Agenda Item 6

# Chelmsford City Council Audit and Risk Committee

## 16th September 2026

## External Auditor Update

Report by:
Financial Services Manager (S151 Officer)

Purpose
To provided members with an update from the External Auditors.

Recommendations
That members note the report.

List of appendices:
1. Rebuilding audit assurance: the path to an unqualified opinion
2. From Reset to Recovery

# Chelmsford City Council

Rebuilding audit assurance: the path to an unqualified opinion

Year ended 31 March 2026

**30 July 2026**

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30 July 2026

Audit and Risk Committee
Chelmsford City Council
Civic Centre, Duke Street,
Chelmsford, CM1 1JE

Dear Audit and Risk Committee Members

**Rebuilding audit assurance – risk assessment update**

We attach our risk assessment update for consideration at the forthcoming meeting of the Audit and Risk Committee.

The purpose of this paper is to provide the Audit and Risk Committee with further detail on the risk assessment procedures performed in respect of opening reserve balances. These procedures have been undertaken in response to the prior-year disclaimed audit opinions and in accordance with the National Audit Office's Local Authority Reset and Recovery Implementation guidance.

This update should be read in conjunction with our Audit Planning Report for the 2025/26 audit, issued on 28 April 2026.

We welcome the opportunity to discuss this report with you at the meeting on 16 September 2026, and to understand whether there are any additional matters which the Committee considers may influence our risk assessment.

Yours faithfully

Debbie Hanson, Partner

For and on behalf of Ernst & Young LLP

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# Contents



Public Sector Audit Appointments Ltd (PSAA) issued the 'Statement of responsibilities of auditors and audited bodies'. It is available from the PSAA website (https://www.psaa.co.uk/managing-audit-quality/statement-of-responsibilities-of-auditors-and-audited-bodies/statement-of-responsibilities-of-auditors-and-audited-bodies-from-2023-24-audits/). The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas. The 'Terms of Appointment and further guidance (updated October 2025)' issued by the PSAA (https://www.psaa.co.uk/managing-audit-quality/terms-of-appointment/terms-of-appointment-and-further-guidance-1-july-2021/) sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice 2024 (the NAO Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the **Audit and Risk Committee and management of Chelmsford City Council**. Our work has been undertaken so that we might state to the **Audit and Risk Committee and management of Chelmsford City Council** those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the **Audit and Risk Committee and management of Chelmsford City Council** for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

Management agree that they remain solely responsible for management decisions relating to the audited body and that we do not, and cannot, act in a managerial capacity nor can we make business decisions for management/the audited body in connection with the services or otherwise, nor advise or recommend that any accounting policy, treatment or reporting is suitable for any particular purpose or specific facts, and management agrees that they will not rely on us as having done so.

If you wish to discuss how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may raise the matter with the Key Audit Partner responsible for services provided under our appointment by PSAA Ltd. Alternatively, you may contact Stephen Reid, UK Head of Government and Public Sector Audit, at 1 More London Place, London SE1 2AF. We will consider any concerns carefully and promptly and will make every effort to explain our position clearly. If your concerns remain unresolved, you may escalate the matter to Anna Anthony, UK&I Regional Managing Partner, at 1 More London Place, London SE1 2AF. If you remain dissatisfied, you may refer the matter to PSAA Ltd or raise it with our professional institute; further details are available on request.

# Rebuilding audit assurance - risk assessment update

## 1. Background and regulatory context

Appendix A explains the expected timeline to full assurance set out in the National Audit Office's (NAO) Local Authority Reset and Recovery Implementation Guidance (LARRIG 01), together with our assessment of Chelmsford City Council's (the Council's) current position. During 2023/24 and 2024/25, the focus of the rebuild process has been on the Council's "natural" rebuild, through completing planned audit procedures for each respective audit year.

As set out in Appendix A, although some planned audit procedures for the 2023/24 and 2023/24 audits could not be completed, the Council has commenced the "natural" rebuild process for these years.

LARRIG 06, issued by the NAO, requires auditors to perform specific risk assessment procedures over reserves. The guidance recognises that reserves balances may contain the cumulative effect of unaudited transactions over more than one financial year and may therefore represent an area of accumulated audit risk. The purpose of this risk assessment is to identify the likelihood and potential magnitude of risks of material misstatement within reserves balances, together with management's readiness to support the historical rebuild process. This assessment informs audit planning, and any potential rebuild of assurance over future audit cycles as well as completion of the capacity and risk assessment return that we are required to make to the Ministry for Housing, Communities and Local Government ('MHCLG').

## 2. Scope of our risk assessment procedures

Our risk assessment covered all reserves disclosed in the Council's Movement in Reserves Statement, including both usable and unusable reserves. In performing the assessment, we considered:

- the nature and purpose of individual reserves;
- the scale and significance of movements during periods subject to a disclaimer;
- susceptibility to material misstatement, including the risks of fraud and management bias;
- the wider governance and control environment of the Council's financial reporting processes; and
- risks associated with the classification of reserves between usable and unusable categories.

The assessment did not seek to re-establish assurance over historic balances. Its objective was to determine whether, where and when, such assurance could be rebuilt over time.

# Rebuilding audit assurance - risk assessment update

## 3. Summary of risk assessment findings

The risk assessment process identified that the risk of material misstatement is not uniform across reserves. Certain reserves were assessed as presenting a higher risk of material misstatement, reflecting factors including:

- the size of balances and the extent of movements during periods subject to disclaimed opinions;
- the degree of judgement required in determining the appropriate accounting treatment; and
- reliance on complex statutory and capital accounting arrangements.

Other reserves were assessed as lower risk, with characteristics that may support a more targeted and proportionate rebuilding of assurance, without undermining audit quality, subject to the availability of sufficient appropriate audit evidence. This assessment underpins the differentiation in audit response which will be adopted across reserves and is intended to promote a consistent and proportionate approach.

