values in the financial statements may be updated by a standard centrally determined index in 2024/25. We note that this is only likely to be required for operational properties, since under 4.1.2.32 of the Code, authorities often elect to adopt a depreciated historical cost basis as a proxy for current value for non-property assets that have short useful lives or low values (or both), while 4.1.2.30 specifies that infrastructure assets must be valued using depreciated historical cost.
27. However, we believe that this proposal should not be applied to 2023/24, given that most local authorities will have already commissioned valuations of their operational properties, and instead should only apply to situations where property valuations are not available.
28. We do believe that indexation should be made the recommended valuation method for accounts' preparers in 2024/25; firstly, to ease pressures on local authority finance teams and local auditors which is discussed further below in our response to Q2, but also to reflect the lower level of business risk in the valuation of operational property in the public sector.
29. Because the valuations are not generally used to support decision making, nor do they impact the net outturn of a local authority, there is limited incentive to manipulate the financial statements in this area, and misstatements in the valuation of operational property are less likely to have a significant impact on public bodies than in the private sector. We therefore consider the level of business risk in this area to be low.

Question 2

Do you consider that this would have a beneficial effect (a net reduction) in the overall workload for preparers, having regard both to additional work that would be required to implement the change, and anticipated 7 reductions in requirements to provide additional evidence to auditors and to resolve auditor queries?

If not, why not? Please provide reasons for your view

30. No, we are not sure that the proposals as they currently stand will have a sufficiently beneficial effect in the overall workload for accounts' preparers, especially where a local authority has already commissioned a full valuation of their portfolio.
31. The consultation highlights that in the above cases, preparers must consider what is the best information to use, having regard to any uncertainty there may be with the valuation, reflecting on the local authority's previous experience in reviewing information from valuers, and issues identified by auditors. Determining which information is best to use is not likely to be straightforward and, in many cases, it is likely that the information from the most recent valuation remains more appropriate.
32. Furthermore, where an accounts preparer elects to use indexation in the above circumstances, this is likely to lead to queries from the auditor as to why they have not used the information provided in professional valuations. ISA 330 requires auditors to consider whether sufficient appropriate audit evidence has been obtained, considering all audit evidence, regardless of whether it corroborates or contradicts the assertions in the financial statements. Thus, auditors are required to consider all evidence available when undertaking audit procedures in this area and will require assurance that indexation is the best information on which to measure assets, especially where there is a significant difference between indexed values and external valuations. Accounts preparers will be required to

provide a robust justification for their choice and auditors will then need to assess that reasoning, adding to the burdens on both.

33. Where valuations have not been commissioned, we consider that applying indexation will be more straight-forward for accounts preparers and is likely to lead to a reduction in auditor queries. Queries around indexation are typically surrounding the suitability of the indices used and whether they have been correctly applied. Requiring the use of a standard, centrally determined index would therefore remove much of the subjectivity in this area and should reduce the number of auditor queries received.
34. As set out in our response to question 1, we recommend only adopting indexation for 2023/24 financial statements in situations where external valuations have not been obtained but recommending the use of indexation for the 2024/25 financial statements.

Question 3

Do you consider that this would have a beneficial effect (a net reduction) in the overall workload for auditors?

If not, why not? Please provide reasons for your view.

35. No, we do not consider that this would have a beneficial effect in the overall workload for auditors, especially if a local authority has already commissioned a full valuation of their portfolio.
36. As mentioned previously, auditors are required under ISA 330 to consider all audit evidence, including both corroborating and contradictory evidence, in concluding whether sufficient appropriate audit evidence has been obtained.
37. Where a full valuation has been commissioned, auditors will be required to analyse management’s assessment as to why either the full valuation or indexation is better information to re-value their portfolio with. This would likely result in auditors having to assess both sets of information to ensure that they agree with management’s assessment, thus potentially leading to additional queries in this area.
38. Where a full valuation has not been commissioned, indexation should lead to a net reduction in the workload for auditors, on the provision that the proposals intend for authorities to be required to use a standard, centrally determined index, as this is where many auditor queries lay when reviewing indexation calculations.
39. Auditing indexation is much more straightforward than assessing a full revaluation, as a full revaluation requires auditors to assess the appropriateness of the input data used and the reasonableness of the assumptions applied under ISA 540 accounting estimates. In contrast, indexation can usually be audited via a direct recalculation or via a substantive analytical procedure. Thus, undertaking the work should be less resource intensive.

Question 4

Who do you consider would be an appropriate authoritative body to determine the indices to be applied?

40. We believe that differing bodies may be best placed to determine the indices to be applied, depending on the type of asset subject to indexation.
41. For property assets, excluding land, a suitable market index from a valuation firm may be appropriate where there is an active market. For property assets without an active market, the BCIS all-in TPI (Tender Price Index) with an appropriate location factor may be suitable. This was suggested as a suitable index by HM Treasury for central government bodies to apply within their Exposure Draft on the Valuation of Non-Investment assets.
42. Within our response to HM Treasury, we suggested that land assets across central government could be re-valued using the UK Residential Development Land Index from Knight Frank. This index may also be suitable for land across local government, as it would not be appropriate to apply the BCIS all-in TPI index to land.

