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## Chapter 6 - Local Government Auditing in England

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### **Abstract**

English local government audit has gone through fundamental change in the last decade and this period of instability looks certain to continue. Since 2014, councils have been audited by private sector auditors appointed theoretically by the councils themselves (though an overwhelming majority of councils have delegated this responsibility). The scope of audit after 2014 reduced to focus mainly on top-down financial management, rather than value for money or inspection. After growing concerns about the scope and quality of audit however, in 2020, the Government commissioned Sir Tony Redmond to review local audit arrangements in England. The Redmond review identified several problems with the reformed structure and made recommendations for change. Currently, the sector is uncertain about what changes will be adopted to solve the issues discovered by Redmond.

Keywords: Public sector auditing; local government; England

### 6.1. Introduction

The UK has traditionally been described as a deeply centralised country, with authority and power clustering within Westminster. The last thirty years have seen changes to this model: with the creation of national Parliaments, Assemblies and Governments in Scotland, Wales and Northern Ireland. These new devolved bodies sit over and above their own local government. This article deals predominately with the local government structures within England, which does not have a nationally devolved Parliament, Assembly or Government. England has a local authority structure which is divided into different types of authority. In some parts of England, there are two levels of local government: county councils and district, borough or city councils sitting underneath them. In some parts of the country, there is a unitary tier of local government which supplies all local services: these include unitary authorities in shire areas, London boroughs and metropolitan boroughs. Councillors are elected every four years: in some councils, the full council is elected every four years, in others half the council is elected every 2 years and in a third set, a third of councillors are elected every year for three years with no election in the third year.

English councils have different functions depending on their status. The fifty eight unitary authorities and thirty two London boroughs (plus the City of London) provide all the local services in their areas - although in the case of London, the Greater London Authority provides London-wide government and has special responsibility for police, fire, strategic planning and transport. The thirty-six metropolitan authorities - which cover six large urban areas, the counties of Greater Manchester, Merseyside, South Yorkshire, Tyne and Wear, West Midlands and West Yorkshire - are responsible for all services in their areas, and although some conurbation wide services such as fire and civil defence, police, and passenger transport are provided through joint authorities. In two tier areas, the twenty four county councils and the Isles of Scilly council provide education, social services and waste disposal whereas the 181 district councils provide rubbish collection, housing and planning. The City of London and Isles

of Scilly have their own constitutional arrangements and are described as sui generis local authorities. Together there are 333 councils of different levels within England. These are supplemented in some areas by parish councils which function as a third tier below district, borough and in some cases unitary authorities and are involved with local issues such as allotments, play areas and grants to help local organisations. Other organisations such as Police and Crime Commissioners, Clinical Commissioning Groups and Fire and Rescue Authorities are responsible for the local provision of services to taxpayers.

Local Authorities spend approximately £100 billion in net revenue spending in 2019-20 (Comptroller and Auditor General, 2021, p. 4). This money is financed through three main streams of revenue. Local Authorities receive some central government grants, a proportion of the business rates raised in their area and council tax receipts. They also make money from fees and charges for providing services, but these offset the cost of those services. They have become involved in renting out property and other commercial transactions more recently. Central funding to local government has been cut drastically over the last ten years, with austerity forming a context in which local accountability and assurance arrangements for funding have become more important (Ferry and Murphy, 2018).

The format of local government accounts is set by the Government. The Local Government Act (2003) allows the Secretary of State by regulations to make provision about the accounting practices to be followed by a local authority. Those regulations - the Capital Finance and Accounting Regulations (2003) - give the Chartered Institute of Public Finance and Accountancy (CIPFA) responsibility for setting out a code to set out proper practices for local authority accounts. The statutory code interprets International Financial Reporting Standards for English local government and CIPFA must maintain “consistency” within its interpretation with the way that the rules are interpreted elsewhere in the public sector (Redmond, 2020, pp. 55-6).

From 1983 until 2014, English local government was audited by the Audit Commission. The Local Audit and Accountability Act 2014 abolished the Commission (Local Audit and Accountability Act, 2014). Its functions were replaced by private sector auditors carrying out audits of the individual local authority financial accounts and issuing opinions that authorities had in place arrangements to secure value for money, but not commenting on whether they actually accomplished it. In particular, this affected the role of audit in accountability and transparency arrangements (Ferry et al., 2015). Councils could now individually procure their audit services. However, the auditor appointment provisions in the 2014 Act were seen by local authorities as “onerous”: the Ministry of Housing, Communities and Local Government (MHCLG) decided to allow authorities to appoint an appointing person to appoint their auditors. 98% of authorities now appoint their auditors through Public Sector Audit Appointments (PSAA) Ltd - a company set up by the Local Government Association (Redmond, 2020, p. 11). At a national level, the UK’s Supreme Audit Institution, the National Audit Office (NAO) took over responsibility for providing nationwide scrutiny of the system of local government as a whole from a value for money perspective. Many of the Commission’s functions with respect to the provision of data and unifying audit and inspection were abolished by the 2014 Act. In 2020, Sir Tony Redmond was commissioned by the Government to examine how the new arrangements had worked in the previous half decade. Sir Tony Redmond’s review was published in September 2020 and the Government responded in December 2020, accepting around 60% of the recommendations of the review but postponing the implementation of some for further consideration.

