

PSAA response to MHCLG consultation on ‘Local audit reform: a strategy for overhauling the local audit system in England’

Introduction

PSAA is pleased to take the opportunity to respond to MHCLG’s consultation on its local audit reform strategy. Our press release of the [18 December 2024](#) set out our overall position on the strategy, and our commitment to working with partners to deliver the change that is needed. Our responses to the specific consultation questions are set out below.

Q1: Do you agree the LAO should become a new point of escalation for auditors with concerns?

Strongly agree. There is a need for the LAO firstly to build and maintain the trust of auditors in terms of how it deals with the information provided to it. It is also vital that bodies are consulted on how the escalation process will work, including at what stage a body will have the opportunity to provide its view, which may differ from that of the auditor. If bodies do not have clarity on how the relationships work and the boundaries of information-sharing/consultation, then there is a risk of bodies deciding not to share rising issues with their auditor.

Q2: Do you agree relevant issues identified should be shared with auditors, government departments and inspectorates?

Agree. On principle we agree as the ultimate driver is the protection of the public purse, but there would need to be a clear framework for sharing to ensure everyone (including bodies) know where they stand. There are existing models within UK audit that could provide useful sounding boards for making this a success.

Q3: Should the LAO also take on the appointment and contract management of auditors for smaller bodies in the longer term? If so, when should responsibilities transfer from SAAA?

In our view MHCLG and SAAA are best placed to work this through including the timing of any transfer.

Q4: Should the LAO oversee a scheme for enforcement cases relating to local body accounts and audit?

Any enforcement scheme would need to be co-ordinated with the relevant Institutes and RSBs, and so we consider this is a matter for them to consider in conjunction with MHCLG.

Q5: How could statutory reporting and Public Interest Reports be further strengthened to improve effectiveness?

The LAO could emphasise how important it is that auditors make use of the options available to them and then demonstrate this by giving the auditor’s consideration of reporting an appropriate weighting in the quality assessments of audit work. It is also important that if auditors consider that their statutory reporting has not been taken sufficiently seriously that they raise their concerns to the LAO (in line with question 1).

Q6: Should the scope of Advisory Notices be expanded beyond unlawful expenditure, or actions likely to cause a loss or deficiency, as defined by the Local Audit and Accountability Act, to include other high-risk concerns?

No. Local Government auditors already have a unique range of options to report their concerns in the public domain, a significant strength of the local audit framework that allies to local government's transparency agenda. Rather than expanding the use of Advisory Notices, our view is that auditors should be encouraged to use these existing options where appropriate. An important driver for achieving this is that quality assessments of their work should cover the entirety of the Code of Audit Practice, including their statutory reporting of concerns (e.g. Statutory Recommendations under Schedule 7 (2) of the Audit and Accountability Act 2014 and Public Interest Reports).

We strongly agree with the local audit strategy's position that audit work should feed effectively into the wider early warning system. This would mean that when an auditor exercises their reporting powers then in most cases it should be for others to decide on whether a direct intervention is appropriate. It is currently extremely rare for an auditor to issue an Advisory Notice, and in our view that is appropriate and they should remain as a response to extreme circumstances only.

We also consider that broadening the use of Advisory Notices would increase the risk of auditors becoming embroiled in political issues, and that it could become another barrier to audit firms being willing to participate in the local government market.

Q7: Should the LAO own the register of firms qualified to conduct local audits?

Yes. A register of firms qualified to conduct local audits has ensured that any procurement process (whether by ourselves as Appointing Person or by an individual or group of bodies) results in an approved firm being appointed. We also note that we have subsequently benefited from there being a defined market when making certain decisions that would otherwise have been more complicated. However, we are also acutely aware that the registration requirements of the current arrangements have become a significant barrier to entry to new firms in some cases, and as the strategy highlights, the supply market is severely restricted.

The strategy sets out that the LAO will be making all local government audit appointments (we note that the City of London Corporation may be subject to specific consideration), and in other areas of the UK where this approach applies there is no register – the procuring body is able to make the assessment of suitability itself. In our view there is therefore a fundamental question of whether there needs to be a register at all when the LAO is in existence, although we note the uncertainty over the future arrangements for the NHS where all bodies are currently required to make their audit appointments from the register.

If there is to be a register for local audit qualified firms, then separating it from the ICAEW and giving it to the LAO means a dual registration process, and a risk of duplication/confusion (there would be a further complication if the NHS retains the current arrangements and the LAO does not procure for that sector) and so consultation with the ICAEW would be important in the decision-making process.

One option would be for the LAO to have a register at firm level only, and for it to ensure that there are no inappropriate barriers to entry.

