Smaller Authorities' Audit Appointments

SAAA's Response to DLUHC Consultation – 5 March 2024

Key Messages

- SAAA welcomes DLUHC's determination to resolve the problem faced by local audit with its system partners.
- The £6.5m threshold for Category 2 authorities is contributing to the backlog and if unchanged will result in additional Category 1 authorities requiring Full Audit, adding to the backlog. This issue must be addressed in the Reset and Recovery phases.
- SAAA, as part of the local audit system, will be a necessary and willing contributor to Phase 3 Reform and would wish that part to proceed at pace.

1 Introduction

SAAA is the sector-led limited company appointed by the then Department of Communities and Local Government as the 'specified person' to procure and appoint external auditors to Smaller Authorities in England. As the 'specified person' we perform the functions set out in the relevant legislation and monitor delivery of ongoing audit contracts, in accordance with The Local Audit (Smaller Authorities) Regulations 2015.

There are over 9,800 smaller authorities in England in 2022/2023, with a turnover approaching £1bn in 2023/2024. In that year, over 100 smaller authorities raised a precept over £1 million.

Smaller Authorities are Category 2 authorities and subject to the Limited Assurance engagement regime, unlike Category 1 authorities which are subject to Full Audit.

Despite that distinction, SAAA forms part of the wider system for local audit. In particular:

- The attractiveness or otherwise of the public sector audit market and the problems experienced by the PSAA, impacts upon SAAA's ability to grow, and develop a diverse provider base for Limited Assurance.
- Along with other stakeholders, SAAA has a keen interest in workforce development and ensuring there are sufficient practitioners and auditors to deliver public sector audit. Limited Assurance work is often seen as a good training ground for interns and part qualified staff to eventually move onto Full Audit work.
- With the PSAA, SAAA have an interest in managing the interface between Limited Assurance and Full Audit. Bodies need to move between the two

smoothly, without loss of audit during the transition. The current difficulties do not facilitate this and add to the backlog problem.

2 General Response to the Consultation

SAAA welcomes the proposed changes set out in both the Department's document and that provided by the NAO. A response to each of the questions posed by the Department is set out in Annex A and will be submitted online. SAAA will also respond to NAO's consultation.

A significant concern of ours is that the measures proposed will simply prove to be a short-term solution to the immediate problem and will not address the underlying issues. In our opinion, both the recovery and reform stages are critical to the long-term improvement of the system.

We are therefore encouraged that the Department recognised the need for Phase 3 (Reform), and support and recommend that this needs a whole system response, including responding to issues affecting Limited Assurance.

In our opinion there are a number of matters that need to be resolved as part of Phase 3 and these include:

- The **treatment of parish meetings**, which does not represent a cost-effective utilisation of resource, relative to risk.

- The **£25k lower limit** which was set in 2015, eight years ago. Between 2017/18 and 2022/23 an additional 449 Smaller Authorities have been drawn into the Limited Assurance regime, as the percentage of exempt authorities has fallen from 55% to 50%.

- The poor compliance with requirements for **internal audit** which are important when external audit is based on a relatively light touch Limited Assurance.

- The lack of any **sustainability assessment** for larger parish and town councils.

In addition, and more urgent, is the impact of the £6.5m threshold for Smaller Authorities' audit. The £6.5m threshold for Category 2 authorities has contributed to the backlog as Smaller Authorities have become Category 1 authorities. If this threshold is left unchanged, it will result in additional Category 2 authorities requiring Full Audit before the backlog is dissipated. On current trends not only will these contribute toward the backlog but it is doubtful if an auditor will even be appointed. Firms will be concentrating upon their existing backlogs rather than taking on new clients. **SAAA are of the opinion that this issue should be addressed now as part of this Phase.**

3 Requirements for Full Audit when moving across the £6.5m threshold

The Local Audit and Accountability Act 2014 Section 6 requires that when a Smaller Authority has a gross income or expenditure for three consecutive years in excess of £6.5m, then it is no longer classed as a Smaller Authority. It must therefore be a Category 1 authority and subject to Full Audit regime.