The following dashboard summarises our assessment of the risk of material misstatement by reserve following the disclaimers of opinion.

Any other reserves are considered to be very low risk. This is either on the basis of immaterial balances or transactions through those reserves, or that the nature of the reserves are such that they mirror the balances on the top half of the balance sheet and, therefore, no additional rebuild procedures are required.

| Reserve - Useable | Risk Assessment | Rationale for Risk Assessment |
|---|---|---|
| General Fund Balance & Earmarked Reserves | Higher inherent risk | The General Fund balance (including earmarked reserve) is material and represents the cumulative impact of revenue and expenditure decisions over a number of financial periods. Although conceptually straightforward, it carries higher inherent risk as any misstatement could materially distort reserves and mislead users on the authority's ability to fund services, meet statutory requirements, set council tax, and sustain its budget. As no audit procedures were performed in disclaimed periods 2021/22 and 2022/23, there remains an increased risk that misstatements arising in the disclaimed periods were not fully identified or corrected through movement-only testing in 2023/24 and 2024/25 and may persist within the opening balance for the current audit year. |
| Capital Grants Unapplied Account | Higher inherent risk | The complexity of grant conditions and the judgement required in determining when income should be recognised, particularly around timing, increases the risk of misstatement of available capital resources and inappropriate recognition of capital financing, despite statutory rules limiting discretion. |

# Rebuilding audit assurance - risk assessment update

| Reserve -Unuseable | Risk Assessment | Rationale for Risk Assessment |
|---|---|---|
| Capital Adjustment Account | Higher inherent risk | The Capital Adjustment Account is material and highly complex, comprising cumulative capital-related accounting and statutory adjustments arising from asset valuations, depreciation, impairments, disposals and financing transactions over multiple years. The closing balance at 31 March 2022 and 2023 was not audited due to the disclaimer of opinion, and audit procedures in subsequent periods were limited to testing in year movements rather than rebuilding assurance over the brought-forward balance. As a result, there remains an increased risk that errors or misstatements arising in the disclaimed period have not been fully identified or corrected and may persist within the opening balance for the current audit year.<br><br>Misstatement of this account could affect the accuracy of the General Fund balance, the Capital Receipts Reserve, the Revaluation Reserve and the Movement in Reserves Statement. Given the disclaimed years and the complexity of statutory capital adjustments, this heightens the risk associated with this reserve. |
| Revaluation Reserve | Higher inherent risk | The Revaluation Reserve is material and arises from periodic valuation, impairment and disposal of property, plant and equipment, which are inherently judgemental. Accordingly, there remains an increased risk that valuation-related misstatements arising in the disclaimed period were not fully identified or corrected through movement-only testing and may persist within the opening balance of the reserve for the current audit year. In addition, the accounting for movements in assets and associated reserves are technically complex, requiring accurate separation of realised and unrealised gains and correct interaction with other reserves. Misstatement of the Revaluation Reserve could also affect the CAA and the accuracy of reserve movements reported through the Movement in Reserves Statement.<br><br>The audit team was able obtain assurance over existence, additions and disposals for 2023/24 and 2024/25, however, due to the gaps in 2021/22 and 22/23, there is insufficient assurance on the opening balance on this reserve. |
| Collection Fund Adjustment Account | Lower inherent risk | The Collection Fund Adjustment Account reflects timing differences between statutory collection fund arrangements and accrual-based accounting, which we assessed to have limited impact to the overall financial statements if misstated. Whilst no audit procedures were performed in 2021/22 and 2022/23, no specific risks of material misstatements have been identified, and underlying transaction streams are not complex. |
| Pooled Investments Fund Adjustment Account | Lower inherent risk | The nature of this reserve (including the accumulated absences account which we grouped into this) means there may be an incentive to misstate to protect the General Fund. Although the balance at 31 March 2025 is not material, debit transactions in 2022/23 which were not audited due to the disclaimed opinion were above tolerable error. As a result, there remains an increased risk that errors or misstatements arising in the disclaimed period have not been fully identified or corrected and may persist within the opening balance. |

# Rebuilding assurance over reserves - Risk assessment

## 4. Implications for the 2025/26 audit

Our risk assessment process has found that the pre-2023/24 gaps in assurance - particularly those relating to reserves and other cumulative balances - can be sufficiently addressed as part of the 2025/26 audit, supporting future progression towards an unmodified audit opinion.

Before we commence our audit procedures, it will be essential for management to have completed a robust review and reconciliation of both usable and unusable reserves in the disclaimed periods, and to provide assurance to Those Charged with Governance that these balances are accurate, supportable, and appropriately documented. This reflects management's primary responsibility for preparing the financial statements and maintaining the underlying evidence base.

To rebuild assurance over the historic position, we will need to audit certain transactions and movements from 2022/23 and 2021/22. We will share details of these transactions with management and will require confirmation that high-quality working papers and supporting evidence can be provided, together with sufficient management capacity to support this historic rebuild without compromising the delivery of planned audit procedures for 2025/26 over closing balances and in-year movements. We will then take the decision, with management, when is most appropriate time to commence the rebuild of reserves.

## 5. Fees

The activities undertaken in relation to this risk assessment, the preparation of the submission required by MHCLG, and the drafting of this addendum are outside the scope of the scale fee set out in our Audit Planning Report issued on 28 April 2026. In addition, procedures relating to the rebuilding of historical assurance will also be outside the scale fee.

Accordingly, we will seek a variation to the scale fee to reflect these changes to the scope of our work and will communicate further through our reporting once the costs are agreed.