Q8: Should the LAO hold the power to require local bodies to make changes to their accounts, so that auditors could apply to the LAO for a change to be directed instead of needing to apply to the courts?

No. Applications to court to change the accounts are extremely rare. The need to change accounts is normally dealt with via discussion between management and the auditor, including making Prior Period Adjustments where material changes are

needed to the accounts relating to a period before the set being audited. We do not consider that empowering the LAO to direct bodies to change the accounts is either an appropriate or helpful addition to this process – the vast majority of amendments are best dealt with via standard accounting and auditing processes.

The concept of an auditor seeking to ask a court to order the rectification of accounts is rooted in the options available to electors when lodging an objection. Rather than seeking to redirect that option in isolation to the LAO, in our view the key issue is that there is a need for a holistic review of the framework for elector rights to ensure that it is fit for purpose in the modern era. This would take into account developments such as the Freedom of Information Act, how the current arrangements are used in practice, and a cost/benefit assessment taking into account the outcomes.

Q9: What are the barriers to progressing accounts reform?

The concept of accounts reform has been discussed for many years across the sector, but there has always been a reason why it has not been delivered. To address this the starting point is to define the purpose of local government accounts and audit. This was an interesting debate within the LUHC Select Committee discussions that illustrated the different views, and the different perceptions has made progress on reform more difficult to deliver. We welcome the greater clarity that the local audit strategy provides on the purpose of accounts and audit, including the clear message on ensuring value for money for the taxpayer. All too often progressing reform has stalled due to dogged adherence to accounting and auditing requirements that are rooted in the requirements of the corporate sector. All parties now need to ensure that their consideration of potential reforms has that message at the forefront, and that their governance arrangements enable change to happen. We have set out our views on the way forward for reform in our answer to question 14a.

Q10: Are there structural or governance barriers to accounts reform that need to be addressed?

Yes. Please see our response to question 9.

Q11: Should any action to accounts reform be prioritised ahead of the establishment of the LAO?

Yes. In our view action to reform the accounts must be a very high priority and it is essential that momentum is built rapidly for change and then maintained. This is a key driver for our answer to question 14a.

Q12: Are there particular areas of accounts which are disproportionately burdensome for the value added to the accounts?

Yes. We have long stated our concerns that the volume of accounts preparation and audit work now perceived to be needed to be Code of Audit Practice compliant in relation to the valuation of operational Property Plant and Equipment and Pensions is disproportionately burdensome. The changes that emerge from the work have little or no effect on the services that local government bodies provide. Rapid reform of both the accounting and auditing approaches is vital if the Local Audit Office is to be able to operate in a fit for purpose framework.

Q13: Do you agree that the current exemption to the usual accounting treatment of local authority infrastructure assets should be extended and if so, when should it expire?

Yes. We agree that it should be extended until a sensible solution is found that does not absorb significant levels of scarce resource on a matter that has little or no impact on the value that taxpayers get from the preparation and audit of accounts.

Q14a: Should the LAO adopt responsibility for CIPFA's Code of Practice on Local Authority Accounting?

Disagree. In line with our response to question 11, we consider that action to reform the accounts is needed urgently, and it cannot wait until the LAO is created. The body best placed to deliver that is CIPFA. However, we are also aware that reform has been discussed for many years with limited change. Nevertheless, we consider that CIPFA is best placed to build and maintain the necessary momentum for change and signalling that the accounting Code is to move to the new body could significantly reduce the chances of that happening in practice.

If CIPFA is given notice that it is to retain the Accounting Code then it is vital that the sector is provided with clarity about its plan to deliver through rapid and sustained action, including key milestones on the road to significant changes that are focused on the needs of the taxpayer. If CIPFA were to retain the responsibility for the Code, it would be vital for it and the LAO to work closely together in the revised governance arrangements, including ensuring that the focus is not lost and that the accounting and auditing requirements are aligned.

If the decision is made now that the LAO will adopt responsibility for the Accounting Code then there would be a significant risk that any momentum that it is building would fall away. There would also be the practical implications of the LAO having responsibility for a Code that applies to all of the UK.

We also note that there are some concerns that having responsibility for both the accounting and auditing Codes in one body comes as a potential conflict of interest. We think that this risk could be managed, but even so our view remains that the best solution is for CIPFA to retain the Code for at least the medium term as this offers the best chance of a positive outcome – the debate could then be revisited in the longer term if appropriate.

Q14b: Are there other options relating to responsibility of CIPFA's Code of Practice?