Limited Assurance is delivered through a relatively light touch review of the AGAR submission, with the checks increasing in rigour as turnover increases. All that is produced is an external auditor's report and certificate which is part of the published AGAR form.

Full Audit however requires there to be an opinion on whether the audited bodies financial statements:

- give a true and fair view of the financial position of the audited body and its expenditure and income for the period in question; and
- have been prepared properly in accordance with the relevant accounting and reporting framework as set out in legislation, applicable accounting standards or other direction.

In addition, unlike Limited Assurance, with Full Audit there are requirements for the auditor to assess issues such as value for money, governance and financial sustainability.

Overall, a Full Audit conducts extensive tests to ensure compliance with proper practices to give reasonable assurance, whilst the Limited Assurance review looks for anomalies to give a level of assurance which is proportionate to size.

The difference is considerable; the skill levels required within the finance team in a Full Audit authority are substantially in excess of that required for effective financial management in a Smaller Authority. Complex regulations start to apply, assets have valued, and in the year in which the transition to Full Audit takes place accounts have to be restated.

Smaller Authorities have to appoint skilled staff in advance and buy in specialist advice to prepare for Full Audit. These one-off costs can exceed £50k. They then face recurring higher staff and audit costs again of around £50k pa.

The difference in audit requirements between Limited Assurance is apparent by looking at scale fees. The SAAA's highest fee (for a £5m+ authority) is £3.7k. The PSAA's fees for the smallest National Park is £40k and for District Councils' exceeds £100k.

It is difficult to justify Full Audit, even for the largest Parish Council.

4 The problems of moving across the £6.5m threshold and the impact on backlogs

The £6.5m limit has not been reviewed since it was set.

Some Smaller Authorities are moving between Limited Assurance and Full Audit due to widely fluctuating income or expenditure, such as DEFRA grants, and other Smaller Authorities' income and expenditure will routinely and predictably exceed £6.5m as they become more active, with double devolution and Community Infrastructure Levy funding coupled with the effect of inflation.

SAAA considers that this will continue to add to the backlog problems and should be resolved as part of Phase 1. The case studies below illustrate this point more fully.

Case Study A – King's Lynn Internal Drainage Board (KLIDB)

King's Lynn IDB have been in and out of Full Audit regime in recent years as a result of a DEFRA supported capital scheme. Having triggered the requirement to have a Category 1 audit for the year ended 31 March 2019, auditors were appointed by PSAA for the three years ended 31 March 2022. These audits were performed but not signed off. Although COVID's effect on external audit resourcing was a factor, the need to value assets such as pumping stations, which had not been valued before and the re-stating of accounts caused significant problems.

After the completion of the capital scheme KLIDB's expenditure fell below the £6.5m limit and KLIDB returned to the Limited Assurance regime for the year ended 31 March 2023. However, the audit performed by SAAA's appointed auditor could not be concluded owing to the outstanding audit reports for the previous 3 years.

Therefore, the last audit report on this public body was for the year ended 31 March 2019, published in September 2019. Its unfinished audits are part of the backlog.

It is difficult to see how these arrangements could be regarded as effectively delivering public accountability.

Case Study B – Lindsey Marsh Drainage Board (LMDB)

LMDB has exceeded the £6.5m threshold for the third consecutive year and therefore became a Category 1 Full Audit authority in 2022/23. LMDB is delivering a significant capital refurbishment programme of its coastal pumping stations. During the period of this programme, likely to be six years, LMDB will remain a Category 1 authority. However, once the project is completed, it is likely to drop below the threshold once more.

The funding for this capital programme comes from central government, is tightly ring fenced and closely monitored by the Environment Agency. LMDB reports that PSAA estimates that is audit costs will be approx. £100,000, a significant increase on current costs. LMDB's core business and scope of activity are unchanged despite an increased capital spending programme.

