



Ministry of Housing,
Communities &
Local Government

Local audit reform

A strategy for overhauling the local audit system in
England

Statement of intent and consultation
December 2024
Ministry of Housing, Communities and Local
Government



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Ministerial foreword

Local government is the foundation of our state. It is critical to driving growth, delivering and reforming the local public services people rely on, and to our democratic system. Our councils, fire, police and rescue authorities have demonstrated remarkable resilience, and an ability to bring communities together, through economic instability, the pandemic and their response to this summer's far-right disorder.

But they have not been empowered to live up to their potential and residents have suffered as a result. Councils across England face extreme financial pressures after cuts, rising costs and ever-higher demand for statutory services. Not only did central government fail to give councils the tools they need to deliver for their residents, but it turned a blind eye when things started to go wrong. After a decade of financial mismanagement, communities and service users have been left paying the price.

Local audit should be the bedrock of local accountability and transparency, of trust and confidence in councils to spend taxpayer money wisely. But the system is broken – we have lost a key part of our early warning system over local government finances at the time we need it the most. The scale of this failure was epitomised by the backlog of outstanding unaudited accounts which led to a paralysis of local audit – with just one per cent of councils and other local bodies publishing audited accounts on time last year and a backlog of nearly 1,000 outstanding audits dating back to 2015/16. More recently the Whole of Government Accounts for financial year 2022/23 - disclaimed primarily due to a lack of audit assurance on local government accounts – serves to further illustrate the dire straits of the system and the contagion caused by the lack of real reform.

This government is committed to devolving significant new powers to Strategic Authorities, and stabilising and supporting local government with fairer funding and an end to damaging micromanagement. But to do that, taxpayers need to be confident that their pounds are being spent in a sound and efficient way. This is why this government has a manifesto commitment to overhauling our broken audit system.

We are determined to get the house in order. Within weeks of entering government, we took the decisive and difficult action, supported by organisations in the local audit system, to clear the unacceptable backlog of outstanding unaudited accounts of local authorities and ensure full assurance can be rebuilt.

The government is grateful for the collective effort of auditors, local authority finance teams and system partners, and pays tribute to the Financial Reporting Council in its system leadership role.

The challenges faced by all are insurmountable without fundamental reform to drive transparency and open the books. That is why we will streamline our fragmented system into one body, the Local Audit Office. The Office will have a focussed and clear remit to lead the required reform and to ensure that local audit, not just for local authorities but the wider system including the NHS, will provide value for money for the taxpayers now and in the future.

This document sets out our ambitious, system-wide proposals to improve local scrutiny and ensure that every pound of taxpayers' money is treated with the care it deserves.

Our approach has been informed by the excellent independent work carried out by Sir Tony Redmond and Sir John Kingman, the previously constituted Housing, Communities and Local Government Committee and the Public Accounts Committee. The government pays tribute to their work.

Jim McMahon OBE MP
Minister of State for Local Government and English Devolution

Introduction

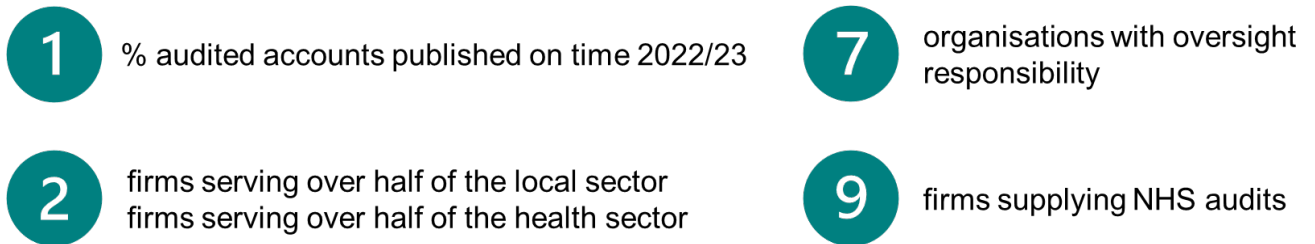
1. Over 600 local bodies, mainly local authorities and NHS trusts, publish audited accounts to ensure transparency, accountability and secure public confidence. Audited accounts are a vital and independent source of evidence of the sector's financial health and value for money for residents, local bodies and elected members. In addition, almost 10,000 smaller bodies operate under a more limited accounting and audit regime.
2. The local audit system for local authorities includes the procurement, contract management and delivery of audit services, codes of practice, regulation and accountability for performance. However, it is complex and dysfunctional. Last year, only one percent of local bodies' audited accounts were published on time and there were 918 outstanding audit opinions as of September 2023. This unprecedented audit backlog has in effect dismantled part of our early warning system over the state of local government finances. The problems with local audit are, however, much wider than simply a lack of timeliness.
3. Although the National Health Service (NHS) local audit system is less complex, and does not have the same backlog of audits as local authorities, timeliness and auditor capacity have been challenging over recent years.
4. The Local Audit and Accountability Act (2014) abolished the Audit Commission, assigning its responsibilities to several organisations and requiring bodies to either choose their own auditor from the private market or opt-in to a centralised procurement process.
5. The Audit Commission became too expansive and did not enjoy the trust of the sector that it oversaw. For at least the past five years, the system that replaced it has failed to respond effectively or quickly enough to issues or provide value for money. There are three systemic challenges:
 - **Capacity.** There is a severe lack of 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 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.
6. Within the constraints of the existing system and since the election, the government has worked with system partners to clear the backlog and provide a pathway to timely audits, as a first step to restoring robust financial oversight of

local government. Government is indebted to partners' collective ongoing work across the system. In particular, the FRC has demonstrated great dedication to its role as system leader and the government recognises that without systemic reform the challenges it faced are insurmountable. This strategy builds on previous reviews and stakeholders' views to propose a streamlined system of local audit with:

- A remit for a new Local Audit Office (LAO)
- The purpose of local audit and its users
- Simplified and proportionate financial reporting
- Improvements to enhance capacity and capability
- Stronger relationships, in particular between local bodies and their auditors, and a reformed audit regime