Yes. In line with our response to question 14a, we consider that CIPFA should retain responsibility with the proviso that it demonstrates appropriate momentum and clear plans of how that will be maintained, working to a defined timetable with clear milestones and outcome measures. This is needed to give the preparers and auditors confidence that the changes to the Accounting Code that are vital will be delivered in a viable manner.

Q15: Should the Accounting Code be freely available if it is not transferred to the LAO?

Yes. We agree that in principle the Accounting Code should be freely available. However, as noted in the strategy, the Accounting Code and the accounts that emerge from it are complicated, and so the guidance notes are key to bridging them for preparers, auditors and interested third parties including electors. The consultation is silent on whether these would also be freely available.

Whatever is decided on charging, there needs to be a realistic funding mechanism for the vital work that is needed to produce an updated Accounting Code, the accompanying Guidance notes and for maintaining them to ensure that they remain fit for purpose.

Q16: What additional support should be provided to finance teams, audit committees and elected members to develop and strengthen financial governance?

Bodies such as CIPFA, the LGA (we support the delivery of its Leadership Essentials courses for Audit Committee Chairs) and ICAEW provide support programmes for

these groups, and so are best placed to work with them to identify what further is needed. As a more general point we think that one of the best ways to help them is to deliver the greater proportionality of accounts and audit products, which makes their roles clearer, more rewarding and more understandable.

Q17: How should KAP eligibility be extended further, should some categories of local audit be signed off by suitably experienced RIs (and if so, which)?

In our response to question 7 we considered the concept of a register of audit firms who are eligible for appointment in the context of the intention for there to be no option for bodies to appoint their own auditor. Similarly, here there is a question of whether there needs to be a specific KAP registration process or whether the Responsible Individual (RI) process can be adapted to incorporate local audit, or whether the LAO could be enabled to approve KAP equivalents (who are not RI accredited). One option would be to mandate the specific CIPFA training designed to allow RIs in firms to gain KAP status (or the accredited in-house equivalent) if they are not sufficiently experienced. We would re-iterate that clarity is needed on the NHS position where local appointment is currently standard.

If some form of KAP specific registration is retained or if it is blended into the wider RI registration process then it is essential that there is agreement across all relevant parties that it will need to be more flexible than is currently the case and so becomes less of a barrier to entry, whilst maintaining public confidence that only firms with the necessary skills are undertaking local audits. As for question 7, we consider that consultation with ICAEW would be helpful in finding the appropriate balance.

In terms of categories, the overriding aim should be that sign off should be done by suitably qualified individuals. If a KAP process is retained (rather than leaving the judgement to firms to deploy their RIs) then more flexibility is needed in terms of registration categories, recognising the different specialisms within local audit. For example, although local government pension funds are earmarked for significant change, until that is delivered it would be helpful to facilitate a specific KAP status in relation to them. Given the significant difference in complexity between NHS and local government accounts there is a case to consider creating NHS only KAPs – this would also recognise that there are suppliers that service the NHS and not local government and would provide greater clarity on the pool of available KAPs for each sector.

Ultimately the driver for change should be for the LAO, the firms, ICAEW and CIPFA, in consultation with MHCLG and the sector, arriving at a framework that does not put inappropriate barriers in place whilst ensuring that those signing local audit opinions have the appropriate training, skills, resources and support.

Q18: Should the market include an element of public provision?

Yes. In our view some form of auditor of last resort needs to be in place as soon as is practicable. We recognise there will be significant challenges in making this a reality.

Q19: If yes, should public provision be a function of the LAO?

The ownership of the public provision partly depends on the model to be brought in – either a permanent workforce (which could be owned by the LAO but be at arm's length or hosted elsewhere) or a resource to be called on (which would be externally based), noting that the commercial arrangements would need to be viable. Whatever the arrangements, the LAO would need the power to direct the public auditor to take up an appointment.

Q20: What should the initial aim be in relation to proportion of public and private provision?

We strongly agree with the concept of having a form of public provision that is

capable of stepping into any local government audit and delivering whatever is needed. The absence of such provision has been a major hindrance to being able to resolve the current supply issues – unlike other areas of the UK or the NAO, there is no ‘grow our own’ option for local audit in the face of limited supply.

We are fully aware of the practical and technical complications of setting up any form of public provision, including the risk that it destabilises current suppliers by absorbing their staff, and any development in this area needs to be carefully co-ordinated with existing and potential suppliers.

There are different models of public provision, and the LAO (or Government whilst it is in development) needs to decide if the public provision is to be a permanent provider that can step in wherever needed, or some form of call off arrangement. The proportion of public provision stems from this strategic decision, but we note that there are significant complications with both models, including developing and maintaining a workforce and audit approach that are fit for purpose to deliver a modern audit, and how to find the balance of keeping the workforce occupied whilst also maintaining their availability to undertake any audit (thereby ruling out it taking on most non-audit work at any LAO client).

