

Audit Committee

28 February 2025



Overhauling the Local Audit System in England – Ministry of Housing, Communities and Local Government (MHCLG) Consultation on Local Audit Reform

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Electoral division(s) affected:

None

Purpose of the Report

- 1 To provide the Audit Committee with an overview of the Government's consultation of Local Audit Reform to which Durham County Council submitted its response by the 29 January 2025 deadline.

Executive summary

- 2 On 18 December 2024, the Government opened a wide ranging consultation on Local Authority Accounts and Local Audit Reform.
- 3 The Local Audit Reform – A strategy for overhauling the Local Audit system in England, commits to a series of measures to fix the broken local audit system, including:
 - A local audit vision with 8 core principles;
 - The establishment of a statutory and independent Local Audit Office (LAO) with 5 strategic responsibilities;
- 4 The Government consulted on a number of specific proposals as part of the strategy, including:
 - Potential additional functions of the new LAO;
 - Simplifying financial reporting requirements to ensure that they are proportionate;

- Improvements to enhance capacity and capability in the local audit sector, such as the introduction of public provision;
- Strengthening the relationship between local bodies and their auditor;
- Reforming the audit regime.

5 The Council submitted a response by the 29 January deadline.

Recommendation

6 Members are asked to note the Government's Consultation on Local Audit Reform.

Background

7 The Minister of State for Housing, Communities and Local Government published a written ministerial statement on 30 July 2024 regarding the backlog in the publication of audited accounts of local bodies in England.

8 In this statement, he acknowledged the Local Audit system in England as broken and advised of his intention to update on the Government's longer term plan to fix local audit.

9 On 18 December 2024, the Government opened a wide ranging consultation on Local Authority Accounts and Local Audit Reform.

10 The current system highlights three systemic challenges:

Capacity. There is a severe lack of external auditors, with a limited number of firms operating in the sector;

Co-ordination. Multiple organisations have a statutory role to oversee and regulate audit, across various sectors, countries (within the UK) and with responsibilities for different frameworks. There is no clear ownership of the system. This limits the ability to align incentives and establish a single vision;

Complexity. Financial reporting and audit requirements are disproportionately complex, beyond the system's capacity and inadvertently incentivises risk aversion. Standards are largely modelled on corporate audit rather than the needs of local bodies.

11 The Local Audit Reform – A strategy for overhauling the Local Audit system in England, commits to a series of measures to fix the broken Local Audit system, including:

- **A local audit vision with 8 core principles;**

1. Value for Money
2. Transparency
3. Capacity and capability
4. External Scrutiny
5. Professionalism
6. Proportionality
7. Stronger Accountability
8. Timely

- **The establishment of a statutory and independent Local Audit Office (LAO) with 5 strategic responsibilities;**

1. Co-ordinating the system
2. Contract management
3. Code of practice
4. Oversight
5. Reporting, insights and guidance

- 12 In his ministerial foreword to the consultation, the Minister of State for Housing, Communities and Local Government stated that Local Audit should be the bedrock of local accountability and transparency, of trust and confidence in councils to spend taxpayers money wisely but that we have lost a key part of our early warning system over local government finances at the time when we need it most.
- 13 He adds that the challenges faced by all are insurmountable without fundamental reform to drive transparency and open the books and that the fragmented system will be streamlined into one body, The Local Audit Office which will have a focused and clear remit to lead the reform and ensure that local audit provides value for money for the taxpayers now and in the future.

Local Audit Reform Consultation

- 14 The real-world consequences of the system failure – of not having an audit, or not having a timely audit, or the delivery of accounts which are disproportionately complex - cannot be underestimated. There is a broad consensus over recent years that a new local audit body would be integral to system reform.
- 15 The proposed strategy for overhauling the Local Audit systems in England commits to establishing the Local Audit Office (LAO), to radically simplify the system, and bring as many audit functions as possible under a single organisation with a focus and expertise in local audit, as the Kingman and Redmond Reviews recommended. The proposed strategy also consults on potential additional functions for the LAO to further unify the system.
- 16 A LAO will form one of several steps towards resolving the sector's most pressing challenges. Alongside the Government's programme to clear the backlog and return to timely audit, relationships must be strengthened and capacity and capability enhanced. The proposed strategy also responds to Redmond's recommendations and provides direction in both regards.

17 The 6 key areas of required reform included in the consultation are summarised below:

- **The purpose of local audit** – Reforms must be guided by a vision statement with 8 core principles and be driven by user needs.

The proposal includes new emphases on the examination of an authority's financial resilience and the provision of early warnings of major governance and financial risks (including material fraud).

The most radical proposal requires auditors to give an opinion on whether an authority has actually achieved value for money (VFM), rather than purely assessing whether adequate arrangements to secure VFM are in place.

Any implementation of this proposal needs to consider that responsibility for VFM in local authorities sits with elected members. The need to maintain auditors' independence and whether there is a risk of being drawn into challenging political decisions also need to be taken into consideration. The capacity and capability of the system to respond to an extension of auditors' responsibilities is a further consideration requirement in this proposal

- **Local Audit Office remit** - The Government accepts the Redmond Review recommendation for a statutory and independent oversight body (the LAO), which would largely take on the roles currently performed by the FRC, PSAA and the NAO, simplifying the system and driving change.

As highlighted earlier in the report. The LAO will have 5 strategic responsibilities. A point of focus within the proposal is to improve the consistency and effectiveness of the auditors' use of special powers (e.g., highlighting issues of concerns where remedial action cannot wait for the publication of the Accounts, or the concerns exceeds the scope of the audit via Advisory Notices or Public Interest Reports).