Figure 1: the current position

Note: excludes smaller authorities, except for oversight organisations



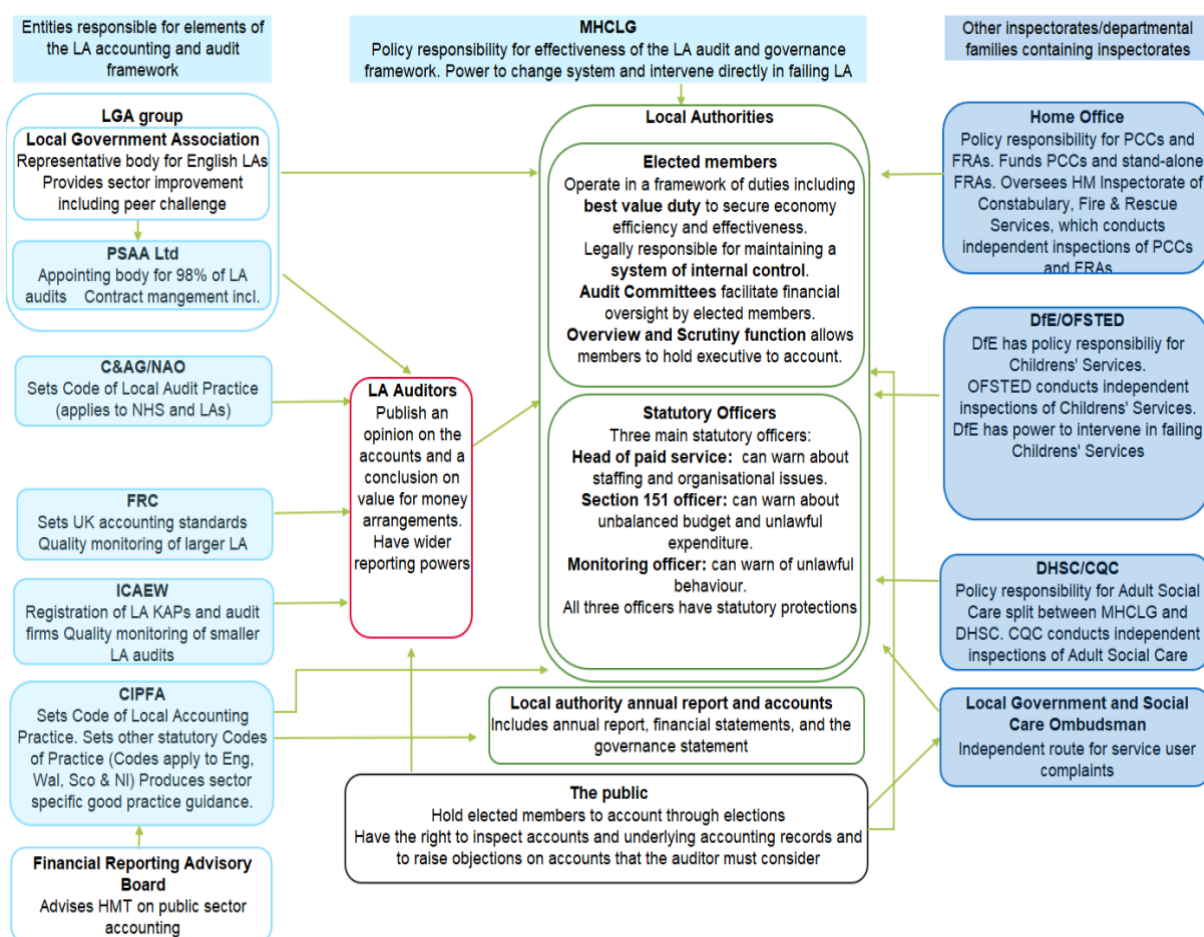
Framework stakeholders

7. The following local bodies are within the framework and must publish audits:
 - a. **Local authorities**, including Police and Crime Commissioners (PCCs), Fire and Rescue Authorities (FRAs), National Park Authorities and transport authorities.
 - b. **Smaller authorities**, including town, parish, community and neighbourhood councils, parish meetings, internal drainage boards, Charter Trustees, Port Authorities and Conservators. These bodies publish Annual Governance and Accountability Returns under a simplified framework. Many aspects of the local audit and accounting system do not apply to these smaller bodies or apply in a modified form.
 - c. **National Health Service (NHS) bodies**. Parts of the framework apply, including audit firms' services and oversight by the NAO, FRC and ICAEW. Parts of the framework do not apply, such as an appointing body.
8. There are seven oversight organisations within the current framework. These stakeholders play significant roles and are impacted by the proposals within this vision:
 - a. **Chartered Institute of Public Finance and Accountancy (CIPFA)** sets the Code of Practice on Local Authority Accounting in the UK.
 - b. **Financial Reporting Council (FRC)** has been the incoming shadow system leader since 2023, to provide a leading voice and co-ordinating role to support the effective functioning of the system. It oversees the audit quality framework, including inspection of Major Local Audits, enforcement, supervision, and professional bodies oversight.
 - c. **Institute of Chartered Accountants in England and Wales (ICAEW)** is an accountancy membership organisation and Recognised Supervisory Body, responsible for the licensing and registration of local auditors, and inspection of non-Major Local Audits.
 - d. **Ministry of Housing, Communities and Local Government (MHCLG)** is the steward of the local government financial framework, with accountability to Parliament.
 - e. **National Audit Office (NAO)** is the public spending watchdog responsible for the Code of Audit Practice.
 - f. **Public Sector Audit Appointments Ltd (PSAA)**, an independent company owned by the Improvement and Development Agency within the Local Government Association (LGA), appoints auditors for local government bodies which opt into its services.
 - g. **Smaller Authorities Audit Appointments Ltd (SAAA)** is the appointing organisation for smaller bodies.

9. The government recognises that local bodies, audit firms and other oversight organisations have all strived to deliver and collaborate within the existing framework and places on record its thanks to all organisations for their professionalism, integrity and dedication. This includes teams at the FRC in its capacity as system leader, CIPFA, ICAEW, NAO, PSAA and SAAA. Our reforms acknowledge that, despite the best efforts of many, the system will continue to fail without structural change.
10. This strategy is intended to build on stakeholders' views and reviews conducted by Sir John Kingman¹, Sir Tony Redmond², the PAC³ and the HCLG Committee⁴. These reviews have provided valuable recommendations to address the considerable challenges.

Figure 2: the current landscape

Source: Redmond Review, 2020. Excludes smaller authorities.



¹ [Independent Review of the Financial Reporting Council](#), Sir John Kingman, December 2018

² [Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting](#), Sir Tony Redmond, September 2020

³ [Timeliness of Local Auditor Reporting](#), PAC, March 2023

⁴ [Financial Reporting and Audit in Local Authorities](#), April 2023

Executive summary

11. Communities need a clear line of sight to the decisions made by their local councils and other local bodies, and transparency on the proper use of finances. They need to be clear where arrangements have delivered value for money for the taxpayer and where they have not. The government has inherited a broken local audit system in England and the challenges experienced by the system are inherent. While external audit is by its nature backwards looking, it provides the only independent check on whether a local bodies' financial statements are true and fair. This is vital not only for good decision-making but for transparency and to enable local communities to hold their councils and other local bodies to account. In addition, there currently exists no consistently applied public facing early warning system to signal when a local body may be at risk.
12. The real-world consequences of this 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. In local government, many local residents, their local bodies and elected members, as well as local media, have been denied local audit as a rich source of information and assurance on the performance of local bodies, and a vital independent check on accounts and value for money arrangements. In addition, although most local authorities have established audit committees to consider auditors' findings this is not currently mandatory. Despite these challenges, auditors have been able to “sound the alarm” in relation to the affairs of some councils, but this has not been universal. Some councils with problems have not had timely audits and there are unfortunate examples of audits which have not identified vital issues, as well as a small number of instances where an auditor has not been appointed.
13. Whilst the picture for local audit in the NHS functions better and does not suffer audit backlog issues, there are challenges in respect of capacity and increased regulatory pressures. This has led to some NHS audits missing deadlines contributing to delays in the annual report and accounts of the Department of Health and Social Care (DHSC), NHS England (NHSE) and the Consolidated Provider Account (NHS providers such as acute hospitals, mental health trusts, community health trusts and ambulance trusts). The FRC has reported interim findings for its [NHS audit market study](#) which is due to publish its final report in Spring 2025. Timely financial reporting is essential for the health sector and as such, DHSC and NHSE are committed to working with MHCLG and key stakeholders to reform local audit.
14. It is a manifesto commitment of the government to overhaul the local audit system to ensure good value for money for local taxpayers and to underpin the stability and transparency of local finances.

15. In 2018, the independent [Kingman Review](#) recommended that regulation and oversight of local audit should be undertaken by a dedicated, separate body with “a deeper expertise in the local audit world”. Two years later, the [Redmond Review](#) agreed that the system would not be successful with the current structure. He recommended a new body to:

“manage, oversee and regulate local audit with the following key responsibilities: procurement of local audit contracts; producing annual reports summarising the state of local audit; management of local audit contracts; monitoring and review of local audit performance; determining the code of local audit practice; and regulating the local audit sector”.