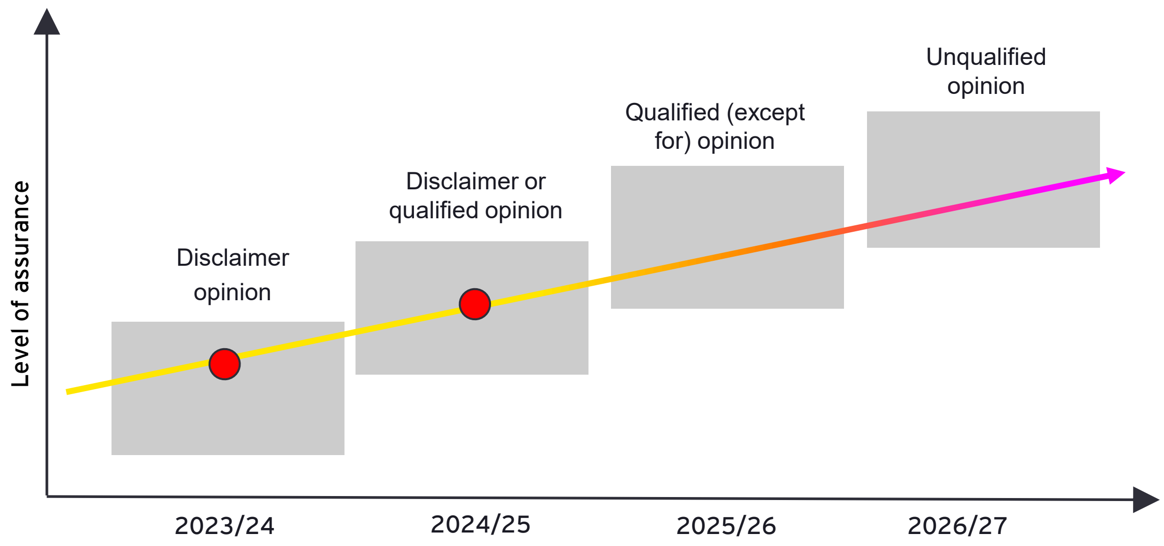
# Appendix A

# Appendix A – Rebuilding assurance

## Progress to full assurance

The chart below illustrates the expected timescale for rebuilding audit assurance as set out in the NAO's LARRIG 01. It also shows our assessment of the Council's progress against that illustrative timescale, together with the reasons for that assessment and the key actions required to successfully rebuild assurance.

The guidance recognises that the journey to full assurance - and therefore an unqualified audit opinion - will typically take a number of years. Progress depends on sustained coordination and engagement between the Council and the audit team across successive audit cycles. Since 2022/23, we have applied a structured, risk-based prioritisation approach to local government audits. This approach is designed to support a return to unqualified audit opinions wherever feasible, while continuing to meet the statutory backstop requirements introduced as part of the local audit reset.




**Council progress**

In 2023/24 and 2024/25, a disclaimer of opinion was issued due to the application of the backstop and the continuing lack of assurance over property plant and equipment (PPE) balances and reserves.

The Council revalued all its PPE in 2023/24, but we were unable to complete all planned procedures on these balances in 2023/24 and 2024/25 due to the backstop date. We are therefore planning to complete those outstanding procedures as part of the 2025/26 audit which, if no issues are identified, should provide us with full assurance over the opening balances. There will however still be movements in the CIES, MIRS, etc between opening and closing valuations which we will not have assurance over based on work completed in the prior years.

As a result, we anticipate that for 2025/26 we will have limited assurance over the following and therefore expect to issue a qualified opinion (assuming all planned procedures can be completed):

- some opening balances for 2025/26;
- Some consequential movements in the CIES and MIRS in 2025/26; and
- the closing reserves balances, due to uncertainty over the opening amounts.

Due to the time required for the impact of the above to work through the accounts, we would not expect to be able to issue an unqualified opinion until 2027/28.

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# From Reset to Recovery

## Chelmsford City Council

## Audit and Risk Committee briefing

August 2026

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# Contents

# 01 | Reset and sector context

The breakdown of local audit in English local government is widely seen as the result of a cumulative set of structural reforms and system pressures, rather than a single failure point. A perfect storm of conditions led to widespread delay in audit completion.

### The structural break: lack of system leader

- In 2015, the Audit Commission was abolished which had previously provided a centralised, integrated system for local audit, inspection and oversight. This redesign led to the loss of a single system leader.
- A lack of consensus between government departments, regulators, standard setters and other stakeholders about the scope of local government financial reporting and audit. Changes to the accounting framework were difficult to implement, with even relatively narrow reforms taking significant time to secure agreement between government bodies.
- This led to increasing audit requirements without a corresponding reassessment of whether the reporting framework remains useful for users of financial statements.

### Fragility in capacity exposed by the pandemic

- Local government finance teams have experienced underinvestment in capacity and capability. Many bodies struggle to recruit and retain qualified finance staff and increasingly rely on temporary resources, creating high turnover and loss of organisational knowledge.
- There are weaknesses in finance skills, financial reporting capability and audit readiness across some bodies, including difficulties keeping pace with increasingly data-driven audit approaches.
- Public sector audit became less attractive because of compressed timetables, regulatory scrutiny and increasing compliance expectations. This led to higher attrition and recruitment difficulties.
- There has been no workforce strategy for local audit despite sector support, suggesting an insufficiently coordinated response to emerging workforce risks.

### Financial reporting system unfit for purpose

- Financial reporting and decision-making in local government has become significantly more complex, driven by commercialisation, investment activities and other developments in local authority business models.
- There is a mismatch between local bodies' concerns about the volume of audit work and regulators' expectations for ever-increasing audit procedures and evidence. The result is a framework that continuously expands rather than being tailored to users' needs.
- Meaningful simplification of financial reporting and audit has proved difficult.
- Outdated digital capability in some bodies can also be a factor, with systems that are unable to support the increasingly data-driven nature of modern audit.

# 01 | Reset and sector context continued

## The challenge has shifted: from restoring timeliness to rebuilding assurance

While there were improvements in the level of unmodified and qualified opinions, key outcomes in 2024/25 included:

- Widespread disclaimed opinions due to limited audit scope
- Continuing gaps in audit evidence and historic assurance remain

As a result, audit opinions no longer imply full assurance for local bodies or key stakeholders.