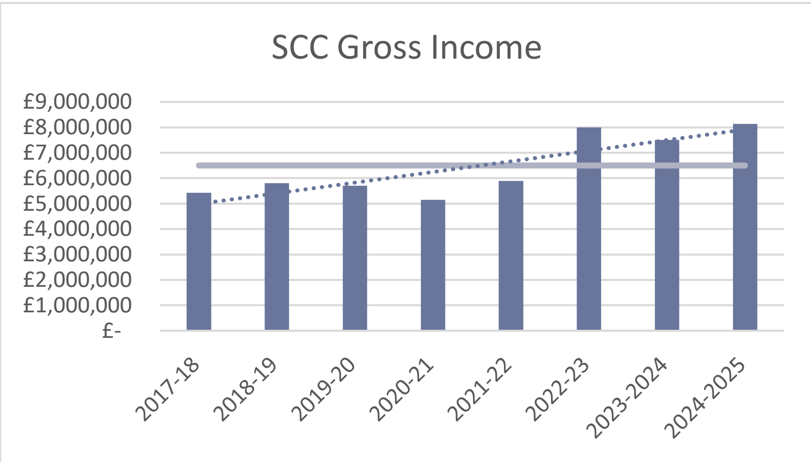
Significantly, as LMDB is now a Category 1 authority, PSAA have tried to appoint an auditor. However, no audit firm applied for this opportunity and so LMDB remains unaudited – and contributes to the backlog.

Case Study C – Witham Fourth District IDB (W4IDB)

This IDB is currently in the Limited Assurance audit regime. Like other IDBs in the process of replacing ageing pumping stations, DEFRA grant income is being sought to refurbish or rebuild these important assets. W4IDB has a normal income of £3.6m but a large pumping station is being built over 3 years from 2025 at a cost of £60-£70m. This will cause this IDB to become a Category 1 authority during the third year of this project.

Given the difficulties in appointing an auditor for LMDB, it is likely that no auditor will be appointed adding to the backlog.

Case Study D – Salisbury City Council (SCC)



The figure left illustrates SCC's gradual increase in income over the last 5 years and shows that for audit year 2024-2025 they will be subject to Category 1 Full Audit.

SCC is a parish council, delivering a wide range of public services, with devolved responsibility for street cleaning and ground maintenance across the parish. The council also receives income from a crematorium, property, and car parking. It will raise £5.6m in precept for 2024/2025.

SCC estimates its internal and external audit costs, and staffing costs to comply, will rise by additional annual recurring cost in excess of £50,000. This is the equivalent of approx. £3.20 on a Band D property precept, or an increase of 0.9%.

In addition, there are likely to be one off costs associated with re-stating its accounts and external support and advice.

SAAA is also aware that there are a number of other IDBs, larger town and parish councils and other Smaller Authorities, who may exceed the threshold during the recovery phase. They will be become subject to Full Audit and require new external auditors to be appointed, potentially adding to the volume of audits at this critical time. This could be up to a further five in the period up to 2028.

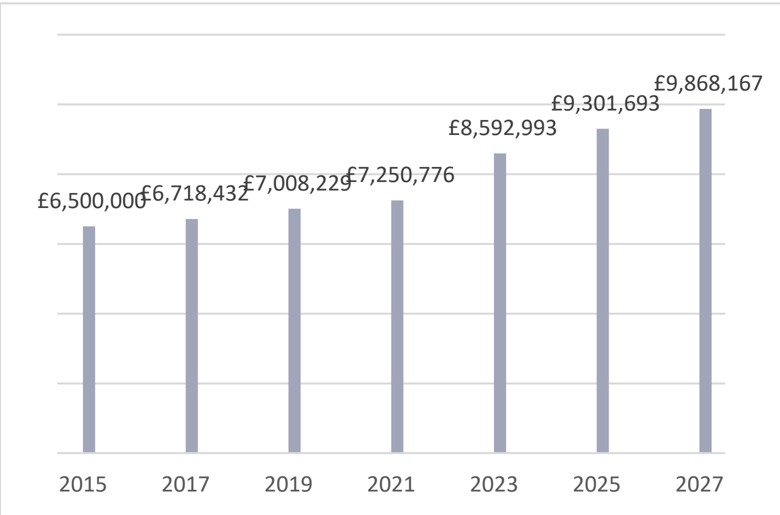
Those parish councils affected by this new regime of Full Audit are unlikely to have the equivalent range of service delivery, asset base or liabilities of even the smallest District Council, and yet they will be subject to the same audit rigours as a sizeable principal authorities. This seems disproportionate and, coupled with the difficulties in appointing suitable auditors, may lead the public to question the value of significant additional audit costs, when combined with the failure to appoint auditors and the failure to complete audits.