16. Parliamentary inquiries have since recommended a new organisation or fundamental reforms. There is a broad consensus over the past six years that a new local audit body would be integral to system reform. The government commits to implementing the recommendations of these reviews and inquiries, which were the result of extensive and independent evidence-based stakeholder engagement.

17. This strategy therefore commits to establish 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. This strategy also consults on potential additional functions for the LAO to further unify the system.

18. A new organisation 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. This strategy responds to Redmond’s recommendations – which are even more pressing – and provides direction in both regards. This strategy also goes further in a number of respects, including consulting on the appropriate audit regime for different sizes of local body and on building an element of public provision.

19. There are six key areas of required reform:

1: The purpose of local audit

Reforms must be guided by a vision statement, key principles and be driven by user needs.

2: Local Audit Office remit

The government accepts the Redmond and Kingman Reviews' recommendations for a new oversight organisation to simplify the system and drive change.

3: Financial reporting and accounts

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

4: 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.

5: 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.

6: 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 purpose of local audit

This section applies to **smaller bodies** where relevant within the scope of the limited assurance regime.

1: The purpose of local audit

Reforms must be guided by a vision statement, key principles and be driven by user needs.

20. The government's objective for a sustainable local audit sector is for a clear purpose for local audit and eight core principles:

Figure 3: the purpose of local audit

Vision statement

A robust local audit framework which achieves public trust and accountability through transparency and promotes value for money.

Purpose of local audit

To provide independent assurance that:

- (a) accounts provide a true and fair view of financial affairs
- (b) accounts are prepared in accordance with requirements
- (c) arrangements are in place to secure value for money

Core principles

1. **Value for money.** A system that provides confidence that bodies and the new LAO have arrangements in place to deliver value for money for taxpayers.
2. **Transparency** of the sector's financial health and value for money arrangements.
3. **Capacity and capability.** A sustainable and resilient market with access to the right expertise and with sufficient capacity to serve all eligible bodies.
4. **External scrutiny** to independently identify issues, challenge and drive improvement
5. **Professionalism.** Building a sector attractive to auditors to build careers and become future audit leaders.
6. **Proportionality.** Local audit that is proportionate and relevant, from regulations to governance.
7. **Stronger accountability.** Scrutiny and reporting of issues and high standards of financial reporting to promote public accountability.
8. **Timely.** High quality accounts audited and published on time to ensure relevance and increase value to the public, including timely reporting of issues.

21. Local audit is a critical element of the accountability system that supports good decision-making in all local bodies, strong value for money, and local democracy. At their best, auditors can be a trusted source of insight and assurance. They will earn that trust by consistently demonstrating independence, objectivity, rigorous impartiality, sound judgement and professional expertise in the public interest.
22. The government has defined the primary purpose of local audit, building on recommendations from the HCLG Committee (November 2023), sector publications and stakeholder engagement. Fulfilling these priorities will mean that local audit can effectively:
- a. Confirm that financial statements are true and fair;
 - b. Examine and comment on the body's arrangements for securing value for money and report on any significant deficiencies in those arrangements;
 - c. Examine and comment on the financial resilience of the body;
 - d. Provide early warning of major governance and financial risks, including the risk of material fraud and financial failure, and make appropriate recommendations for managing such risks;
 - e. Report on major failures in governance and value for money through a separate public interest report and make recommendations for improvement where appropriate;
 - f. Assist those charged with governance to fulfil their responsibilities for stewardship of public funds;
 - g. Support transparency by communicating effectively with the main users of the accounts.
23. Local bodies, auditors and the LAO will cooperate to achieve these purposes and collaboratively build confidence that public money is well managed.
24. Effective action against fraud and corruption is a cross-government priority and is an important aspect of making the sector fit, legal and decent. The primary responsibility for preventing and detecting fraud lies with management. Both internal and external auditors have a valuable role in assessing a council's controls and fraud risks and rebuilding local audit will support action against fraud and corruption. International Standards on Auditing (ISAs) have been strengthened recently with additional requirements on auditors, designed to improve the prospects of detecting material misstatements of accounts arising from fraud. However, officers, who oversee day-to-day operations, are in the first instance best placed to detect fraud and corruption.
25. As in the corporate world, audit must independently verify the accuracy of financial reporting to assure stakeholders who are ultimately the public, for both authorities and the NHS.

26. Local audit also has a responsibility to assess arrangements to secure value for money (VFM), which is greatly valued by local bodies and stakeholders. The NAO introduced a requirement for auditors to comment on VFM arrangements in their annual report, rather than provide only a binary opinion, in their 2020 Code of Practice. This commentary must address as a minimum: financial sustainability, governance and improving VFM (economy, efficiency and effectiveness).
27. From 2024/25 onwards, auditors of local bodies will be required to issue their annual report with a VFM commentary each year by 30 November. For the NHS, the requirement is to issue no longer than one month after the audit deadline. Auditors are required to confirm that arrangements are in place, and do not need to assess whether VFM was achieved.
28. The government agrees with the Redmond Review's recommendation for a post-implementation review to assess whether changes to the 2020 and 2024 Code of Practice, concerning the requirement to consider VFM arrangements, have improved this core function. For local bodies, the government commits to MHCLG or the LAO holding this review by the end of 2027, to give time for the backlog to clear and for authorities to receive at least three VFM commentaries.
29. This review will also consider if auditors should assess whether local bodies achieve VFM, rather than purely assessing their arrangements to secure it. This review would need to be cognisant that responsibility for VFM in local authorities sits with elected members. The review would also need to consider the need to maintain auditors' independence and whether there is a risk of being drawn into challenging political decisions. There would also need to be consideration of the capacity and capability of the system to respond to an extension of auditors' responsibilities.

Commitments

The government commits to:

- a local audit vision with eight core principles.
- undertake a post-implementation review to assess whether changes to value for money requirements in the 2020 and 2024 Code of Practice have led to more effective consideration of financial resilience and VFM, and to conduct this review by the end of 2027. This review will consider whether auditors should assess VFM achievement.

Local Audit Office remit

2: Local Audit Office remit

The government accepts the Redmond and Kingman Reviews' recommendations for a new oversight organisation to simplify the system and drive change.

Remit

30. The dispersal of oversight of local audit is a fundamental failure of the current system, particularly for local authorities. A statutory and independent Local Audit Office (LAO) is necessary to streamline and simplify the system. It will take on functions currently fragmented across the framework and bring together strategic oversight and technical expertise to identify and address challenges swiftly.
31. This is not a return to a bloated Audit Commission. Lessons will be learnt, and the LAO will be proportionate and operate within its strategic objectives and the principles of this strategy.
32. The LAO will have five strategic responsibilities:
 1. **Coordinating the system**
 - i. Coordinate and lead the local audit system
 - ii. Champion auditors' statutory reporting powers
 2. **Contract manage**, set fees, procure, commission and appoint auditors to all eligible bodies (excluding the NHS at this stage).
 3. **Code of Practice**
 - i. set the [Code of Audit Practice](#)
 - ii. issue statutory guidance to auditors
 4. **Oversight**
 - i. a quality regulatory framework (inspection, enforcement and supervision)
 - ii. professional bodies
 5. **Reporting, insights and guidance**
 - i. collation of reports made by auditors
 - ii. national insights of local audit issues
33. The LAO's remit will impact system partners. The FRC's current responsibility in relation to audit quality and inspection, enforcement, and some elements of supervision for the audit of English local bodies as well as system leadership will end. The LAO will take on responsibility for the NAO's Code of Audit Practice, and the FRC will continue to oversee International Standards on Auditing (ISAs).