Question 5

By what date would you need this information to be able to effectively implement an indexation approach?

43. Accounts preparers will need information regarding what centrally determined index they must use as soon as possible, to effectively implement an indexation approach for 2023/24.

44. The Accounts and Audit Regulations 2015 require local authorities to published unaudited financial statements by 31 May each year. This allows two months from the financial year end for local authorities to complete work on their financial statements, which would include work surrounding the application of indexation if these proposals were implemented.

45. Application of indexation will also be a new concept for local authority finance teams and they may require adequate time to create appropriate working papers to implement the changes.

46. We therefore recommend that this information is provided to local authorities as soon as possible, however we recommend limiting the use of indexation in 2023/24 to authorities who have not already commissioned a full valuation.

Question 6

Do you have any other comments on this proposal?

47. We have no further comments.

Question 7

Do you agree with the proposal that, for local authorities in England only and for the 2023/24 and 2024/25 reporting periods, the application of the requirements of the Code should be amended so that reduced pension disclosures are required, as outlined in the exposure draft?

If not, why not? Please provide reasons for your view, noting any specific pension disclosures for which you consider this approach to be problematic.

48. Yes, we support the proposal to amend the requirements of the Code to reduce pension disclosures closer to those in FRS 102 for a temporary period. We do however believe that consideration should be given to extending these proposals beyond 2024/25 on a permanent basis.

49. We believe it is important that local authority financial statements contain information on employee pension plans. Such plans can have a material effect on the long-term financial performance and position of local authorities and hence it is important that there is sufficient information for stakeholders to understand the position. However, local authority pension plan financial statements and valuation are publicly available, and in that context reducing pension disclosures for a temporary period in order to help address the backlog in audit opinions does not seem unreasonable.

50. Furthermore, the disclosure requirements in FRS 102 are already robust and we concur that they provide sufficient information on employee pension plans for stakeholders. Therefore, reducing the level of pension disclosures beyond the temporary period may also be reasonable and this could apply across the UK jurisdictions.

51. These changes are unlikely to have a significant impact in reducing the burden on preparers and auditors during the recovery period however.

Question 8

Do you consider that this would have a beneficial effect (a net reduction) in the overall workload for preparers, having regard both to additional work that would be required to implement the change, and anticipated reductions in requirements to provide additional evidence to auditors and to resolve auditor queries?

If not, why not? Please provide reasons for your view.

52. No, we consider that the proposals are likely to have minimal impact in reducing the overall workload for preparers for 2023/24 financial statements, and only a limited impact for 2024/25.
53. Most preparers will already be organised and ready to produce draft financial statements for 2023/24 with the existing disclosures in mind, since prior to these proposals, no changes were made to Section 6.4 of the 2023/24 Code from the previous 2022/23 Code. Almost all preparers will have already completed disclosures in their 2022/23 and prior financial statements, which meet the Code's requirements.
54. Reduced disclosures may lead to fewer auditor queries, simply because an auditor will have fewer disclosures to review. However, this is likely to have a relatively small impact considering that the overall reduction in disclosure requirements is limited.

Question 9

Do you consider that this would have a beneficial effect (a net reduction) in the overall workload for auditors?

If not, why not? Please provide reasons for your view.

55. Yes, we believe that the reduction in pension disclosures may lead to a small reduction in the overall workload for auditors, however this is not likely to be significant.
56. The proposed changes are small, reducing the need for an authority to disclose additional information where existing disclosures required by the Code are deemed insufficient (Paragraph 3), the need to disclose sensitivity analysis (Paragraph 11) and the need to disclose strategies to manage risk (Paragraph 12). Removing this information will result in there being fewer disclosures for an auditor to review, however these items were unlikely to have led to substantial issues on the auditor's side.
57. There remains a large amount of work for an auditor to perform relating to pensions disclosures, with the bulk of the work required surrounding the audit of the net liability/asset table, the reconciliation of fair value of the scheme assets, and assessing the actuarial assumptions and input data used to ensure they are reasonable and appropriate.
58. Thus, while the proposals are welcome and we support their alignment with FRS 102, we do not consider they will have a huge reduction in the overall workload for auditors.

Question 10

Do you have any other comments on this proposal?

59. We have no further comments.

Question 11

Do you have any other comments on how the short-term proposals might be implemented?

For example, having considered the proposal in this ITC, to the extent that you are in favour of them, do you agree or disagree that this is an appropriate matter for specification in the Code, which is a matter for CIPFA/LASAAC to determine under its usual process?

60. We believe that the proposals must be implemented in a timely manner for them to be effective in reducing burdens on preparers and auditors for 2023/24. There is more time available for 2024/25 financial statements.

61. Considering that local authorities are required to publish unaudited financial statements for 2023/24 by 31 May 2024, under the Accounts and Audit Regulations 2015, it is important that local authorities are given as much notice as possible to ensure that they have sufficient time to consider and implement the required changes.

62. We agree that this is an appropriate matter for specification in the Code, which is a matter for CIPFA/LASAAC to determine under its usual procedures. We hope that the Board will consider responses to the consultation as speedily as possible and consider whether appropriate amendments to the proposals could be made without delaying the planned publication of these changes to the Code.