PSAA has already struggled to appoint external auditors to an IDB, and it seems likely that with the focus on recovery, auditors may inevitably concentrate upon existing clients rather than take on new clients, especially those unfamiliar with the rigour of Full Audit. It is therefore reasonable to assume that PSAA will continue to struggle to appoint external auditors to Smaller Authorities, entering the Full Audit requirement.

5 Possible solutions

There are three possible solutions to this problem worthy of exploration to ameliorate the issue the that £6.5m threshold causes:

- **OPTION 1 Increase the £6.5m limit and extend the period from 3 years to say 5 years.**



The chart to the left shows the effect of past and projected inflation on the £6.5m threshold, applying an inflation factor of 3% for future years.

This shows a reasonable limit of in excess of £10m could be used simply to reflect inflation. This would reduce the number of smaller authorities exceeding the threshold in the next few years.

Whilst this may ameliorate the problems for Parish Councils and some IBDs, with inflation and growing drainage and flood problems and potentially more ambitious larger schemes, it would not solve the issue of large capital schemes. Extending the length of time that the new threshold of say £10m has to be exceeded from 3 years to at least 5 years may be necessary as well.

Further analysis with partners would be necessary to validate the financial limits (£10m) and timescale (5 years), and to assess changes to Auditor Guidance Note 02 (AGN02) to deal with the audit of large capital grants.

Our legal advice is that these changes could be achieved by way of a Statutory Instrument. Section 6(5) of Local Audit and Accountability Act 2014 (LAAA) provides that the Secretary of State may by regulations amend this section. This allows the

Government to change the £6.5m smaller authority limit by regulations, using the procedure set out in Section 43 LAAA.

Even though this solution may have some attractions, it merely delays resolving the problem as inflation will simply erode any new limit. Even index linking a new limit may not be appropriate; more fundamentally it is difficult to justify applying Full Audit requirements to temporary increases in expenditure or larger Town Councils.

- **OPTION 2 Exclude DEFRA grants from the calculation of the £6.5m limit.**

Superficially this is an attractive option, but it may open the debate about other grants or whether perhaps community infrastructure levy spending should be excluded (in the case of community town and parish councils) when calculating the £6.5m limit.

It may be difficult to see how this could be achieved quickly because it may be necessary to consult more widely on any other grants that may be treated in a similar way. Furthermore it represents a complication of the system rather than a streamlining.

As far as we have been able to assess it is not possible to simply remove capital schemes from the calculation of the £6.5m limit and so some form of legislative action would be required.

Legal advice to SAAA suggests that changing categories of expenditure may be rather more complex legislatively. The Act is about class of authority and relevant audit arrangements not about types of expenditure.

This is not a solution for Parish Councils. It may not be even a solution for IDBs as a number of IDB's recurring running costs are approaching the £6.5m limit.

- **OPTION 3 Change the regulations such that town and parish councils, IDBS and other smaller authorities are designated as Smaller Authorities regardless of turnover.**

If the designation of Smaller Authorities no longer relied upon turnover, the problem of inflation eroding the £6.5m limit and the need for periodic reviews of the limit is resolved.

The problems with larger DERFA funded schemes is also avoided.

This change would need to be underpinned by changes to AGN02 which could include specified procedures for the audit of grants.

This could be achieved after technical discussions between the NAO with DEFRA and other relevant parties, on DEFRA supported capital expenditure.