## The auditing practices

### 6.2. Contemporary History

In 2014, the Government abolished the previous system of local government audit in England. Until 2014, the Audit Commission had audited all English local government and the NHS (Ferry, 2019, p. 8). Part of the objective of the reform was to improve the efficiency of local audit by creating a competitive market, forcing audit firms to compete on price and quality. However, it had an additional

objective. By the end of the Commission's life, it had both audit and inspection elements in their regime. The Commission's inspection regimes led to scoring and ranking local authorities in league tables through the Comprehensive Performance Assessments and Comprehensive Area Assessments. The 2014 changes involved both an institutional change - abolishing the Commission and replacing it, as described above, with individually commissioned local audits - and a change in the nature of audit itself. After 2014, local audits gave an opinion on the truth and fairness of the data in the accounts published by local authorities and on whether arrangements to preserve value for money were in place at the local authority audited (Ferry, 2019 p. 25). Critics of the Audit Commission model argued that it was both inefficient and centralising: reducing the scope of audit allowed local communities to take responsibility to hold their own authority to account.

After 2014, the audit system continued to develop under two pressures. Firstly, local authorities, as discussed above, found it "onerous" to bid separately for audits and instead 98% of the authorities bid together, as part of the PSAA. Secondly, the English Local Authority sector faced cuts in government spending over the entire period. These cuts changed the risk profile of local authorities, raising the chances that local authorities, who are unable to run a deficit, would have to reduce statutorily provided services (Ferry and Murphy, 2015; Murphy et al., 2018). Several councils, as diverse as Northamptonshire and Croydon, have since run into financial difficulties.

The Government had promised in 2014 that it would conduct a review of the local audit system in England after the system bedded in. This was made more politically urgent by criticisms from the NAO and the Public Accounts Committee of the financial sustainability and governance of the sector. In 2018, the collapse of the major outsourcer, Carillion, led to several reviews of private sector audit. Sir John Kingman's review of audit regulation suggested far reaching changes in the private sector - including creating a new body to replace the Financial Reporting Council (FRC) and recommending that "arrangements for local audit need to be fundamentally rethought" (Kingman, 2018, p. 15). The Government responded to its existing commitment, to concerns raised by the NAO and to the Kingman report by commissioning Sir Tony Redmond to write a review. The Redmond report was published in 2020. The report identified many flaws in the English local audit system and made recommendations for change - some of which have been accepted, others of which the Government have said they are still considering (MHCLG, 2020).

### 6.3. Structure: fragmented *versus* single unit

The 2014 reforms decentralised local government audit in the UK. The NAO took an overarching role in carrying out value for money investigations into the entire sector. The NAO was constitutionally limited however from examining the workings of individual local authorities, as it was led by an Officer within the House of Commons and reported to that assembly (Ferry, 2019, p. 25). The reforms also created a regulatory structure to ensure that audit quality was preserved. The NAO set a framework - a code which auditors of local government and the NHS were required to comply with (Comptroller and Auditor General, 2015, p. 7). From 2018-19, the FRC took on statutory responsibility for quality assurance of the larger local authority audits and the Institute for Chartered Accountants in England and Wales (ICAEW) for the quality assurance of the smaller local authority audits (Redmond, 2020, p. 14). For 2019-20, 487 local authorities, local police, and local fire bodies in England were subject to audit under the NAO's Code of Audit Practice (Comptroller and Auditor General, 2021, p. 4). The MHCLG has "responsibility for overall expenditure control within local authorities" and "the effective operation of the local authority audit and accounting framework" (Redmond, 2020, p. 17).

There have been frequent criticisms that the post 2014 arrangements have taken decentralisation too far. Firstly, critics identified that the reforms have led to a lack of "clear information about the nature and causes of the pressures currently facing local government" (Guerin et al., p. 27). Secondly, in terms of audit regulation, both Sir Tony Redmond and Sir John Kingman found in their reviews that no one

organisation was responsible for the system wide regulation of local government audit and this had consequences for systemic leadership (Redmond, 2020, p. 15).

#### 6.4. Audit(or) independence

Lord Sharman (2001, p. 24) in a major review of public sector audit had stated as a fundamental principle that auditors must be seen to be independent and that independence should be understood to “encompass the methods of appointment of auditors, the financial relationship between auditor and auditees”, and their independent decision about what and how much work to do. Lord Sharman’s report built on a long history within the UK of a defence of the independence of the national auditor from interference by the executive (Funnell and Dewar, 2017; Ferry and Midgley, 2021). Lord Sharman’s insistence on the priority of independence has been repeated many times. For example, the Code of Audit Practice said that auditors should “carry out their work with integrity, objectivity and independence” and in line with their ethical obligations, as set out by the regulatory bodies (Comptroller and Auditor General, 2015, p. 8).