A further question would be whether public provision would be available to the NHS market if its procurement does not become part of the LAO’s responsibility.

Q21: Should the Secretary of State, in consultation with the LAO and for defined periods, set an envelope within which the body could determine the appropriate proportion of public provision for the market?

We consider that this would be a matter for MHCLG and the LAO to discuss when the practicalities of generating public provision have been worked through.

Q22: Do you think that the Chair of an audit committee should be an independent member?

Our view is that this should be left to individual bodies to decide. There will be strongly held but fundamentally differing views, and the practicalities of finding a suitable person willing and able to perform the role is likely to differ across areas. Imposing a single solution on all bodies would risk undermining other measures to improve the standard of audit committees in the sector.

Q23: Do you have views on the need for a local public accounts committees or similar model, to be introduced in strategic authority areas across England?

No. We do not have a view on this matter, other than to note two matters. Firstly, that if it were to be implemented then care would be needed to ensure that it does not overlap with other ways for the local audit system/LAO to follow up on audit matters arising. Secondly, the Public Accounts Committee has invaluable support from the NAO in carrying out its wide-ranging reviews. Careful consideration would need to be given to the remit given to any local model, and how it would be supported to deliver that remit.

Q24: Would such a model generate more oversight of spending public money locally?

See Q23.

Q25: How would the creation of such a model impact the local audit system and the work of local auditors?

See Q23.

Q26: Do you agree that the MLA threshold should be increased?

Yes. The current threshold of £500m income or expenditure was set in 2014 without

a mechanism for increase and is now applying to bodies it was never intended to cover. We also suggest that in the context of LGR proposals that consideration is given to whether there needs to be an MLA limit when designing the future inspection regime.

Q27: Do you agree that some local bodies should be declared exempt from the regulatory focus of an MLA? For example, should Integrated Care Boards be exempt?

We consider that there is merit in examining the MLA regime as a whole, including why some suppliers will not accept appointments for them.

Q28: Do you agree that smaller authorities' thresholds should be increased?

Yes. Our biggest concern is the extremely problematic challenge that bodies currently face when moving between the limited assurance regime and the full audit regime, and one of the gaps in the current fragmented framework is that no organisation has a role in supporting that transition. The gap has proved insurmountable for bodies and extremely costly in terms of money and scarce accounting and audit resource. A pragmatic solution is needed, and options other than increasing the threshold need to be considered as doing that alone does not address the gap issue. One possibility is that there is a stepped process within the SAAA regime with the requirements increasing. It may also be appropriate for certain types of body to stay in that regime even if they are subject to temporary but very significant spikes in expenditure due to grants, such as Internal Drainage Boards. Care would need to be taken to allow for the circumstance where a body is created but has little or no expenditure in its initial accounting period, but is then expected to be subject to full audit from then on. We would be keen to work with MHCLG, SAAA and the NAO and others as appropriate on the way forward.

Q29: Do you agree that the lower audit threshold of £25,000 should be increased broadly in line with inflation?

We do not have a view on this.

Q30: Are there other changes that would improve the accounting and limited assurance regime for smaller authorities?

We are aware that SAAA has been considering this matter and has developed an Effectiveness and Efficiency Improvement Plan, and so defer to them.

Q31: What additional support, guidance or advice do local bodies and/or auditors need for future statutory deadlines (including backstop dates) for the publication of audited accounts?

It is vital that the firms' approaches to building back assurance vary as little as possible, and that they are practical and proportionate as well as Code of Audit Practice compliant. Any variance in the amount of work done should be due to differing circumstances at the bodies (which we note could be significant). We have long been calling for proportionate accounts and audit, which has been echoed by others. However, there has been very little progress to-date in practice despite much effort. The Government's call for accounts and audit to be focused on the needs of the taxpayer is encouraging, but unless the volume of work needed to deliver a Code of Audit Practice compliant audit is reduced then the preparer and auditor resource available will not be sufficient, and there is a risk that disclaimed and modified audits will continue.

Q32: Do you think that financial reporting and/or auditing requirements should be amended for a limited period after the backlog has been cleared and as assurance is being rebuilt, to ensure workload and cost are proportionate?

Yes. All avenues need to be explored to find ways to avoid build back taking many

years and/or the risk of perpetual disclaimers (whilst maintaining the integrity of the sector's accounting). Whilst some options have a risk of issues being missed, if nothing is done to address the challenges particularly at bodies that have several years of disclaimers there is a risk that some bodies will struggle to get back to unmodified opinions.