AGN02 already adjusts the audit requirements by size. The NOA may need to consider additional requirements for larger bodies with recurring expenditure or income over £6.5m. However, at this stage these changes are likely to be modest as it can be argued that much of the increases in recurring expenditure are attributable to inflation.

The legal advice that we have received is that removal of the financial limits and designating Parish Councils, IDBs and other smaller authorities as Smaller Authorities can be achieved by way of Statutory Instrument.

On balance this last option is preferable as it is a long term sustainable solution. It is likely to command the support of the National Association of Local Councils and the Association of Drainage Authorities.

6 Conclusions

The theory behind the £6.5m limit is that those authorities which exceed it should have a more robust audit; the reality is that, given the current turmoil they are likely to have no audit at all.

This is regrettable in terms of public accountability and governance, but it may also undermine the perception of success of this Phase. There is no auditor of last resort and it is likely that these authorities will be a continuing focus on the backlog.

The analysis above suggest that in practice it is not necessary or appropriate to subject them to Full Audit; appropriate assurance can be given by modifications of the Limited Assurance regime.

The problem highlighted in this submission may be relatively straight forward to fix and we would need to justify why action has not been taken now. We believe that this issue must be addressed in the Reset and Recovery phases.

As the £6.5m limit is explicitly linked to the current issues upon which you are consulting, it is entirely valid and reasonable to act on this matter now and not delay.

We would support the Department convening an urgent meeting with key partners to test and refine the proposed solution above and the legal advice we have had that this may be achieved by way of Statutory Instrument.

SAAA welcomes this opportunity to contribute to finding a long-term solution to the predicament in local government audit. We would be pleased to meet with you to discuss the points we have raised if you think that would be useful.

D Bowles
Chair
SAAA
5 Mar 2024

Appendix A to SAAA's Response to DLUHC Consultation – 5 March 2024

SAAA's Response to DLUHC Consultation

Phase 1: 'Backstop' proposals for financial years 2015/2016 to 2022/2023

1. Notwithstanding the possibility of exemptions in exceptional circumstances (covered by questions 3 and 4 below), do you agree that Category 1 authorities should be required to have published audited accounts for all financial years up to and including financial year 2022/2023 by 30 September 2024?

agree *~~disagree unsure~~*

Do you have any comments on this issue?

No

2. Do you agree that the requirement at Regulation 10(2) for Category 1 authorities to publish a delay notice should be disapplied in relation to any outstanding audits covering financial years 2015/2016 to 2022/2023?

agree *~~disagree unsure~~*

Please explain your response

It will aid recovery

3. Do you think it would be appropriate for Category 1 authorities to be exempt from the statutory backstop date of 30 September in circumstances where the auditor is unable to issue their opinion due to outstanding objections to the accounts that could be material to that opinion?

agree *~~disagree unsure~~*

Please explain your response

It will aid recovery

4. Do you think there would be any other exceptional circumstances which might create conditions in which it would be appropriate for Category 1 authorities to be exempt from the 30 September backstop date?

~~agree disagree~~ **unsure**

Please explain your response, including, where relevant, details of exceptional circumstances you consider would justify an exemption.

SAAA is unclear how authorities which have transitioned between Full Audit and Limited Assurance will be treated (for example Kings Lynn Draining Board).

SAAA is unclear on the effect of the backstop date on a Smaller Authority which has transitioned to Category 1 but not had an auditor appointed (Lindsey Marsh Drainage Board).

5. We intend to publish a list of local bodies and audit firms which meet statutory deadlines for the publication of audited accounts and those which do not. Do you think there should be additional consequences for Category 1 authorities or audit firms (excluding an authority or firm covered by an exemption) if they do not comply with the statutory deadline of 30 September 2024?

~~agree~~ **disagree** ~~unsure~~

Please explain your response and, where relevant, include any suggested consequences

Whilst the intent of the requirement might be to improve performance by such targets, one needs to be cognisant of the unintended consequences. In our opinion the problems with the Full Audit requirements and the necessary resources (external audit and internal staffing) are deep rooted and are not all attributable to any one party. We need to attract and retain external auditors and staff. This provision could be seen as 'name and shame' and so counterproductive. It may also have the unintended consequence of making Limited Assurance regime work for Smaller Authorities less attractive to new audit firms, who will become increasing aware of problems within the broader sector.

