

**FINANCE, AUDIT AND RISK COMMITTEE
13 MARCH 2024**

PART 1 – PUBLIC DOCUMENT

TITLE OF REPORT: MEASURES TO ADDRESS THE EXTERNAL AUDIT BACKLOG

REPORT OF: *Service Director: Resources*

EXECUTIVE MEMBER: *Non-Executive function*

COUNCIL PRIORITY: SUSTAINABILITY

1. EXECUTIVE SUMMARY

The Department for Housing, Levelling Up and Communities (DHLUC) have published a consultation and cross-system statement on addressing the backlog of Local Government audits. This proposes the following:

- *A reset phase where all audit opinions up to and including 2022/23 will be cleared by 30th September 2024.*
- *A recovery phase which will set back-stop dates for audits to be completed for years from 2023/24 onwards.*
- *A reform phase involving addressing systemic challenges in the local audit system and embedding timely financial reporting and audit.*

2. RECOMMENDATIONS

- 2.1. That the Committee notes this report including implications on the approval of the Statement of Accounts for 2022-23 onwards.

3. REASONS FOR RECOMMENDATIONS

- 3.1. To make the Committee aware of the consultation as it will have a significant impact on the Committee's role in approving the Statements of Accounts for 2022-23 onwards.

4. ALTERNATIVE OPTIONS CONSIDERED

- 4.1. The actions being consulted on may not be taken forward. But given the wide involvement in developing these proposals, this seems unlikely.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

- 5.1. No consultation is relevant to this report.

6. FORWARD PLAN

- 6.1 This report does not contain a recommendation on a key Executive decision and has therefore not been referred to in the Forward Plan.

7. BACKGROUND

- 7.1. The Committee will be aware of substantial delays in the audits of Local Authority accounts. This Council has fared relatively well in only having one year's accounts outstanding (2022/23). Some Councils have many years of accounts audits outstanding.
- 7.2. Under the Account and Audit Regulations a Local Authority is supposed to publish their draft Accounts by 31st May each year. The audit is then supposed to take place so that the final audited accounts can be approved by 31st July each year. There are currently very limited implications for auditors not meeting their deadlines. The audit firm is required to write to the Council to explain the delay. The Council then has to publish a statement explaining the delay on their website.
- 7.3. In June 2019, Sir Tony Redmond was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. His report (the Redmond Review) was published in September 2020. This review made a number of recommendations.
- 7.4. The impacts of the Covid pandemic have resulted in amendments to the Accounts and Audit Regulations to delay the dates above (i.e., to the time allowed for Councils to complete the draft accounts and the time for auditors to then complete their work),
- 7.5. The audit sector has also been significantly affected by accounting scandals in the private sector. The response to this has been to increase the work required to complete audits, including in the public sector. The audit sector have also struggled to attract and retain staff. Some Councils have also engaged in transactions that require a greater degree of audit scrutiny and work.
- 7.6. Like the majority of Councils, our audit appointments are arranged through Public Sector Audit Appointments (PSAA). They determine who our auditor will be and also set scale fees for audits. For the 2022-23 Accounts our auditors are Ernst and Young (EY). For the 2023-24 onwards (for an initial term of 5 years) our auditors are KPMG.

8. RELEVANT CONSIDERATIONS

- 8.1. On 8 February 2024, DHLUC issued a consultation and joint statement on how to address the audit backlog. The joint statement included commitments from the Financial Reporting Council (FRC), National Audit Office (NAO), Chartered Institute of Public Finance and Accountancy (CIPFA), Institute of Chartered Accountants in England and Wales (ICAEW) and Public Sector Audit Appointments (PSAA).
- 8.2. The joint statement proposes introducing the necessary changes to achieve the following three phases of action:
- **Phase 1: Reset** involving clearing the backlog of historical audit opinions up to and including financial year 2022/23 by 30 September 2024.

- **Phase 2: Recovery** from Phase 1 in a way that does not cause a recurrence of the backlog by using backstop dates to allow assurance to be rebuilt over multiple audit cycles.
- **Phase 3: Reform** involving addressing systemic challenges in the local audit system and embedding timely financial reporting and audit.

8.3. The joint statement (and supporting documents) provides a lot of detail on the substance of what is proposed as well as the detailed changes that would enable it to happen. The following paragraphs set out the expected implications for us, our audits and the approval of our Statements of Accounts. Noting that this is all subject to the final decisions made following the consultation.

2022-23 Statement of Accounts

8.4. There would be a back-stop date for the Statement of Accounts to be approved by **30th September 2024**.

8.5. This means there will need to be a meeting of this committee at the end of September. Any audit work should focus on Value for Money (VfM), and EY have already carried out some VfM work. It will be up to EY to determine how they prioritise their audit work and therefore how much audit work they do for us. EY will need to issue an opinion which will either be unmodified, modified (qualified or adverse) or disclaimed. Unmodified would mean that they have carried out enough audit work to determine that the accounts are materially accurate and give a true and fair view. Modified would mean that they have found issues with the accounts that means they are not materially accurate. A disclaimed opinion means that they have not been able to carry out enough audit work to make a conclusion. Unless we happen to be prioritised by EY, a disclaimed opinion would seem the most likely outcome.

8.6. The PSAA have said that they will review scale fees to reflect the amount of work actually carried out by audit firms.