34. Once established, the LAO would adopt PSAA's full responsibilities to procure, appoint and contract manage, further streamlining the local audit system, excluding NHS bodies. For the NHS, further consideration needs to be given pending the final results of the FRC's market study.
35. In the short term, the government will work with all stakeholders to develop a transition plan which will clearly set out roles and responsibilities. In the longer term, clear governance and escalation routes will ensure that concerns raised about any aspect of the local audit process will be considered by a single authority. Suitable ethical walls will be established to mitigate conflicts of interest.

1. Coordinating the system

36. The LAO will coordinate and lead the sector, harnessing the opportunity of having related functions within a single organisation. It will work closely with local bodies, system partners, the market and government, and maintain focus on the purpose of local accounts and local audits to serve the users.
37. In the current system, concerns can be raised with PSAA, the FRC or ICAEW, depending on their nature. Bringing quality oversight, standards and procurement functions together in the new office will streamline accountability and increase transparency.

Champion auditors' statutory reporting powers

Parts of this section apply to **NHS bodies** and to **smaller bodies**

38. Auditors have statutory powers to publicly highlight issues of concern where either remedial action cannot wait for the publication of accounts, or the concern exceeds the scope of an audit. This early warning system can take the form of statutory recommendations, Advisory Notices or Public Interest Reports, which can identify issues such as emerging threats to financial sustainability. These reports are valuable to the public and have been integral to local decision making and informing government intervention.
39. There is an opportunity to enhance this early warning system. The consistency or effectiveness of the use of these statutory powers is not currently monitored. The LAO will:
- a. review the remit and use of powers with a view to strengthening early warning across the sector to ensure stakeholders including the public, authorities and government, are informed and able to take remedial action – and reflect any changes in the Code of Audit Practice.
 - b. become a new, stronger point of escalation for auditors with concerns.
 - c. ensure concerns are shared with inspectorates and government departments where relevant.
 - d. monitor the use of these powers to assess effectiveness and provide clear guidance for auditors' responsibilities.

- e. champion the use of these powers, supporting and empowering auditors who wish to raise concerns in the public interest.

40. Decisions to intervene under the Local Government Act 1999 (Best Value framework) would remain with MHCLG.

2. Contract manage

- 41. Centralising procurement in an overarching body for local audit, with appropriate and strong contract management levers, would ensure a robust process for independent appointment, and give certainty and sustainability to the market. Therefore PSAA's responsibilities for contracting and appointing auditors and setting fees for local authorities would be transferred to the LAO.
- 42. At present, local authorities opt-in to PSAA's services. 99% of eligible bodies have opted into 2023/24-2027/28 procurement, demonstrating the benefit of a centralised service and the lack of benefit that the opt-in power grants authorities. The option to opt-in will end as it adds unnecessary complexity.
- 43. Independence is key to the success of appointing auditors. Audit firms need to be confident that they are free to report without fear or favour. Contract continuity is also integral to sector stability. MHCLG will work with the PSAA and audit firms to minimise disruption during transition.
- 44. MHCLG is aware that all of PSAA's contracts for 2023/24 – 2027/28 include an option for extension for up to 2 years, subject to audit firms' agreement. PSAA is considering whether to offer that option to the firms and will work with MHCLG to seek the best contractual position and to minimise disruption.
- 45. There are two options to go further. NHS bodies in England appoint their own auditors and face difficulties in securing appointments. The LAO's remit could be expanded to include NHS bodies. This would be a major reform and increase in the scale of centralised procurement. Further consideration is needed, including through the FRC's NHS Audit Market Study in Spring 2025, and any proposals for change would be subject to consultation to explore implementation in the longer term.
- 46. In addition, smaller authorities like town and parish councils could become in scope. The focus of the LAO in the first instance will be on the sustainability of audit for principal authorities, as challenges faced by smaller bodies are not as extensive. The vast majority of limited assurance reviews are completed on time and no smaller bodies have opted out of SAAA's procurement system. The government is interested in views on whether SAAA's responsibilities for appointments should transfer to the LAO and if so, the timescale for this transition.

3. Code of Audit Practice

Set the Code of Audit Practice

This section applies to **NHS bodies** and **smaller bodies**.

47. Unlike shareholders, taxpayers cannot divest from their local bodies. As is set out in the Code of Audit Practice the *“audit of a public sector organisation is wider in scope than that of a private sector body. Special accountabilities attach to the use of public money and the conduct of public business. It is not part of the auditor’s responsibilities to question the merits of policy, but the auditor does have wider duties (depending upon the relevant legislation) to scrutinise and report not only upon the truth and fairness of the financial statements but also on aspects of stewardship of public funds. The auditor carries out this work on behalf of the public and in the public interest”*.
48. The Code sets out how auditors should take forward their statutory responsibilities in considering the audited body’s arrangements to secure VFM through the economic, efficient and effective use of its resources. It also sets out how auditors should consider whether, they should report on any issues in the public interest, or make written recommendations to the audited body which need to be considered by the body and responded to publicly.
49. Responsibility for setting the Code of Audit Practice will transfer from the Comptroller and Auditor General (C&AG) to the LAO, as will the power to issue statutory guidance. The LAO will also take on the C&AG’s statutory responsibility to promote best professional practice in local audit.
50. The C&AG has previously determined that the ISAs should form the regulatory underpinning for local audit, creating regulatory alignment with corporate audit. The LAO will have powers to examine both the Code and ISAs and review their interpretation and/or application to the local sector.

4. Oversight

Parts of this section do not apply to **smaller bodies**.

A quality regulatory framework

51. The LAO will have responsibility for implementing a robust quality regulatory framework for the local audit market and for ensuring the continuous improvement of those operating within it. The LAO will have specific expertise in delivering these functions which will be harnessed across all aspects of the local audit process. This will ensure a holistic approach which focusses on provider-led improvement, with direct quality oversight to be used proportionately and where other levers have failed.
52. The LAO will ensure that quality oversight will be guided by a clear and transparent set of principles. The new framework will recognise that timeliness is a key element of audit quality, and there should be appropriate incentives and consequences to ensure that draft accounts and audits are completed by the published deadline. Any such requirements should be applied fairly across both accounts preparation and audit.
53. The LAO would have responsibility to design and oversee an audit inspection regime. It will have the power to continue the existing practice of delegating responsibility for conducting inspections (currently FRC for Major Local Audits (MLAs) and ICAEW for non-MLAs) if it determines that this would be the optimum way to ensure a robust and independent process. Final regulatory judgements will be made by the LAO.
54. Inspections would assess compliance with relevant standards (as set out in the Code of Audit Practice). The LAO would report on these inspections at regular intervals, when considered to be in the public interest.
55. Local audit-specific elements of supervision would be conducted by the LAO, such as acting as a point of contact for firms in the local audit system, promoting good practice and supporting firms to address any quality concerns.
56. The responsibility to determine the importance of any breaches found by inspections and any subsequent supervisory or enforcement action will rest solely with the LAO. Enforcement action would continue to be a last resort, mitigating any adverse impact on incentives or timeliness.
57. To provide clarity that there is a single regulator with responsibility for local audit, the government will consider whether the LAO could oversee a scheme for enforcement cases related to local body accounts and audits. The LAO and FRC will need to work closely together to ensure that schemes are administered consistently across local audit, statutory audit, and accountancy enforcement and that sanctions are applied fairly to each.
58. The government notes the Kingman review's argument that the existing mechanism for auditors to apply to the courts for a declaration that an item in

an audited body's accounts is unlawful and an order to change the accounts is cumbersome and out of step with regulatory powers in other countries. It will be a priority for the government that the LAO supports auditors to raise concerns where appropriate, and that processes in the system are simplified including whether there is a case for the LAO to hold the power to require local bodies to make changes to their accounts.