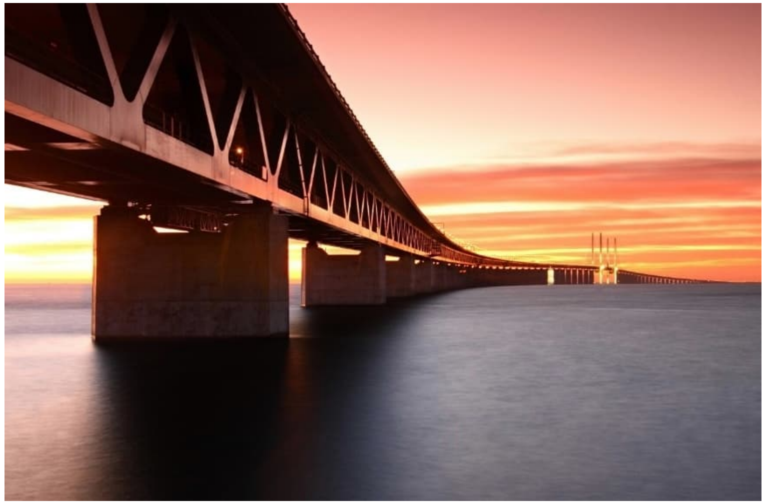
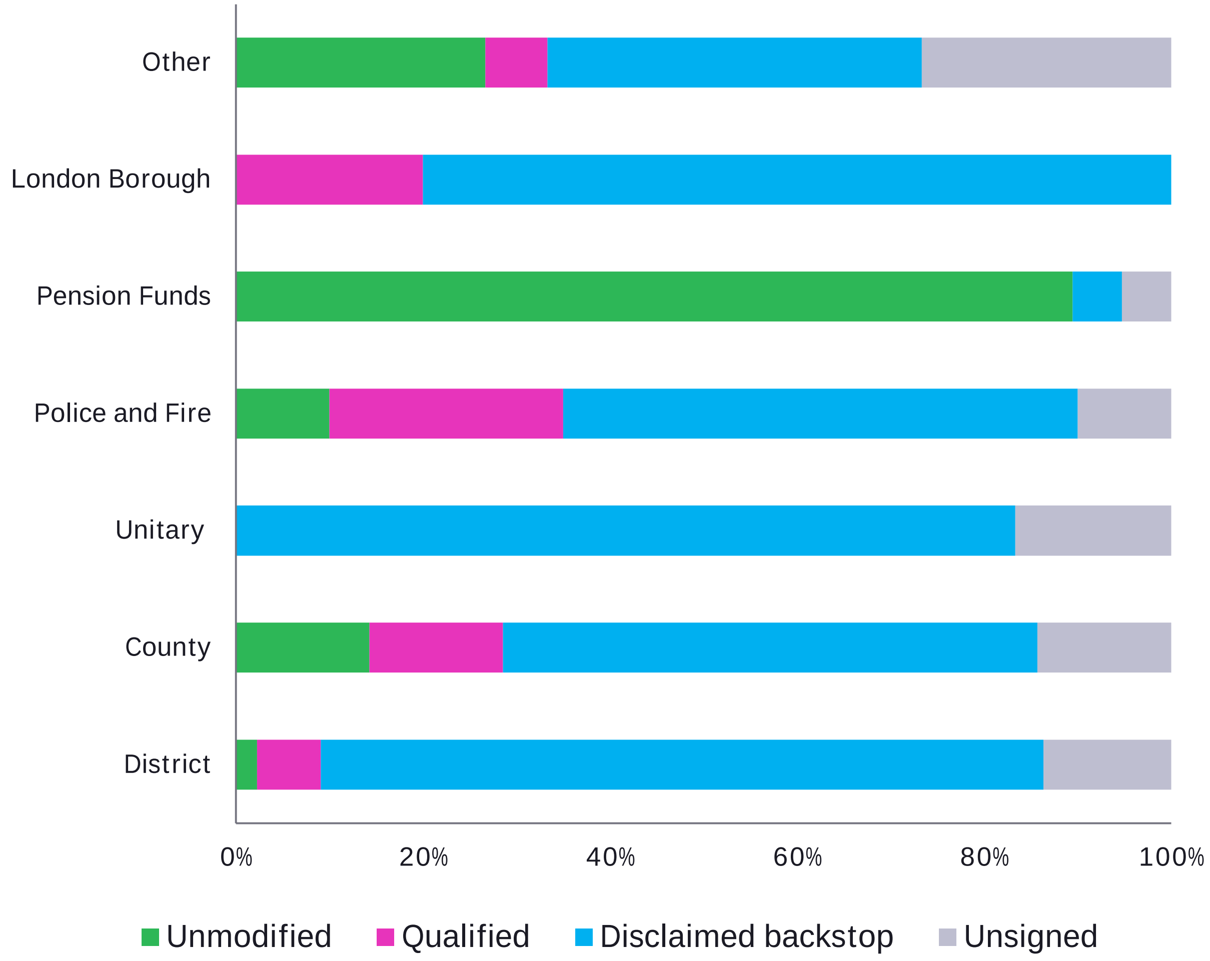


Figure 1
Most EY local government body audit opinions continued to be disclaimed in 2024/25



# 01 | Reset and sector context continued

## Audit committees should judge progress by assurance recovery trajectory

EXPECTED TIMELINE

### 2023/24 — Disclaimer opinion

- Pervasive gaps over opening balances, comparators, and in-year movements.
- Lack of assurance over PPE valued on a cyclical basis
- Lack of assurance over Reserves (cumulative nature).

### Current Audit Status 2024/25 — Disclaimer or qualified opinion

Continuing impact from 2023/24:

- Lack of assurance over all the comparator I&E transactions, PPE (where cyclical) and reserves.
- Potential for qualified except for, but more likely to be disclaimed.