The LAO would have overall responsibility for audit inspection (although it may delegate the work to others), and consideration is being given to whether there should be a scheme for enforcement related to the financial statements that would require authorities to make changes to the accounts.

- **Financial reporting and accounts** - Reforms should consider the needs of the user and the impact of accounting requirements on the work of the account preparers, auditors and the wider audit system.

The Government acknowledges the range of views on the purposes and users of accounts. Local accounts must be fit for purpose, proportionate

and relevant to account users. There is a clear need to ensure that accounts contain the correct level of information and disclosures to benefit the users and achieve the purpose of the accounts. The Government is committed to working with sector partners to review the content and format of local authority accounts to ensure that the requirements of the Accounting Code and those practices set out in legislation are appropriate and do not create any excessive or unnecessary burden. The review will consider the definition of the purpose and user of local accounts, any impact definitions may have on accounts and audit, as well as any unintended consequences

The consultation also highlights the Government's consideration of the now MHCLG Committee's November 2023 recommendation that decoupling the Pension Fund Accounts from the main accounts, publishing them separately and subjecting them to a separate audit certificate would have numerous benefits to local government, however there is no dedicated/ specific question around this topic for response within the consultation.

The consultation document states that infrastructure asset accounting will remain unchanged in the medium term via secondary legislation to extend the current exemption.

Views are also requested for how the reform of the Code of Practice on Local Authority Accounting in the UK (the Code) could be facilitated (e.g., by making the Code an LAO responsibility). It is also proposed that the Code should be freely available.

- **Capacity and capability** – Delays and complexity disincentivise the right skills from entering the market, leading to less timely, less effective audit. The Government will work to ensure that bodies have skilled and resourced account preparers. In order to strengthen the capacity of the sector, consideration will also be given to supplementing private sector audit with public provision

The Government is committed to ensuring that authorities have skilled and resourced account preparers and will work with the LGA and CIPFA on a programme of improvement support. The FRC's Local Audit Workforce Strategy (yet to be published) will be built upon to enable greater alignment between corporate and local audit and provide a more flexible career progression for individuals.

The eligibility criteria for Key Audit Partners will be reviewed as part of the proposal to ensure that there are no unintended barriers for partners wanting to join the profession and that the sector has the widest possible pool of qualified auditors.

The consultation also considers whether there are further ways to build public provision to supplement capacity and strengthen the sector, including consideration as to whether there should be supplemental public provision of audit.

- **Underpinning the system: relationships and audit regimes** – Existing relationships between local bodies and their auditor need to be strengthened and their respective relationship with the LAO must be clear. The collective scrutiny of audits as part of the democratic process, such as Audit Committees will be strengthened and the potential for local accounts committees for strategic authority areas in England will be considered. Audit regimes will be reviewed to ensure they are fit for purpose in the short and long term.

A key role of the LAO will be to maintain strong links between central government (in its stewardship capacity), the NAO, inspectorates of relevant bodies, and local auditors, allowing a transparent and supportive government approach when concerns are raised about particular bodies.

The strategy proposes that Audit Committees will be mandated for local authorities, with at least one independent member, and audit reports require consideration by full council. Views are also sought on whether the committee chair should be an independent member.

- **Local audit backlog** - Significant and difficult work undertaken by finance teams and auditors to clear the backlog to date is a necessary step to reform. The Government recognises that there is further work required to support the recovery process including guidance, advice and support

The Government aspiration is that disclaimed audit opinions driven by backstop dates should be limited in unexceptional cases to the next two years (i.e., up to and including 2024/25 – backstop date of 27 February 2026).

The Government recognises that further cross system work is required to support the recovery process, and the consultation informs that the Government will work with system partners to ensure that additional guidance, advice and practical support is available. Consideration may also be given to temporary measures additional to the extended exemption from normal accounting for infrastructure assets (as noted earlier in the report) to ensure that the preparer workload and cost is proportionate (subject to the appropriate management of any risks to public funds).

- 18 The Council submitted its response to the consultation on the 29 January 2025 and will continue to respond to all relevant / linked consultations as they arise.
- 19 Further updates will be provided to Audit Committee as required.

Other useful documents:

- [Local audit reform: a strategy for overhauling the local audit system in England - GOV.UK](#)
- [Redmond Review.pdf](#)
- Audit Committee 25 September 2020 - Independent Review of Local Authority Financial Reporting and Audit [Committee](#)
- Audit Committee 30 September 2021 - [07 Update on the Independent Review of Local Authority Financial Reporting and Audit.pdf](#)
- Audit Committee 1 July 2022 - Update on the Independent Review of Local Authority Financial Reporting and Audit (Redmond Review) – Government consultation response - [Committee](#)

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Appendix 1: Implications

Legal Implications

The consultation informs of the intention to amend the Accounts and Audit (England) Regulations 2015, with the extension of the infrastructure accounting statutory override via secondary legislation.

Finance

There are no direct financial implications arising for the council as a result of this report, although by responding to the consultation and understanding any impact on the Council, we are demonstrating efficient arrangements for the proper administration of the council's financial affairs.

Consultation

None

Equality and Diversity / Public Sector Equality Duty

None.

Climate Change

None.

Human Rights

None.

Crime and Disorder

None.

Staffing

None.

Accommodation

None.

Risk

This report requires no decision, a risk assessment has not been carried out.

Procurement - None