2023-24 Statement of Accounts

8.7. The current proposal is that Councils should still prepare their Accounts by the end of May. There is a consultation question as to whether this should be extended. It would seem reasonable that this deadline should be extended as (1) the auditor of the 2022-23 accounts may want to carry out audit work during that period and there would not be the resources in the Accounts team to do both at the same time, and (2) the auditor of the 2023-24 accounts can't actually do any work until the 2022-23 Accounts are approved.

8.8. The proposal is that there should be some reduction in the work required in preparing the accounts. This would relate to infrastructure assets, the valuation of operational property and pension disclosures. This would apply for the 2023-24 and 2024-25 accounts. This will provide some benefit to us, but mainly only in relation to the pension disclosures.

8.9. The back-stop date for the completion of the audit and approval of the final accounts will be **31st May 2025**.

- 8.10. This is the first year that KPMG will be auditing our accounts. They are already carrying out work on VfM and also to understand us and our processes. But if EY have issued a disclaimed opinion on our 2022-23 accounts, then KPMG won't be able to rely on some or all of the opening balances for the 2023-24 accounts. This would therefore increase the work that they need to undertake. This may have an impact on how long their work takes and also the audit fees that we need to pay. They may be in a position where they can't carry out enough work by the back-stop date and would need to issue a disclaimed opinion.

2024-25 Statement of Accounts

- 8.11. The reduction in work required in preparing the accounts (detailed in paragraph 8.7) will apply in 2024-25 as well.
- 8.12. Draft Accounts will need to be completed by 31st May 2025.
- 8.13. The back-stop date will be **31st March 2026**.
- 8.14. As each year passes, the likelihood of needing a disclaimed opinion reduces, but it is still possible that it may be required.

2025-26 Statement of Accounts

- 8.15. There is a commitment (as part of the Reform phase) to make systemic changes to stop this happening again. That could involve the simplification of Local Government accounts as the less detail that there is, the easier they are to prepare and also easier to audit. This would build on the findings of the Redmond review.
- 8.16. The back-stop date will be 31st January 2027.

2026-27 Statement of Accounts onwards

- 8.17. In each year the draft accounts will continue to need to be completed by 31st May.
- 8.18. The back-stop date for the approval of the final accounts will be 30th November.

Consultation

- 8.19. We provided a positive response to the consultation, as it is clear that something needs to be done and lots of key organisations have been engaged in drawing up these proposals. The consultation closed on 7th March. It is not specified when the results of the consultation will be known, but given the proposed timelines it is clear that a quick turn-around will be required.

9. LEGAL IMPLICATIONS

- 9.1. Paragraph 10.1.5 (a) of the Constitution the Finance, Audit and Risk Committee "review and approve the Statement of Accounts". Paragraph 10.1.5 (s) determines that the Committee will "comment on the scope and depth of external audit work and to ensure it gives value for money". Paragraph 10.1.5 (t) determines that the Committee will "receive reports or recommendations from the external Local Auditor, other than public interest reports (which shall be direct to Full Council)". If adopted, the changes described

in this report are likely to result in the Committee receiving different reports to what they are used to.

- 9.2. The Audit and Account Regulations 2015 determine the timing of when Statement of Accounts should be produced by and when they should be audited by. The proposals would lead to an amendment and strengthening of these regulations, which will be the Audit and Account Regulations 2024.

10. FINANCIAL IMPLICATIONS

- 10.1 There are no defined financial implications arising from this report. If EY carry out less audit work on the 2022-23 audit, then that should reduce the amount that we would need to pay for their audit work as the PSAA would reduce their scale fee to reflect the work done. However that may mean that KPMG need to carry out more work on the 2023-24 audit (and/ or subsequent audits) which could affect future amounts that need to be paid.

11. RISK IMPLICATIONS

- 11.1. Good Risk Management supports and enhances the decision-making process, increasing the likelihood of the Council meeting its objectives and enabling it to respond quickly and effectively to change. When taking decisions, risks and opportunities must be considered.
- 11.2. The work of external audit helps to provide assurance on the finances and Value for Money of the Council. Significant delays to when this audit work takes place means that it provides less assurance. In the short-term if audit results are disclaimed then that also affects the level of assurance that the external audit work provides. However, something needs to happen to get back to the timely completion of external audits.

12. EQUALITIES IMPLICATIONS

- 12.1. In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.
- 12.2. There are no equalities implications in relation to this report.

13. SOCIAL VALUE IMPLICATIONS

- 13.1. The Social Value Act and “go local” requirements do not apply to this report.

14. ENVIRONMENTAL IMPLICATIONS

- 14.1. There are no known Environmental impacts or requirements that apply to *this report*.

15. HUMAN RESOURCE IMPLICATIONS

- 15.1 Having a better idea of when audits will take place allows the Accounts team to ensure that the audit work can be supported, as it requires significant input in providing information and responding to queries.

15.2 For the 2023-24 Statement of Accounts if they are still required to be produced by 31st May 2024, then that will cause resource pressures. Those pressures will be more acute if EY look to carry out any 2022-23 audit work during that period.

15.3 There is work from other teams that contributes towards the Statement of Accounts and associated documents. In particular, the Corporate Policy team in preparing the Annual Governance Statement. These changes should not affect the total volume of work, but may affect the timing of that work.

16. APPENDICES

16.1 Appendix A- Joint statement on dealing the audit backlog.

16.2 Appendix B- Response to consultation questions.

17. CONTACT OFFICERS

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18. BACKGROUND PAPERS

18.1 *None*