Phase 2: 'Backstop' proposals for the recovery period, financial years 2023/2024 to 2027/2028

6. Notwithstanding the possibility of exemptions in exceptional circumstances (covered by questions 7 and 8 below), do you agree that Category 1 local authorities should be required to publish audited accounts for financial years 2023/2024 to 2027/2028 by the following dates? 2023/24: 31 May 2025, 2024/25: 31 March 2026, 2025/26: 31 January 2027, 2026/27: 30 November 2027, 2027/28: 30 November 2028

agree ~~disagree unsure~~

Do you have any comments on these dates?

In general we agree but draw your attention to the concerns expressed at question 4

7. Do you think it would be appropriate for Category 1 authorities to be exempt from the statutory backstop dates for Phase 2 in circumstances where the auditor is unable to issue their opinion due to outstanding objections to the accounts that could be material to that opinion?

agree ~~disagree unsure~~

Please explain your response

8. Do you think there would be any other exceptional circumstances which might create conditions in which it would appropriate for Category 1 authorities to be exempt from the backstop dates for Phase 2?

agree ~~disagree unsure~~

Please explain your response, including, where relevant, details of exceptional circumstances you consider would justify an exemption

In our response at question 4 we identify that one authority has not had an auditor appointed. In our more detailed submission to the Department we are concerned that others may follow and also fail to have auditors appointed. Their treatment needs to be considered.

9. We intend to publish a list of local bodies and audit firms which meet statutory deadlines for the publication of audited accounts and those which do not. Do you think there should be additional consequences for Category 1 authorities or audit firms (excluding an authority or firm covered by an exemption) if they do not comply with the statutory deadlines for Phase 2?

~~agree~~ **disagree** ~~unsure~~

Please explain your response and, where relevant, include any suggested consequences

As with question 5 whilst the intent of the requirement might be to improve performance by such targets one needs to be cognisant of the unintended consequences. In our opinion the problems with the Full Audit requirements and the necessary resources (external audit and internal staffing) are deep rooted and are not all attributable to any one party. We need to attract and retain external auditors and staff. This provision could be seen as 'name and shame' and so counterproductive. It may also have the unintended consequence of making Limited Assurance regime work for Smaller Authorities less attractive to new audit firms, which will become increasing aware of problems within the broader sector.

10. The Accounts and Audit Regulations 2015 (regulation 15(1)(a)) currently requires Category 1 local authorities to publish unaudited accounts by the 31 May following the end of the financial year. In light of the proposed deadlines for the publication of

audited accounts, do you think the 31 May deadline remains appropriate for financial years 2024/2025 to 2027/2028?

~~agree disagree~~ **unsure**

Please explain your response perhaps we should say unsure and reference the IDB's and concerns about Salisbury??

SAAA is unclear about the effect that this deadline will have on the publication of audited accounts for Internal Drainage Boards (IDB) and Salisbury City Council and others, who have gone over, or will have gone over the £6.5m threshold, particularly in their first year of Full Audit. This requirement may be unreasonable given the scale of change they face in that first year.

11. The existing annual deadline for the publication of unaudited accounts is 31 May. As set out above, we are proposing a backstop date for the publication of audited accounts for the financial year 2023/2024 of 31 May 2025. This would mean that 31 May 2025 would be the statutory deadline for both the publication of audited accounts for financial year 2023/2024 and unaudited accounts for financial year 2024/2025. Do you expect this would create any significant issues?

~~agree disagree~~ **unsure**

Please explain your response perhaps we should reply as 10?

It is not clear how this will apply to Lindsey Marsh Drainage Board where it has not been possible to appoint an auditor.