### 2025/26 — Qualified (except for) opinion

- Assurance in place over opening and closing balances, and assurance gained over each in-year movement.
- Likely gap over specific comparator balances may remain on PPE due to the extent items have not been valued since 2022/23. The impact on the CIES & reserves would require to be assessed.
- However, with the anticipation of incorporating build-back guidance focusing on reserves, there is increasing probability that gaps in assurance can be specifically identified, leading to higher likelihood of a qualified report (not disclaimed).

### 2026/27 — Unqualified opinion

- Expectation that all items resolved.
- Auditor will need to reassess the PPE cyclical valuation impact -but may be able to work with the authority to ensure that items previously valued in 2022/23 were revalued by this time or would be immaterial.

CURRENT AUDIT STATUS OF CHELMSFORD CITY COUNCIL

- The Council's progress is in line with the expected timescales for rebuilding assurance set out in LARRIG 01.
- The main areas where further is necessary to rebuild assurance are valuation of property, plant and equipment, assurance over income & expenditure entries relating to PPE, assurance over grants received in advance balances, and assurance over reserves.

Extract from Appendix A in the 2024/25 Audit Results Report.

# 02 | Monitoring progress: the summary of assurances

## For most local government body audits, there are cumulative gaps in assurances brought forward

Our audit reporting across our local government portfolio highlights areas with continuing assurance gaps.

Across local government, the gaps most commonly impact:

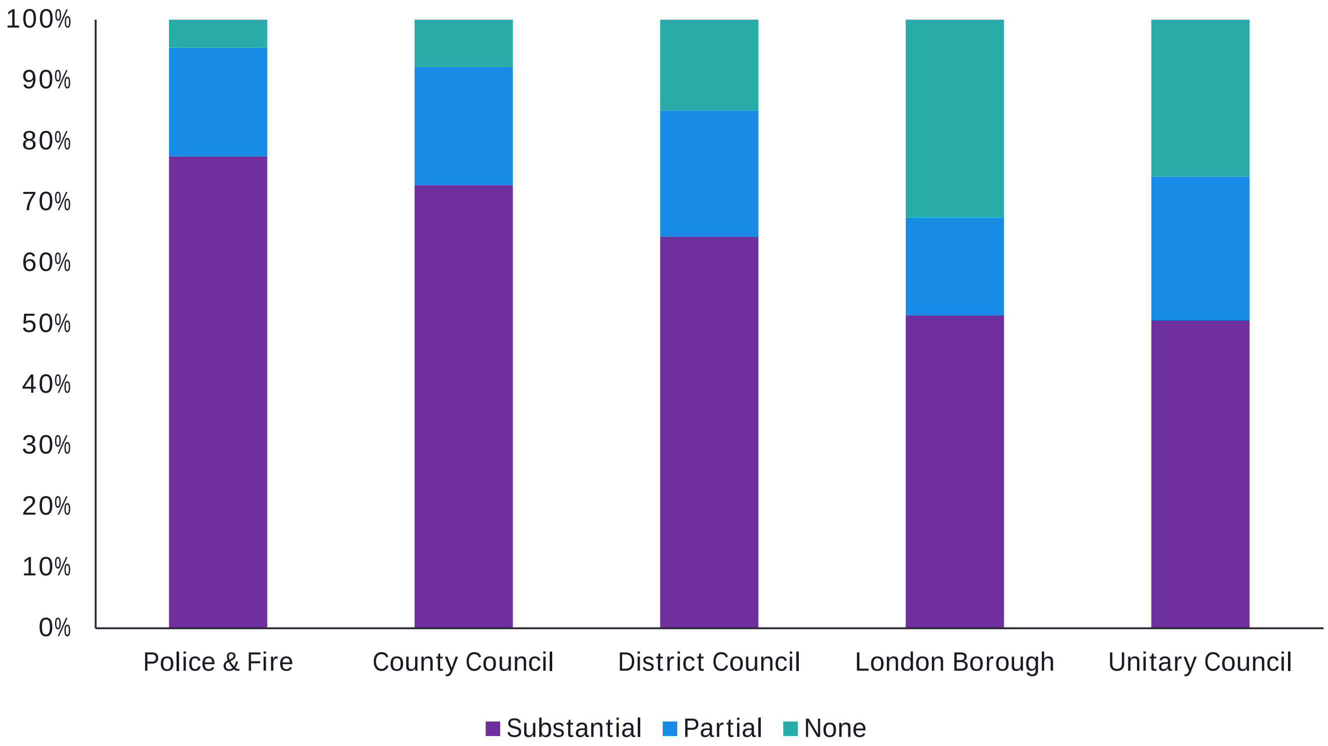
- Reserves
- Property, Plant and Equipment; and
- Income & expenditure.

Assurance is rebuilt incrementally over time. A simplified buildback trajectory is:

| Year 1: | Year 2: | Year 3: |
|---|---|---|
| Disclaimer (or disclaimer with emphasis on remedial work) | Qualified opinion(e.g., limitation of scope confined to specific balances) | Unmodified opinion |

Figure 2

We were more likely to complete full audit procedures for less complex bodies, including Police & Fire bodies, but this was not consistent



# 02 | Monitoring progress: the summary of assurances continued

## Significant gaps remain in assurance across reserves

Why does this matter?

- Reserves are a critical lens on sustainability and risk
- Misclassification can misstate financial capacity and resilience.

Figure 3

In many local government bodies, reserves are analysed into two categories: usable and unusable and are inherently more complex.

In normal circumstances, auditors can audit any movements in-year, and rely on the prior year audited closing balance as the opening balance. After a disclaimer opinion, the opening balance was never audited. Instead of understanding what changed this year, the auditor has to ask whether the entire balance, built up over several years, is accurate.

