

Statement made by

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## Statement

Local authorities and other local bodies, including police, fire, transport and waste authorities, as well as national parks, provide vital public services to local communities. Effective local audit ensures transparency and accountability for public money spent on these vital services, and builds public confidence.

The Government has inherited a broken local audit system in England. This is evidenced by a significant backlog of outstanding unaudited accounts. Last year, just one per cent of councils and other local bodies published audited accounts on time. The backlog is likely to increase again to around 1000 later this year, and without decisive action will continue to rise further. This is not acceptable, and it cannot continue.

This government's manifesto committed to overhaul the local audit system to enable taxpayers to get better value for money. A growing backlog will severely hamper necessary fundamental reforms to repair the system, and will continue to undermine local accountability and governance. We must act now to get the house in order and to rebuild the system so that it is fit, legal, and decent, and the public have an effective early warning system.

This statement outlines immediate actions the Government – together with the Financial Reporting Council (FRC), the National Audit Office (NAO), and organisations in the wider system – is taking, which are designed to address the backlog and put local audit on a sustainable footing. The previous Government launched a welcome consultation on this issue in February. Despite a lack of action, there was clear support for the core elements of the approach to clearing the backlog. All key local audit organisations support these bold measures, recognise their exceptional nature, and continue to share the conviction that this urgent and decisive action is needed to reset the system and repair the foundations of local government.

Local authorities and other local bodies, alongside their auditors, are our partners in this plan to restore a system of high-quality and timely financial reporting and audit, while managing the impact of this in a sustainable way. I commend the commitment of local finance teams and auditors in their work to date.

### Proposed secondary legislation

I intend to lay secondary legislation when parliamentary time allows, and, at the point at which the Comptroller and Auditor General requests, I would also lay a new Code of Audit Practice (again, subject to parliamentary time). Taken together, these measures aim to facilitate a return to timely, purposeful audits of local body accounts. The secondary legislation would amend the Accounts and Audit Regulations (2015) to set a series of backstop dates.

The first backstop date would clear the backlog of unaudited accounts up to and including 2022/23, but given the size of the audit backlog, it is unlikely that all outstanding audits will be completed in full ahead of this date. The Government recognises that this is likely to have unfortunate consequences for the system in the short term, and has been forced to take this difficult decision due to the backlog we inherited. This Government is determined, however, to make the tough choices necessary to begin rebuilding the foundations of local government. Where auditors have been unable to complete audits, they will issue a 'disclaimed' or 'modified' audit opinion. Auditors are likely to issue hundreds of 'disclaimed' audit opinions and disclaimed opinions will likely continue for some bodies for a number of years.

The proposed legislation will include five further backstop dates up to and including financial year 2027/28 to allow full assurance to be rebuilt over several audit cycles. It is the aspiration of the Government and key local audit system partners that, in the public interest, local audit recovers as early in this five-year period as possible. This means disclaimed 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), with only a small number of exceptional cases, due to specific individual circumstances, continuing thereafter. The proposed backstop dates are:

- Financial years up-to-and-including 2022/23: 13 December 2024
- Financial year 2023/24: 28 February 2025
- Financial year 2024/25: 27 February 2026
- Financial year 2025/26: 31 January 2027
- Financial year 2026/27: 30 November 2027
- Financial year 2027/28: 30 November 2028

While there will be modified and disclaimed opinions, auditors' other statutory duties – including to report on Value for Money (VfM) arrangements, to make statutory recommendations and issue Public Interest Reports – remain a high priority. Our government will make that crystal clear.

For financial years 2024/25 to 2027/28, the date by which Category 1 bodies should publish 'draft' (unaudited) accounts will change from 31 May to 30 June following the financial year to which they relate. This will give those preparing accounts more time to ensure they are high-quality accounts. This in turn will benefit auditors while still ensuring publication shortly after financial year end.

The proposed legislation will outline the following scenarios in which bodies may be exempt: where auditors are considering a material objection; where recourse to the court could be required; or from 2023/24, where the auditor is not yet satisfied with the body's Value for Money arrangements. Where such an exemption exists, the legislation would include a requirement to publish the audit opinion as soon as practicable. For transparency, if a body is exempt, they would be required to publish an explanation of their exemption at the time of a backstop date.

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 proposed backstop dates, which will make clear where 'draft' (unaudited) accounts have also not been published. I intend to keep this under close review and may explore further mechanisms to take appropriate action, should reasons given be inadequate.

As previously committed to, the FRC and the Institute of Chartered Accountants in England and Wales (ICAEW) will not carry out routine inspections of local audits for financial years up to and including 2022/23, unless there is a clear case in the public interest to do so.

#### Communications to support local bodies and auditors

There will be extensive communications and engagement on these measures, to make clear the necessity of these steps and emphasise the context for modified or disclaimed opinions. 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. Auditors will be expected to provide clear reasons for the issuing of such opinions to mitigate the potential reputational risk that local bodies may face. We will work with partners to provide communications support to the system.

Guidance for auditors would be published by the Comptroller and Auditor General and endorsed by the FRC, confirming that there are no contradictions to the requirements or

the objectives of International Auditing Standards (UK). A proportionate approach is required and all system partners including the FRC, NAO and auditors, are aware that this is the Government's objective. The FRC's and ICAEW's regulatory activity would consider auditors' adherence to the Code and whether proper regard has been given to the statutory guidance.

#### Audit fees

Issuing a disclaimed or modified audit opinion and a subsequent return to being able to fully complete audits will require differing levels of work by auditors. Public Sector Audit Appointments Ltd (PSAA) will set scale fees and determine fee variations where the auditor undertakes substantially more or less work than assumed by the scale fee and will consult with bodies where appropriate. In doing so PSAA will apply the following principles: if auditors have worked in good faith to meet the requirements of the Code of Audit Practice in place at the time the work was conducted (and have reported on work that is no longer required), then they are due the appropriate fee for the work done, and the body is due to pay the applicable fee, including where there is a modified or disclaimed opinion. Conversely, if an auditor has collected audit fees in part or in full, and the backstop date means that the total work done represents less than the fee already collected, then the auditor must return the balance and refund the body the appropriate amount – this ensures that the bodies pay only for work that has been done and reported.

#### Conclusion

I recognise that aspects of these proposals are uncomfortable. Given the scale of the failure in the local audit system that this Government inherited, however, we have had to take this difficult decision to proceed. Without this decisive action, the backlog would continue to grow, and the system will move even further away from timely assurance. The secondary legislation I will lay will give effect to these proposals and start to repair the foundations of local governance. Significant reform is needed to overhaul the local audit system to get the house in order and open the books. I will continue to review the evidence, including considering the recommendations of external reviews to date, and will update the House in the Autumn on the Government's longer-term plans to fix local audit.