Furthermore, the peak in local audit work in May 2025 may affect the overall workforce capacity for local audit system. This could have the unintended consequence of slowing or delaying the Limited Assurance work for Smaller Authorities if system capacity (staff) is diverted to the tasks occurring at, and in the lead up to, 31 May 2025. As well as adversely impacting Limited Assurance, it may have adverse impacts for both Limited Assurance and Full Audit with an unintended consequence of driving up pay rather than driving up capacity.

12. The government anticipates that the Phase 1 backstop proposals will result in modified or disclaimed opinions. A modified or disclaimed opinion at the end of Phase 1 would require auditors to subsequently rebuild assurance. The Phase 2 backstop dates are intended to enable this work to be spread across multiple years. Given this additional work, and noting the further explanation at paragraphs 15 to 46 of the Joint Statement, do you have any views on the feasibility of audited accounts being published by the proposed statutory backstop dates for Phase 2?

Please respond in the free text box below

No comment other than the reservations expressed at 10 and 11 above.

Publication of an audit letter
13. Do you agree that it would be beneficial for the 2015 Regulations be amended so that Category 1 bodies would be under a duty to consider and publish audit letters received from the local auditor whenever they are issued, rather than, as is currently the case, only following the completion of the audit?

agree ~~disagree unsure~~

Do you have any comments on this issue?

No

Equality impacts
14. Do you have any comments on whether any of the proposals outlined in this consultation could have a disproportionate impact, either positively or negatively, on people with protected characteristics or wish to highlight any other potential equality impacts?
Please add any comments in the free text box below

No comment

Further feedback
15. Finally, do you have any further comments on the proposed changes to the 2015 Regulations not covered by the questions so far, including relating to any unintended consequences?
Where possible, please limit your response to 500 words

SAAA is the specified person to procure and manage the appointment of external auditors for Smaller Authorities. Smaller Authorities are Category 2 authorities and their gross income or expenditure cannot exceed £6.5 million.

If this occurs for three consecutive years, the Smaller Authority becomes a Category 1 authority and subject to Full Audit regime. SAAA are concerned that this is contributing to the backlog problems, caused in part because of the significant difference between Limited Assurance and Full Audit, with accounts having to be re-stated.

The need to resolve this issue, as this Phase of recovery, is set out in more detail in SAAA's submission to the Department - SAAA's Response to DLUHC Consultation -5 March 2024. That document explains the problem in more detail with a number of possible solutions considered.

The track record of authorities moving from Limited Assurance to Full Audit is not good:

- ***Kings Lynn Internal Drainage Board moved from Limited Assurance to Full Audit in 2019/20. Since then not a single audit has been signed off. Its capital expenditure has subsequently fallen and it is now back in Limited***

Assurance. The auditors appointed by SAAA are not able to sign off the accounts, as the prior years have not been signed off.

- *Lindsey Marsh Drainage Board moved to Full Audit in 2022/23. PSAA were not able to appoint an auditor. They will now be contributing to the backlog.*
- *Salisbury Town Council and Witham Fourth Drainage Board will likely move into Full Audit in 2024/5 and 2025/6 respectively. There can be little confidence that auditors will be appointed.*

Other bodies could move to Full Audit during the recovery period.

The difference between Limited Assurance and Full Audit is considerable. There is no audit opinion on the accounts being 'true and fair' or of having 'complied with relevant accounting frameworks and regulations'. With Limited Assurance there is also:

- ***no value for money work***
- ***no assessment of financial sustainability.***
- ***limited assessment of governance.***

SAAA are concerned that for IDBs one off capital grants are distorting the position and not delivering effective audit. For Parish Councils, the exposure to Full Audit is disproportionate given the scale of their activities.

In our submission to the Department we reviewed a number of ways that these problems can be overcome and propose that the current £6.5m limit be abolished and that IDBs, Parish Councils and other smaller authorities be designated Smaller Authorities regardless of turnover. AGN02 already has different requirements for different levels of expenditure. It is proposed that it be revised to strengthen audit requirements for 'larger' Parish and Town Councils/other smaller authorities, and for dealing with DEFRA funded schemes.

It is proposed that this matter needs to be resolved as part of this Phase.