59. The government's plans for the creation of the LAO and implementation of new quality processes will build in appropriate time for the market to adjust to changes.

60. The government is not currently proposing to change quality monitoring for smaller bodies.

Professional bodies

61. The LAO would take responsibility for oversight of professional bodies (ICAEW, CIPFA) with regard to their remit on the eligibility, registration and conduct of local auditors.

62. This duty would include the power to recognise additional Recognised Supervisory Bodies for local audit and to issue statutory guidance to set the required level of competence and experience for key audit partners.

63. As set out further below, ahead of establishing the LAO, MHCLG will review eligibility criteria for Key Audit Partners (KAP) before this responsibility is transferred, to ensure that there are no unintended barriers for partners wanting to join the profession, and that the sector has access to the widest possible pool of suitably qualified auditors.

64. Currently ICAEW, as the only existing Recognised Supervisory Body, has delegated responsibility from the FRC for the register of firms able to conduct local audits. The government welcomes views on whether the LAO should take on this register or whether it should remain with the RSB(s). The FRC would continue to register Public Interest Entities' auditors, including where these are local bodies.

5. Reporting

65. Audited accounts provide a wealth of verified financial insight, and their value will increase as timeliness issues are overcome. The LAO will have powers to gather and publish accounts and audit reports. It will publish timely and independent reports on local audit health, including timeliness, emerging trends or issues, audit quality and market sustainability. The LAO would also place a duty on auditors to provide the necessary data to allow it to fulfil this role.
66. National reporting could include auditors' commentaries on VFM arrangements to further increase transparency and insight. As a key point of contact for local authorities' auditors to escalate concerns, the LAO could also report on statutory recommendations, Advisory Notices and Public Interest Reports at a national level.
67. Models of reporting could include a single comprehensive annual report or a reporting cycle of single-issue bulletins at relevant junctures through the annual audit cycle.

Commitments

The government commits to a LAO which would:

- be statutory and independent, with a remit to streamline and simplify the system.
- assume the functions of appointing and contracting auditors for local authorities. This would remove the power for authorities to appoint their own auditor.
- adopt ownership of the Code of Audit Practice from the NAO and deliver relevant training. It would have powers to interpret ISA requirements for the local audit context (though the FRC would continue to maintain ownership of ISAs for the UK as a whole).
- hold responsibility for quality oversight of local audit, including overseeing an inspection programme, enforcement and some elements of supervision
- publish national insight reports on local audit health, which could include emerging trends, quality, market sustainability, VFM arrangements and statutory recommendations and PIRs.
- oversee professional bodies with regard to their remit for the qualification, registration and conduct of local auditors.

Consultation

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

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

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?

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

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

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?

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

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?

Financial reporting and accounts

3: Financial reporting and accounts

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

This section does not apply to **NHS bodies** and applies in part to **smaller bodies**

68. Local accounts are statutory documents that must be published annually, as set out in the Local Audit and Accountability Act 2014, the Accounts and Audit Regulations 2015.
69. High quality financial reporting enhances decision-making, increases accountability to the public and builds trust in services. It is right to expect a high standard for our local services.
70. Accounts serve multiple purposes. Local authority accounts are a set of financial statements, a budget execution report, a grant return, a consolidation return and a means of assurance on VFM. Local accounts should empower users to hold authorities to account and should accurately:
 - a. indicate revenue, expenditure and financial position
 - b. indicate ability to manage funds
 - c. adhere to recognised accounting requirements
 - d. assure multiple and wide-ranging stakeholders, including local decision making and democracy.
71. The purposes of local accounts are therefore broadly the same as corporate accounts. However, local accounts differ from the corporate world in five main ways:
 - a. Local authorities provide extensive services across multiple sectors
 - b. Income sources are diverse, including taxes and grants, and subject to statutory or other restrictions
 - c. The separate accounting of revenue and capital
 - d. Specific requirements such as reserves, or disclosures not part of normal IFRS accounting
 - e. Two different frameworks to recognise revenue, under the Code of Practice (predicated on IFRS) and for revenue accounts, which must meet the statutory obligation to balance a budget annually. Statutory adjustments are required to reconcile these two requirements, which in turn require disclosures.

72. These factors result in longer and more complex accounts, which can have an adverse and wide-ranging impact on the:
- f. Timeliness of accounts, which also impacts the Whole of Government Accounts (WGA)
 - g. Comprehension of accounts, limiting the ability of the public and councillors to hold authorities to account
 - h. Capability required of the local finance and audit professions
73. There is a clear need to ensure that accounts contain the correct level of information and disclosures to benefit the users and to achieve the purpose of accounts. The government will work closely with the NAO in relation to trying to ensure accounts are appropriate both for the local sector and requirements such as the WGA.
74. The audit framework needs to recognise the different risks and audiences of corporate and local accounts. The purpose of local accounts and audit should serve users, and a well-defined users base is essential to allow local bodies, auditors and the LAO to ensure the effective delivery of audits. The users of accounts are wide-ranging and can be divided into primary and secondary groups.
75. Auditors must have a clear articulation of the purpose of the accounts they are auditing in determining materiality. A well-defined user base is essential in establishing appropriate thresholds and capturing what would be deemed material to meet the needs of users. Setting overall audit materiality affects the scope of testing and directly impacts the volume of work required. Further work to provide this clarity in relation to users will be undertaken ahead of the establishment of the LAO.

Review of the purposes and users of local accounts

76. The government acknowledges the range of views on the purposes and users of accounts and is grateful for LUHC Committee's recommendations concerning local authority financial reporting. Local accounts must be fit for purpose, proportionate and relevant to account users. 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. This review will consider the definition of the purpose and user of local accounts, any impacts definitions may have on accounts and audit, as well as any unintended consequences.

Pension fund accounts

77. The government will consider the LUHC Committee's November 2023 recommendation that decoupling the pension fund accounts from the main accounts and publishing them separately and subject to a separate audit certificate would have numerous benefits for both local government and the NHS. It would reduce the risk of local audit delays impacting the timely production of pension fund annual reports. It would ensure local authority

accounts are shorter, less technical, and more focussed. It would allow for more specialised auditors to assess the pension fund accounts, although the government expects that in most cases the preparation and audit of these accounts would be carried out as part of contracts covering the main authority accounts and audit, as now. It would also mirror the approach successfully adopted by the Local Government Pension Scheme in Scotland and Wales.

Infrastructure Assets

78. Until 2022, the accounting of local authority infrastructure assets had not been an issue of significance. Increased scrutiny of the audits of these bodies in recent years, particularly in relation to the accounting for property, plant and equipment, resulted in increased requirements for local authorities to provide auditors with evidence in respect of infrastructure assets. Many authorities were unable to provide sufficient evidence of the cost and current value of these assets and this situation contributed to delays in the completion of local audits. Many question the proportionality in costly valuations and related work of local authority finance teams in assessing assets and responding to auditor queries on these assets when they will never be sold. In 2022 a short-term exemption to normal accounting treatment for these assets was created, with the expectation that a longer-term solution would be established before the legislation expires on 31 March 2025.

79. A longer-term solution has not been developed and if the current legislation were to elapse it would require infrastructure assets to be measured in accordance with normal accounting treatment within the 2025/26 accounts. To avoid any disruption of the planned audit backstop programme and reduce burden on preparers, the government intends to extend – via secondary legislation - the current exemption, reducing the audit workload in the medium term. The government is committed to identifying a longer-term solution as part of the review of local accounts.