### Usable reserves

- Result from the body's activities.
- Can be spent in the future and therefore are the key focus of assessments of financial resilience.
- Include:
  - General Fund
  - Earmarked reserves
  - Capital receipts reserve.

### Unusable reserves

- Derive from accounting adjustments such as revaluations (for assets that typically cannot be sold) and pension valuation movements.
- Cannot be used.
- Include:
  - Pensions reserve
  - Revaluation reserve
  - Capital adjustment account.

If movements are incorrectly recorded balances may appear in the General Fund when they are not actually available.

Elected members may therefore make decisions on the assumption of flexibility that isn't there.

# 02 | Monitoring progress: the summary of assurances continued

## Our assessment of audit readiness informed our reporting to all committees

Our ability to complete the audit is reliant on the timely development of well-supported accounting judgements, the provision of accurate and relevant supporting evidence, access to the finance team, and management's responsiveness to issues identified during the audit.

In this context, we assessed audit preparedness for each local government body against eight criteria (Figure 4) and reported the outcomes to Those Charged with Governance within the Audit Results (ISA 260) Report for each body.

In 2024/25 we found that:

- 87% of local government bodies met earlier timescales for the production of the financial statements.
- However, quality and completeness – not speed – increasingly constrained audit progress.

Figure 4

Most local government bodies were well prepared for audit and met deadlines for the delivery of draft financial statements that were of a good quality

# 03 | How do you compare to peers?

## Our assessment of audit readiness informed our reporting to all committees

Bodies that were able to produce well-supported draft financial statements and respond effectively to audit queries are significantly more likely to progress from disclaimer to qualified opinions.

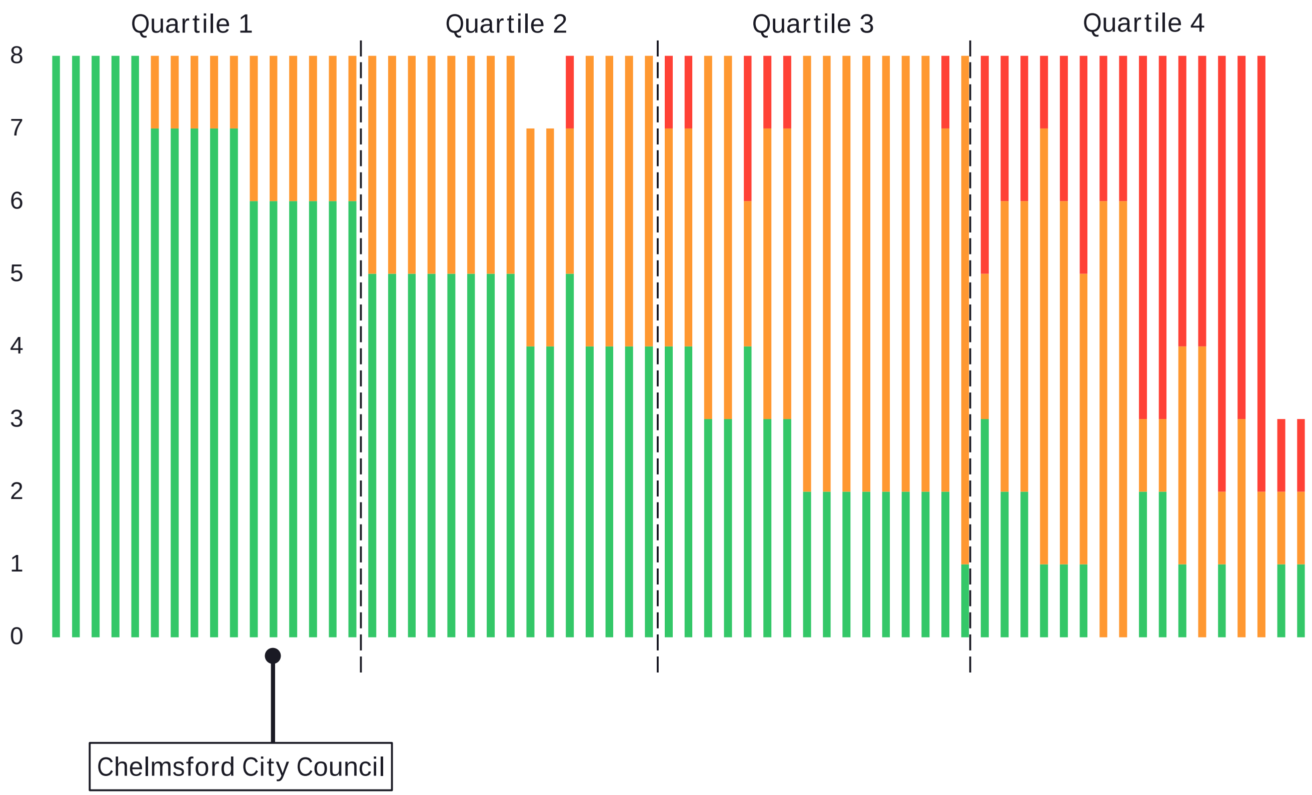
Where readiness remained weak, auditors were often unable to complete sufficient planned procedures, regardless of the body's complexity or size.

Arrangements were effective

Improvements required

Arrangements were ineffective

Figure 5
Where the opinion remained on disclaimed or qualified, we found that we could split bodies into 4 main groups, with advanced, well-prepared bodies in Quartile 1.



# 03 | How do you compare to peers? Continued

## Our assessment of audit readiness: District Councils

Key factors include:

- Timely draft financial statements;
- Quality working papers;
- Robust evidence including from management specialists; and
- A responsive finance team.