However, there were concerns that despite the rhetoric of independence, local auditors might find themselves compromised by their appointment by their auditee, the Local Authority. Despite some concerns, the creation of PSAA and the fact that most local authorities do not actually appoint their auditor, but have contracted out that appointment, has led to fewer risks materialising than might have been expected (Ferry, 2019, p. 24). The competitive pressure in the sector is much less than expected, with fewer suppliers to the sector than prior to the reform (when the Audit Commission contracted out 30% of its audits) (Ferry, 2019, p. 35).

Currently a greater risk exists in the independence of the audience for audit reports: Redmond (2020, p. 73) concluded that the ability of Audit Committees to scrutinise the administration and use audit reports was undermined by a lack of “independent, technically qualified members”. The National Audit Office conducted a survey in 2019 which supported Redmond’s conclusions: they found that there was “a substantial body of authorities where governance arrangements are showing signs of stress in the context of the financial pressures acting on the sector” and specifically mentioned audit committees as a vulnerability for some authorities (Comptroller and Auditor General, 2019, p. 10). Furthermore, the National Audit Office also found that many local authorities did not understand that the “main purpose of the auditor’s report is not to bring new issues to local public bodies’ attention, but to provide public assurance on the adequacy of the arrangements in place during the year” (Comptroller and Auditor General, 2019a, p. 7).

#### 6.5. Inspection as performance management (KPIs): service and organization levels

The move to the new regime not only abolished the Audit Commission but also dismantled the centralised measurement of KPIs at service, organisation and place based levels. The Audit Commission coordinated and brought together a lot of inspection activities with its audit work. After its abolition, much of this inspection activity continued - for example the schools inspectorate and the Care Quality Commission both examine local authority services for vulnerable children and adults - however it is not brought together nor do the inspections present a comprehensive picture of a council’s operations. The Local Government Association (LGA) sponsors a programme of sector led performance management, but it is optional and there is no systematic attempt to assess which councils are poorly performing (Ferry, 2019, p. 32). There is little evidence that inspectors and auditors communicate in the way that they did under the previous regime (Redmond, 2020, p. 16). The Redmond review recommended that the inspectorates and auditors should share information prior to the publication of the annual report (Redmond, 2020, p. 5). The Ministry in its response to the review said that it would work with partners “to support the sharing of key information between inspectorates and external auditors” (MHCLG, 2020). We will await to see what this means in practice.

## 6.6. Public/Private/Hybrid audit regulatory setting

English local government auditing, after the 2014 reforms, is mostly carried out within the private sector. The sustainability of this private sector model has been called into question in recent years, given that audit fees in the sector have dropped over recent years at a time when audit fees in other sectors have risen (Redmond, 2020, p. 21). De Widt et al. (2020, p. 11) found that just under 40% of the officials they surveyed in local authorities were concerned about the long term sustainability of the audit market in the light of reducing audit fees.

There are elements of audit arrangements that remain in the public sector. Since 2014, the NAO has had responsibility for performing nationwide value for money inquiries into local government. These have identified important issues such as the financial resilience of local government and examined cross cutting themes such as homelessness and social care. However, these reports do not focus on individual councils but on the ministry and the result of the audit is a hearing in the Public Accounts Committee involving the Permanent Secretary (leading civil servant) within the ministry rather than any official in local government.

## 6.7. Scope: financial, VFM auditing and/or other public interest area

After 2014, English local government audit moved towards a model in which the focus of audit became the top-down assessment of financial conformance (Ferry and Eckersley, 2015). The Government removed mandatory performance metrics and assessments. The Government left in place some reporting within the system that dealt with wider issues: auditors had to report about whether the local authority concerned had arrangements to protect value for money. In 2020, the NAO published a new audit code. The new code is more extensive in its requirements on auditors when it comes to examining value for money. They will now have to look specifically at financial sustainability, governance and improving economy, efficiency and effectiveness (Comptroller and Auditor General, 2020, p. 17). It remains to be seen how this new code will impact on the way that audit is conducted.

## 6.8. Final remarks

English local government audit has been going through a process of reform since 2014 with the abolition of the Audit Commission. The Redmond Review in 2020 has prompted further changes - though at the time of writing, the detail of these changes is not yet clear. The COVID-19 pandemic has had further dramatic effects on the delivery of local government audit, delaying the publication of audit opinions and placing more pressure on the system of local accountability (Comptroller and Auditor General, 2021, p. 7). The focus of the audit reforms in 2014 was to strip away national metrics and to move to a private sector solution: this has created gaps in the data around local government, local accountability and the relevance of audit to local authorities themselves. In the long-run, this suggests that further fundamental change is likely and that it will potentially restore some of the aspects of the system which were removed in 2014.

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