Code of Practice on Local Authority Accounting in the UK

80. There is also an opportunity to consider how best to ensure reform to the Code of Practice on Local Authority Accounting in the UK. All system partners agreed in 2023 that proportionate financial reporting, audit and regulatory requirements must be applied and that Accounting Code changes were therefore needed in the medium and long term, while ensuring that high quality financial reporting and the utility of financial statements to account users is maintained. The government is therefore keen to seek views on what could be done to ensure progress is made prior to the establishment of the LAO. The government is interested to understand whether there are governance or structural barriers to reform.

81. The process for approving amendments across multiple organisations increases rigour but delays reactive and prompt changes to the Code. It may therefore be worth considering whether accounting and audit functions should

be brought together with responsibility for the [Code of Practice on Local Authority Accounting in the UK](#) moving from CIPFA and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) to the LAO. Any such move would consider the potential conflict of interest in a body with responsibility for both accounting and audit.

82. The Code of Practice applies to all local authorities in the United Kingdom. MHCLG commits to working with the devolved governments to determine the appropriate governance structures and responsibilities as part of ensuring that that accounting practices are consistent across the UK.
83. The government recognises that to improve the transparency of financial reporting and ease of auditing, all related bodies must be using the same reference material. The Accounting Code provides the most comprehensive and relevant information for local authorities and auditors to ensure correct practice has been applied. Using the latest version of the Accounting Code to develop accounts will allow for greater standardisation and compliance. The government is therefore considering open access to all those who need to understand the latest version of the Accounting Code.
84. The Redmond Review called for 'Standardised Statements of Service Information and Cost'. The government understands standardised statements could bring benefits to reporting production and comparability. There are however challenges with standardising accounts due to the variation in local bodies, unique financial line items, and local circumstances. These issues will be considered as part of the wider reforms to accounts. Such considerations will also extend to the possibility of introducing standard statements for larger bodies within the limited assurance regime.

Commitments

The government commits to:

- review, in consultation with relevant stakeholders, the content and format of local authority accounts. This will include ensuring that the accounting code does not require more disclosures than are necessary and consider the purposes and users of local authority accounts.
- work with devolved governments to determine the appropriate approach to ensure accounting practices are consistent across the UK including if the Accounting Code is transferred to the LAO.
- consider whether to develop primary legislation to separate pension fund accounts from administering authority main accounts.
- ensure that if the Accounting Code is transferred to the LAO, it would be freely available to users of local body accounts.
- consider the introduction of Standardised Statements in the longer term.

Consultation

Q9: What are the barriers to progressing accounts reform?

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

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

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

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?

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

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

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

Capacity and capability

4: 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.

This section does not apply to **smaller bodies**.

85. The government's swift action to clear the local audit backlog enables auditors to resume work on up-to-date accounts and VFM reporting, where assurance is most valuable. This will remove the disincentive for professionals entering a system paralysed by delays. The local audit market should also benefit from measures the FRC is taking to improve overall audit supply by developing mutual recognition agreements with other jurisdictions, for example.
86. At present, there is barely sufficient capacity in the market. Ahead of the creation of the LAO, MHCLG will consider what further measures can be taken to increase supply. This will build on the work undertaken by the FRC for the local audit workforce strategy based on greater alignment between corporate and local audit, to enable more flexible career progression for individuals.
87. The government agrees that in some areas greater alignment would be beneficial – for example between professional accountancy qualifications. The distinctive public service element of local audit remains a key attraction for many professionals and this will be directly supported by the LAO, which will adopt the training on the local auditor's additional 'quasi legal' duties currently provided by the NAO.
88. The LAO will work alongside the FRC to support the wider audit profession and it will be equipped with a range of levers – including market oversight, contract management and auditor training – to promote a healthy local audit market.

Key Audit Partners

89. The eligibility requirements for signing audit opinions are statutory and unique to the sector. Key Audit Partners (KAPs) must sign off opinions and a firm must have two registered KAPs to compete in the market. This requirement and the low numbers of KAPs, only around 100, to support current contracts, is a barrier to both market entry and capacity. A new pathway towards the registration of KAPs was opened in 2023 through the knowledge-based Diploma in Local Audit developed by CIPFA. This was endorsed by the FRC as 'pre-approved specialist training' in November 2024.

90. This pathway accelerates senior auditors or Responsible Individuals (RIs) moving into the local audit profession and enables them to train new auditors.
91. Ahead of establishing the LAO, MHCLG will review eligibility criteria for Key Audit Partners (KAP) to ensure that there are no unintended barriers for partners wanting to join the profession, and that the sector has access to the widest possible pool of qualified auditors. There is also a case for considering whether some categories of local audit could be signed off by suitably experienced RIs and this will also be considered.

Account preparers

92. The role of finance teams' account preparers in ensuring high quality financial reporting is key. MHCLG funds the Local Government Association (LGA) to deliver a programme of improvement support which, through working with partners such as the Chartered Institute of Public Finance and Accountancy (CIPFA), offers support to finance teams, audit committees and elected representatives. This programme develops and bolsters local authorities' financial reporting and governance. MHCLG will work with these partners to explore how any future programmes can build on this work to support delivery of reforms to the local audit system.
93. As part of its response to the Redmond Review, the previous government committed to provide £15m per year to local authorities to cover additional audit costs, to a total of £60m. The previous government's commitment to fund the final £15m (for FY 2024/25) will be honoured. MHCLG will consider new burdens associated with this vision and related legislation.
94. In the NHS, DHSC and NHS England support finance teams with timely guidance and training resources to support them to undertake their roles.

Growing capacity through public provision

95. Capacity is barely sufficient to respond to the needs of the local audit system and a small number of local authorities do not have an auditor. It is therefore important to consider whether there are ways to build some public provision to supplement capacity and strengthen the sector. The government is seeking views on whether and how to grow public provision. This would be achieved by working with firms and other system partners to ensure that additional provision achieves overall growth in public sector auditors without reducing private sector capacity.
96. Given that capacity is so constrained that a small number of bodies currently do not have an auditor, work to build public provision would need to be urgently considered ahead of the establishment of the LAO. Consideration would also be given as to whether the LAO should have the power to provide some level of public provision or if the provision should sit separately. If the LAO delivers this function, appropriate ethical walls would need to be in place. In addition, it is proposed that the Secretary of State would, 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.

Commitments

The government commits to:

- review KAP eligibility criteria to remove barriers to entry.
- work with the LGA on targeted support for local authority finance teams, audit committees and elected members to strengthen financial governance.
- provide £15m funding to local authorities for 2024/25 to honour the final year of the previous government's commitment to £45m funding in the current spending review.
- consider new burdens associated with this vision and related legislation.

Consultation

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

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)?

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

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

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

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?

Underpinning the system: relationships and audit regimes

5: 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.