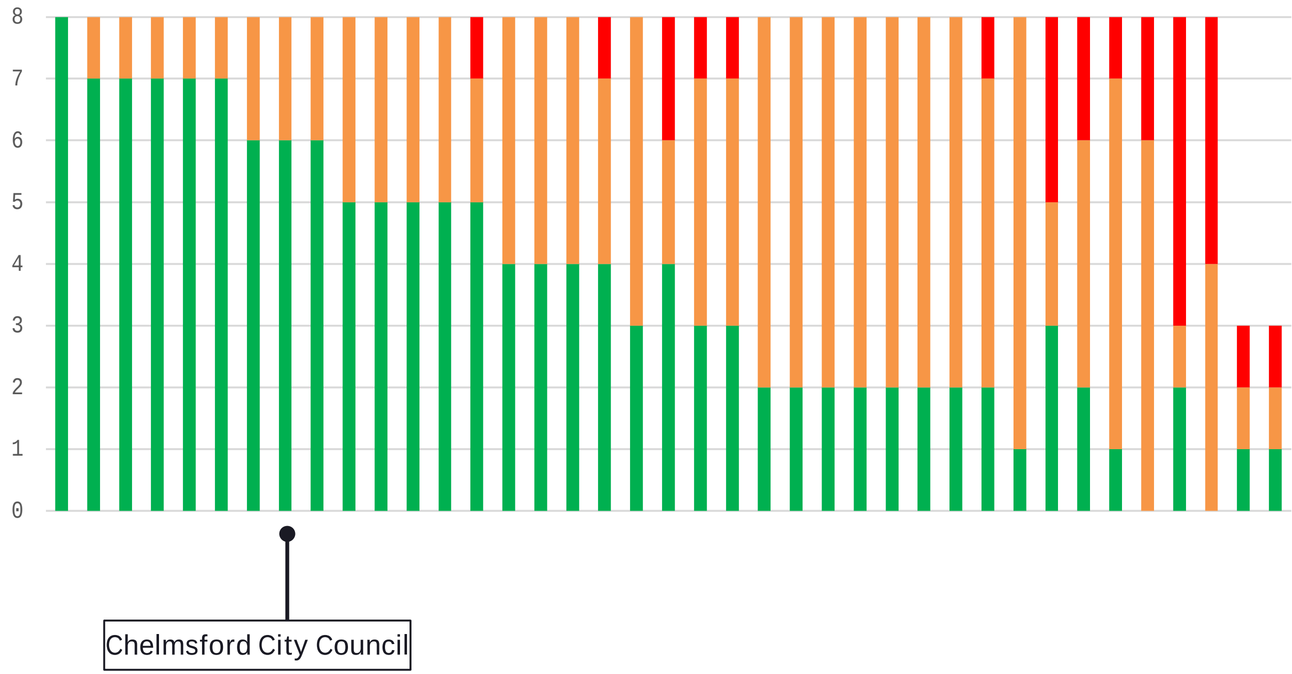
Arrangements were effective

Improvements required

Arrangements were ineffective

Figure 6

How the council compares to similar bodies (district councils) that met the backstop deadline



# 03 | How do you compare to peers? (cont'd)

## Summary of assurances: District Councils

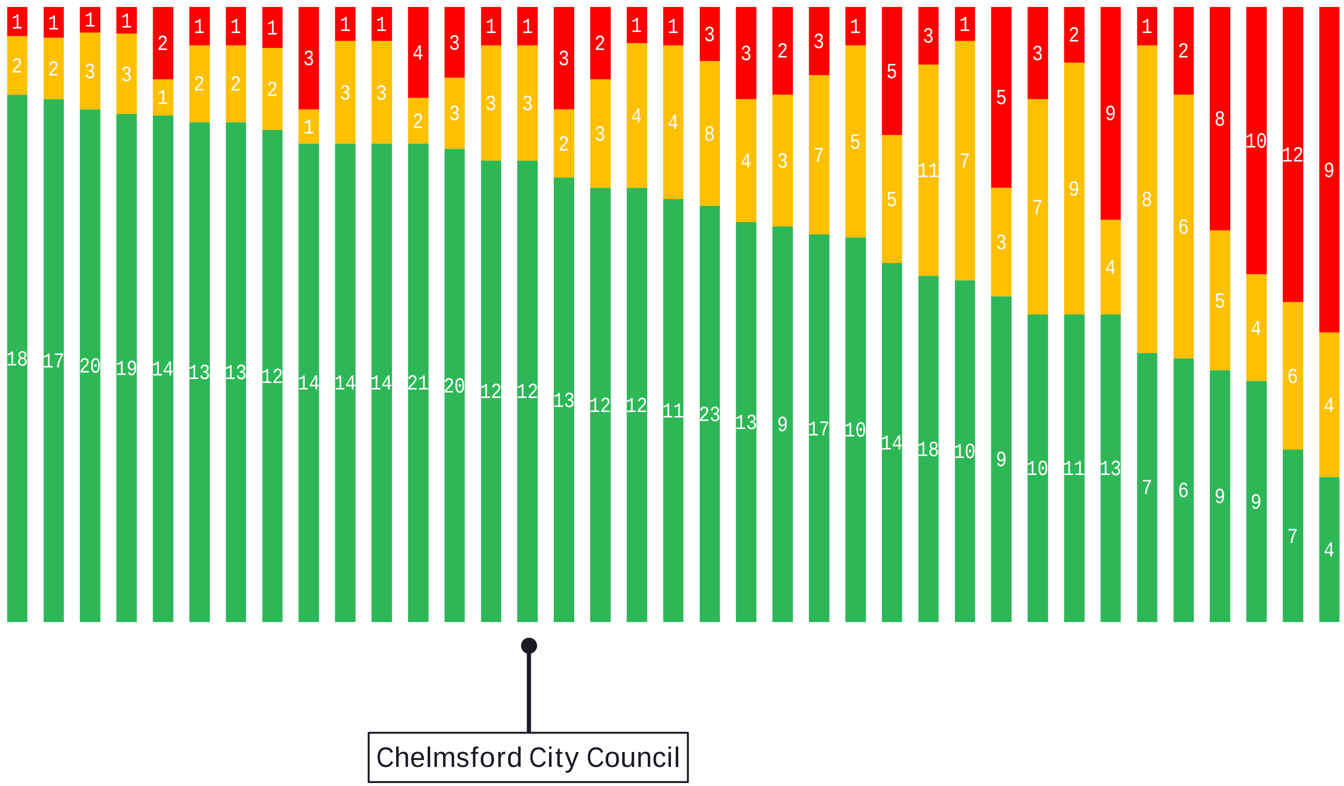
There were two district councils where no assurance could be provided.

