

AGENDA ITEM.

**REPORT TO AUDIT &
GOVERNANCE COMMITTEE**

30th SEPTEMBER 2024

**REPORT OF DEPUTY CHIEF
EXECUTIVE & DIRECTOR OF
FINANCE, PERFORMANCE &
TRANSFORMATION**

EXTERNAL AUDIT BACKSTOP ARRANGEMENTS

SUMMARY

As noted at previous Audit and Governance Committees there is a significant backlog of outstanding external audits. Last year, just one per cent of councils and other local bodies published audited accounts on time.

As stated in a letter provided to all local authorities from Jim McMahon (Minister of State for Housing, Communities and Local Government) on the 30th July, attached at **Appendix A**, the backlog is likely to increase again to around 1000 later this year, and without decisive action will continue to rise further.

The government is committed to overhauling 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.

This report outlines the 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.

RECOMMENDATIONS

To note the report.

DETAIL

The term “audit backstop” refers to a deadline to ensure that all outstanding audits are completed by a specific date. This is particularly relevant in the context of local government audits in England.

The backlog in local government audits in the UK has been caused by several factors:

- **Shortage of Expert Audit Staff:** There has been a significant shortage of qualified audit professionals, making it difficult to complete audits on time.
- **Increased Complexity of Audits:** The audits themselves have become more complex, requiring more time and resources to complete.

- **Capacity Issues:** Both audit firms and public bodies have faced capacity issues, struggling to handle the volume of work required.
- **Lack of Competition in the Audit Market:** Limited competition among audit firms has also contributed to delays.
- **Systemic Issues:** There has been a lack of a shared vision and coordination within the local audit system, further complicating efforts to address the backlog.

These factors combined have led to a significant delay in the publication of audited accounts, impacting transparency and accountability in local government financial reporting.

The backlog in local government audits has several significant impacts on local councils and their operations:

- **Reduced Transparency and Accountability:** Delays in publishing audited accounts hinder transparency and accountability for local government spending, which can affect public trust.
- **Financial Uncertainty:** Without timely audits, councils may face difficulties in financial planning and management. This can lead to challenges in budgeting and allocating resources effectively.
- **Increased Borrowing Costs:** Councils with delayed audits might experience issues with their credit ratings, making it more expensive to borrow money for essential projects and services.
- **Operational Disruptions:** The backlog can cause operational disruptions as councils may need to allocate additional resources to address audit issues, diverting attention from other important tasks.
- **Risk of Governance Issues:** Delayed audits increase the risk of governance or financial issues being identified too late, potentially leading to more severe problems down the line.
- **Impact on Other Public Services:** The backlog in local government audits can also have knock-on effects on other areas of government spending, such as the NHS and central government.

These impacts highlight the importance of resolving the audit backlog to ensure that local councils can operate effectively and maintain public trust.

BACKSTOP ARRANGEMENTS

On the 10th September the Government laid in Parliament two pieces of legislation which gave effect to the backstop proposals, the Accounts and Audit (Amendment) Regulations 2024 and, on behalf of the Comptroller & Auditor General, a draft Code of Audit Practice 2024.

The legislation included 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 if the auditors are unable to complete their work by the backstop dates, disclaimed opinions could be required. This 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.

The Council has always achieved an unqualified opinion from the auditors on its accounts. With the most recent set of accounts for 2022/23 completed and the required audit opinion was issued in May 2024 so the backstop arrangements for that year are not applicable to the Council.

The action to tackle the backlog, while vital, does not provide a long term sustainable solution to the wider local audit system. There will need to be a significant reform to overhaul the current system. The Government is working with partners to explore how best to achieve this.

The potential first year where backstop arrangements may apply for Stockton is for the 2023/24 financial year. It is hoped the Council will avoid any backstop requirements but as in previous years, issues outside of our control such as audit assurance on the pension fund may impact timeframes.

For financial years 2024/25 to 2027/28, the date by which local 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 the Council more time to ensure they are producing high-quality accounts. This in turn will benefit auditors while still ensuring publication shortly after financial year end.

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.

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