The section on relationships and committees does not apply to **NHS bodies** or to **smaller bodies**

97. In its oversight of the local audit market the LAO will have clear expertise in understanding the issues auditors are raising, and their relevance to sustainability issues in the sector. As such it will also have a liaising role to ensure that there are strong links between central government in its stewardship capacity, the NAO, inspectorates of relevant bodies, and local auditors so that issues in the sector are understood and actioned effectively.
98. The government expects that this activity could a) enable auditors to understand how the government is assessing financial sustainability and risk and reflect this in their approach to their work, b) ensure that information is shared where appropriate to enable Departments to spot potential issues early and establish appropriate support before they escalate, and c) involve regular briefings for Departments which summarise auditors' overall understandings of trends and concerns relating to the bodies they work with.
99. This will aid a transparent and supportive approach from government when it responds to concerns that have been raised about particular bodies, including clearly setting out its intended response (e.g. extra monitoring, check in meetings with the body involved).
100. The Redmond Review recommended that key concerns relating to service and financial viability be shared between local auditors and inspectorates including the Office for Standards in Education, Children's Services and Skills (Ofsted), the Care Quality Commission (CQC), and His Majesty's Inspectorate of Constabulary and Fire & Rescue Services (HMICFRS), prior to completion of the external auditors' annual report to increase the overall pool of auditors. The government expects the proposed new body to engage with these and similar organisations at a strategic level to discuss financial and service viability issues.
101. Another of the key recommendations of the Redmond review was formalising the facility for key personnel such as the Head of Paid Service or Chief Executive (CEO), Monitoring Officer (MO) and the Chief Financial

Officer (CFO) to meet with the Key Audit Partner at least annually. A strong relationship between these key individuals, as well as with the Audit Committee chair is vital for a well-functioning audit system which enables auditors to identify problems across the year and bring these to the local bodies attention, and scrutinise – therefore aiding fuller accountability. It would act as a route for early warning signals to be identified and dealt with, including for new body to consider. Importantly it is a route for auditors to hold the CEO and CFO to account and vice versa. The LAO also provides a potential route for escalation and resolution of issues between parties.

102. New powers are not needed for this, and there is already good practice that is happening in a number of places. Our intention is to formalise and reinforce the expectations for this relationship and the need for it to be strengthened and maintained regularly. Our expectation is that the relevant Codes including the Code of Audit Practice, and requirements set by industry bodies such as CIPFA and Solace for CFOs and CEOs respectively should all make clear the importance of meetings between these key officers and their audit partners, and the need for these to take place on a twice-yearly basis at least. Regular engagement and firming up of this relationship would also build links in support of Sir Tony's recommendation that internal audit is recognised to be a key support in the delivery of external audit, where consistent with the Code of Audit Practice.
103. Many have reported to recent inquires that the previous system in which District Auditors operated engendered a culture in which a pragmatic relationship was developed between local bodies and their auditor, where the body and auditor worked together to jointly solve issues and problems, sometimes robustly, and from the viewpoint of respective professional responsibilities. Some reported that the time and space for auditors to engage in this depth of relationship does not exist in the current system.
104. District Auditors were part of a wider, extensive and geographically diverse public provision which no longer exists. It is therefore not considered feasible to recreate this role at this point. This document sets the government's intentions on the role of the auditor in the current system. The LAO will further strengthen this arrangement, with a responsibility and a role through its contract and market management to ensure constructive, productive relationships between body and auditor. This will include working with the body and auditor where relationships are challenging, but also encouraging and facilitating deeper relationships to be fostered, including to enable bodies to talk informally to auditors ahead of novel or potentially risky decisions that might be later examined by auditors. This would also play a part in improving the early warning of financial concerns and therefore preventing problems from occurring or worsening.

Audit committees and full council

105. The Redmond Review recommended that audit committees should be mandatory for all local bodies, with at least one independent member, and audits should be considered by full council (for local authorities).
106. The department acknowledges the progress made in this area. Most local bodies now have an audit committee. However, the government is minded to standardise scrutiny to increase public confidence and consistency with other bodies such as strategic authorities.
107. The government proposes to mandate audit committees, including the provision for one independent member, and for local authorities, audit reports to be considered by full council. The government would also like to understand views on whether the chair of the audit committee should be an independent member in order to rebuild confidence and value for money oversight.

Local Public Accounts Committees (PACs)

This section does not apply to **NHS bodies** or to **smaller bodies**

108. Alongside a reformed local audit system, the government is also considering new local public accounts committees for strategic authority areas in England. With greater powers and funding comes more responsibility, and there is a need to ensure that robust accountability is in place. This includes reporting and monitoring, strengthening public spend oversight and improving transparency of spending decisions.
109. These forums could be set up to improve external scrutiny of value for money on local public spending, drawing on audit findings and interacting with the new body.

Audit regimes for different types and sizes of local body

Major Local Audits

This section does not apply to **smaller bodies**

110. Major Local Audits (MLA) are defined as local public bodies with total income or expenditure of at least £500m, or local government pension funds with gross assets of over £1 billion or more than 20,000 members. The current MLA thresholds, set in the Local Audit (Professional Qualifications and Major Local Audit) Regulations 2014, have not been updated since their inception. There are currently 25 local authorities and circa 150 NHS bodies in scope of becoming MLAs in FY 2024/25.
111. Whilst MLA status does not require additional financial reporting or audit procedures, MLAs are subject to regulatory oversight (audit quality reviews and, potentially, enforcement action) from the FRC to reflect their complexity and higher risk. ICAEW's Quality Assurance Department (QAD) is responsible for reviewing local audits conducted under the Local Audit and Accountability Act that are not major local audits. Recent experience has suggested that audit firms consider the FRC regime to be more demanding and to carry a higher reputational risk, and have typically undertaken additional audit testing and quality control procedures to mitigate this risk, resulting in higher fees. The perceived additional regulatory risk of MLAs has been considered as a barrier to entry, deterring new entrants to the market and causing others to refuse to take on MLAs when they do enter the market. This has made it more difficult for PSAA to allocate audits for local authorities efficiently. It is worth noting that NHS bodies, pension funds and police and crime commissioners are particularly susceptible to the current MLA threshold, due to the scale of their expenditure or assets, although they do not all necessarily present high audit risks.
112. As the system is reformed, there is an immediate need to provide support for both local bodies which may shortly become MLAs and for auditors who are constrained in their capacity.

Smaller authorities

This section does not apply to **NHS bodies**

113. A smaller authority is defined in the 2014 Local Audit and Accountability Act as an authority in which both gross annual income and gross expenditure is below a statutory threshold of £6.5m over a three-year period. Smaller authorities prepare a short Annual Governance and Accountability Return (AGAR) instead of accounts, and the AGAR is subject to a limited assurance review rather than a full audit. Authorities below the lower threshold with a gross income or expenditure below £25,000 per

annum, can declare exemption from a limited assurance review. Neither threshold has been reviewed since its inception in 2015.

114. Smaller bodies are unlikely to have the equivalent range of service delivery, asset base or liabilities of even the smallest of District Councils and yet are at risk of becoming subject to full financial audits at far greater cost – and therefore drawing on the limited capacity in the audit market for principal authorities. For example, internal drainage boards may receive grant funding that takes them over the upper threshold for a period of time, before returning to normal levels below the threshold. The largest of the smaller authorities pay £3,780 in audit fees in comparison to the ‘smallest’ body subject to category 1 audit which pays an audit fee of £40,000 (a 958% increase). In some cases, authorities and bodies which have exceeded the £6.5m threshold have failed to secure auditors and have therefore contributed to the audit backlog. In addition, nearly 600 previously exempt smaller bodies have become subject to limited assurance between 2018-19 and 2022-23, meaning that the exemption rate has fallen from 56% to 50% of smaller authorities.