Assurance gaps can compound over time, leading to an increased risk of disclaimers in years beyond the timelines set by the National Audit Office.

- Full assurance
- Partial assurance
- None

Figure 7 How the council compares to other district councils that met the backstop deadline

2024/25 summary of assurances



# 03 | How do you compare to peers? (cont'd)

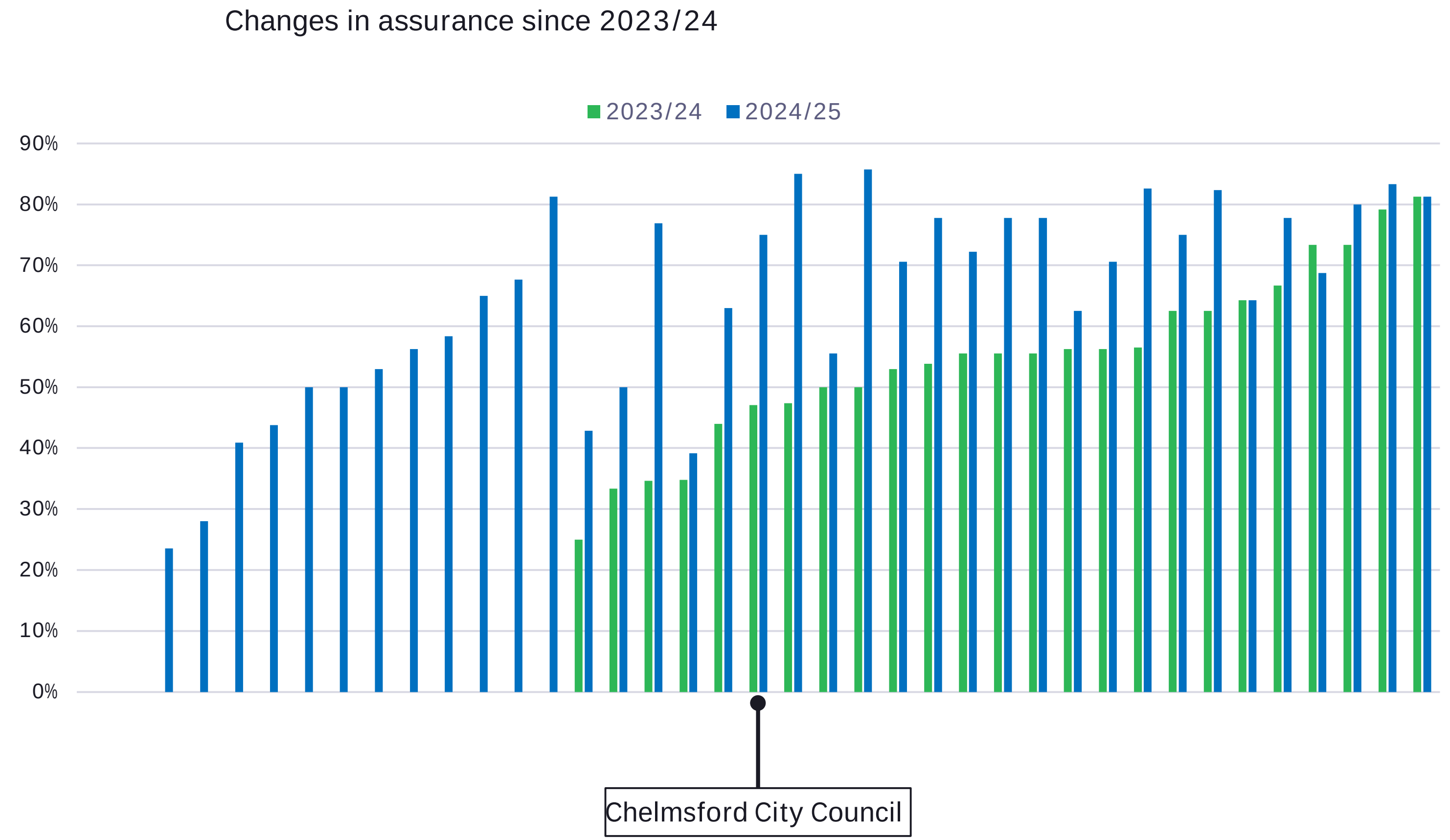
## Summary of assurances:

## District Councils

Assurance gaps can compound over time, leading to an increased risk of disclaimers in years beyond the timelines set by the National Audit Office.

We reported on improved assurance between 2023/24 and 2024/25 for most audited bodies but gaps in assurance remain, particularly for reserve and property, plant and equipment balances.

Figure 8 How the council compares to other district councils that met the backstop deadline



# 04 | Practical actions for the committee to consider

Figure 8

The next phase of recovery is in rebuilding assurance.  The committee's role is critical in driving readiness and overseeing governance to support the recovery trajectory


Focus on assurance, not just the opinion

Do you understand what has been audited and where gaps remain?

Treat audit readiness as a standing risk

Regular reporting on readiness and gaps

Track assurance recovery across balances.

Technology development and execution

Is the finance system fit for purpose and does it support the finance team to deliver?

Strengthen governance and controls, including internal audit

Reinforce the three lines of defence, and ensure that recommendations on control weaknesses are addressed

Strengthening finance capacity

Challenge capacity and resource levels

Support investment in people and expertise

Ensure stability in leadership where possible.

Sustain recovery

Active oversight

Clear prioritisation

Early intervention if off-track

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