

6 December 2023

Dear Section151 Officer colleagues

Local Audit market update

I am writing as a follow up to my letter of 26 July 2023 about Government proposals to re-establish the local authority audit framework on a more sustainable basis, with a focus on providing assurance on public bodies' most recent financial information.

The proposals were referenced in a ministerial statement over the summer, but formal guidance from the Department for Levelling Up, Housing & Communities (DLUHC) and the Financial Reporting Council (FRC), as the incoming shadow system leader, are still pending. As such, I wanted to use this opportunity to update you on EY's approach and how we are prioritising our delivery to best prepare for implementation of the proposals.

About the proposals

The challenges facing the existing framework for local authority audit are well-documented and have been highlighted by auditors, the Redmond Review, the National Audit Office, the Public Sector Audit Appointments Ltd (PSAA), the Local Government Association and Parliament. The problem continues to grow. Recently, the PSAA reported that only 5 out of 467 Local Government bodies received a 2022/23 audit opinion by 30 September 2023, taking the total outstanding opinions to around 918.

The Government's proposals will help to reset local authority audit, with auditors able to focus on providing assurance on public bodies' most recent financial statements. Additionally, there will be benefits to authorities in reducing demands on your teams by allowing them to focus on the most recent financial year.

Since the cross-system ministerial statement EY has invested significantly in engaging with DLUHC and the FRC, as well as other stakeholders to support the reset and recover the local audit market. Whilst we cannot pre-empt the final ministerial guidance, and the below may be subject to change, we understand that the proposals will still seek to:

- Use legislation to set statutory deadlines (backstop dates) for account preparers and auditors to clear the backlog, acknowledging this will result in qualifications and disclaimers of opinions in the short term. This is currently expected to be 31 March 2024.
- Continue to require auditors to report on value for money, alongside existing statutory powers.
- Find a sustainable solution for the future, which may require:
 - Changes to the CIPFA code for preparation of accounts;
 - An audit approach that seeks to rebuild assurances on account balances over a period of time rather than in the first year following a qualification (disclaimer or scope limitation);
 - Developing an escalated reporting framework for audit firms and local bodies to resolve issues ahead of statutory deadlines; and
 - Continued investment in the capacity in the audit market.

Our approach

Following the ministerial statement in July and the continuing expectation of a 31 March 2024 backstop date for the completion of all outstanding audits to 2022/23, we have taken a number of steps to support the delivery of consistent high-quality audits and prepare for implementation of the proposals. These include:

- **Maximising the completion of historic audits** – working to close open audits where audit work is substantially complete and with a high likelihood of issuing an opinion in a short period of time. Currently, the delivery of these audits is likely to be phased through to early 2024.
- **Pension fund audits** – These audits are not subject to the reset of the system; we continue to prioritise completion of all these audits to 2022/23.
- **Value for Money reporting** – As there are no anticipated changes to value for money reporting requirements, auditors' exception reporting responsibilities and statutory powers we continue to prioritise the completion of our reporting up to the 2022/23 financial year. Given the increasing focus on the financial sustainability of the local government sector, as well as a focus on those authorities who are seen to be at greater risk of not achieving value for money, this is an important priority in providing necessary assurances to stakeholders.
- **Planning for 2023/24 audits** – Where capacity allows, we will seek to commence planning for 2023/24; focusing on the most recent set of financial statements and supporting the reset.

This clarity in approach has enabled us to successfully close out a higher proportion of historic audits over the last few months, seeking to maximise the level of assurance provided whilst we await further statements and/or consultations on the proposed measures to reset the local audit system. It also means that we are focused on areas of the audit that will either provide or contribute to a final reporting deliverable to you.

We are continuing to engage with DHLUC and the FRC on the proposals and will continue to review our approach as more information becomes available.

Preparing for the proposals – our ask of you

To ensure we can respond positively and quickly when the Government proposals are finalised, it would be helpful if you could continue to do the following:

- **Stakeholder engagement** – Ensure key stakeholders in your organisation are sighted on the Minister's proposals and recent communications, including this letter, so that they are apprised on the status and decisions being made.
- **Flexibility** – We understand that the issues experienced by the preparers of financial statement and auditors over the last few years have been difficult to manage, and that collectively we have a finite level of capacity. We ask that you continue to work with us on the priority areas above.
- **Financial statement preparation** – We know that there are some authorities where draft financial statements through to 2022/23 have not yet been prepared and subject to an inspection period. If you are one of those authorities, this needs to be prioritised to meet your statutory responsibilities regardless of the last year of audit. Failure to do so may also prevent our ability to close out historic audits and issue an opinion as part of the proposed reset, as well as being able to move forward with your 2023/24 audit within the required timelines.
- **Planning for 2023/24 year-end** – Acknowledging that it has been a while since we have all operated under traditional delivery deadlines, we would like to engage with you to ensure the effective reset and recovery from the 2023/24 financial year. Going forward, it will be important to agree joint protocols for ways of working, as well as expectations on accounts and audit preparation and delivery.

Audit plays a vital role in underpinning trust, transparency, and confidence in local government bodies; EY is committed to our role in serving the public interest by delivering consistent high-quality audits. As we collectively navigate through the proposals and this period of uncertainty, I wanted to thank you for your engagement to date. The proposed system reset offers all stakeholders an important opportunity to move forward. We remain committed to achieving the reset of the local audit system and look forward to continuing to work collaboratively with you over the coming months.

If you or your elected members have any questions or would like to discuss any aspect of this letter, please don't hesitate to contact me or your key audit partner.

Yours sincerely



Stephen Reid
Partner, UK Head of Public Sector Audit
for and on behalf of Ernst & Young LLP