Definitions and criteria for types of audit

115. The government is clear that the correct level of assurance for a local body – whether an MLA, non-MLA or smaller authority - must be based on the relative risk for the type of body as well as the level of income and expenditure within the body – and that there must be proportionality of accountability and oversight.
116. The government is committed to removing, where possible, potential cliff edges in the local audit system – for MLAs, non-MLAs and smaller authorities. This includes considering whether to move away from a solely threshold-based system towards one linked to the type of body, with reporting and audit requirements scaled to the nature, size and risk of the bodies concerned.
117. For MLAs, the government will consider amending primary legislation to ensure definitions are proportionate to risk. This would enable some local bodies or authorities to be declared exempt from the regulatory focus of an MLA and will specifically consider whether Integrated Care Boards (ICBs) should be exempt.
118. The government will consider the definition set in primary legislation of smaller authorities, including whether certain types of authority, including parish councils and internal drainage boards, should be classified as smaller authorities regardless of income or expenditure. The government will also consider how any additional risk could be mitigated by a more graduated application of thresholds providing for an increase in reporting and/or audit requirements as thresholds are exceeded, whilst preserving smaller authority status. This could include a requirement for standardised accounts for the largest of smaller bodies, providing more information than is currently included in the AGAR.

119. For MLAs, non-MLAs and smaller authorities this work will consider the potential for bespoke audit regimes for different types of body. Any changes would serve to improve upon the accountability and oversight gleaned by audits and by the limited assurance regime whilst also serving to protect smaller authorities from the risk of becoming a principal authority and the disproportionate cost and administrative burden which that entails.
120. Aligned with this work, and as recommended by the Redmond Review, there will be a review of the information provided in the AGAR, considering whether sufficient and useful information is presented to members and taxpayers in an accessible and efficient way.
121. There will also be a review of other aspects of the audit regime for smaller bodies, both to streamline them where possible and to strengthen them where appropriate to maintain an adequate level of assurance for taxpayers. This will include consideration of whether to simplify the exemptions regime for parish meetings, to require electronic submission of AGARs. It will also consider whether to require internal audit reports to be considered by the full council or board of a smaller body. There will also be consideration of the effective operation of the legal right of local electors to inspect and object to accounts and the coverage of the Transparency Code.

Urgent action to amend thresholds and exemptions

122. In the immediate term, the government is considering the need for secondary legislation to amend thresholds for both MLAs and smaller authorities.
123. For Major Local Audits, the government proposes to increase the threshold and make ICBs exempt altogether. This would provide temporary relief for bodies who are approaching or have recently breached the £500m threshold and potentially make it easier to clear the audit backlog.
124. For smaller authorities, the government is considering uplifting the smaller authority upper threshold, so that temporary financial relief can be offered to smaller authorities which are likely to exceed the current threshold and add to the audit backlog.
125. In parallel with such legislation the lower audit threshold of £25,000 could be uplifted broadly in line with inflation, allowing the smallest of authorities to remain exempt from external audit. The government commits to periodically reviewing audit thresholds that remain in the system to ensure that the regime remains proportionate to risk.

Commitments

The government commits to:

- require twice-yearly meetings between Key Audit Partners (KAPs) and authorities' statutory officers (Head of Paid Service, Monitoring Officer and Section 151 Officer).
- mandate audit committees with at least one independent member and consideration at full council, where this requirement does not yet apply in the sector.
- consider new local accounts committees for strategic authority areas in England, which would interact with auditors and the new LAO.
- consider moving from an exclusively threshold-based system towards one also linked to the type of body, with reporting and audit requirements scaled to the nature, size and risk of the bodies concerned.
- review the accessibility of AGAR's format and information.

Consultation Questions

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

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?

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

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

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

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?

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

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

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

Local audit backlog

6: 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.

This section does not apply to **NHS bodies** or to **smaller bodies**

126. In September 2023 nearly 1,000 local body accounts had not been audited, stretching back to 2015/16. For 2022/23, just one percent of local bodies published audited accounts on time. This significant and unacceptable backlog of outstanding unaudited accounts has blighted financial assurance of local bodies in England and denied local residents a key check on how their taxpayers' money is used and whether value for money arrangements are adequate. It also means that those making decisions on the future use of funds on behalf of those residents, whether local officials or elected representatives, do not have this vital information. It is a clear demonstration of a malfunctioning system.
127. Together with key audit system partners the government has taken decisive action to tackle the backlog. It legislated to set a statutory backstop of 13 December 2024 to clear the backlog of unaudited accounts up to and including financial year 2022/23. The legislation also set further backstop dates for financial years 2023/24 to 2027/28 to enable the system to recover. These measures will enable auditors to focus on up-to-date accounts, where assurance is most valuable.
128. Due to the time constraints, auditors have issued hundreds of 'disclaimed' audit opinions at the first backstop for financial years up-to-and-including 2022/23, and these will likely continue for some bodies for years. There is a clear public interest in the system recovering as soon as feasible. It is the aspiration of the government and key local audit system partners that disclaimed audit opinions driven by backstop dates, should, in most cases, be limited to the next two years (up to and including the 2024/25 backstop date of 27 February 2026).
129. To support this aspiration, a proportionate approach to the rebuilding of assurance following disclaimed opinions is required by auditors - and all system partners including the FRC, NAO and auditors, are aware that this is the government's objective. The NAO has published implementation guidance for the reset and recovery period, endorsed by the FRC, advising auditors on how to approach the task of delivering outstanding audits and subsequently rebuilding audit assurance where audit opinions have been disclaimed and qualified.

130. The government also recognises that further cross system work is needed to support the recovery process. The government will work with system partners to ensure that additional guidance, advice and practical support is available. As noted above, the government intends to extend the exemption from normal accounting for infrastructure asset values, which should reduce the audit workload in the medium term. The government is also willing to consider additional temporary measures to ensure that workload and cost is proportionate, subject to appropriate management of any risks to public funds.
131. As the Written Ministerial Statement of 30 July highlighted, Ministers and system partners recognise that aspects of the proposals are uncomfortable. Local bodies should not be unfairly judged based on disclaimed or modified opinions caused by the introduction of backstop dates that are largely beyond their control. To support this, auditors should clearly communicate the reasons for issuing such opinions. Additionally, even where these opinions are issued, auditors' other statutory duties – including to report on VFM arrangements, to make statutory recommendations and issue Public Interest Reports – remain a high priority.
132. For the duration of the backstop programme, bodies that are non-exempt but have failed to comply with a backstop date will be required to publish an explanation; to send a copy of this to the Secretary of State (to facilitate scrutiny) and publish audited accounts as soon as practicable. The government also intends to publish a list of bodies and auditors that do not meet the backstop dates, which will make clear where draft (unaudited) accounts have also not been published.

Commitments

The government commits to:

- work with system partners to produce additional guidance, advice and support.
- amend secondary legislation to extend existing exemptions to include infrastructure asset values, to reduce the audit workload in the medium term.
- consider any further, temporary exemptions to ensure workload and cost is proportionate.

Consultation Questions

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?

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?

Annex A: Timeline

The table below sets out a provisional timeline for the transition to the new local audit system. This may change, including due to the outcome of this consultation. In addition, MHCLG is aware that all contracts for 2023/24 – 2027/28 include an option for extension for up to 2 years, subject to audit firms' agreement. PSAA is considering whether to offer that option to the firms. Appointments to smaller bodies operate under different contracting periods.

Milestone	Indicative timeframe
Engagement, technical workshops and consultation	January - February 2025
Engagement continuing on elements of secondary legislation	Spring 2025
Introduction of primary legislation, subject to Parliamentary timetable	Mid-2025
Laying of relevant secondary legislation, subject to Parliamentary timetable	Mid-2026
LAO legally established, public delivery built up (either within LAO or separately as consulted upon) with the ability to take on vacant contracts where appropriate	Autumn 2026
Procurement exercise for next appointing period (further clarity on the quality oversight framework, including enforcement, would be provided by this point)	From early 2027
LAO fully resourced and begins contract management with other elements of its oversight, as set out in the transition plan to give the market clarity and time to adjust.	By 2028