Chelmsford City Council Audit and Risk Committee

21st March 2024

External Audit of Accounts – Dealing with the Backlog

Report by:
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Purpose
To inform Members of the Government's proposals to clear the nationwide backlog of external audits.

Recommendations
Contents of this report are noted.

1. Introduction

1.1. The Committee has received many reports on the delays in the City Council's external audits, caused by a nationwide failure of external auditors to meet their contractual obligations in delivering local government account audits.

1.2. As of December 2023, there were 771 overdue external audits, and with most local authorities having more than 2 years of accounts unaudited.

1.3. The position for Chelmsford is that the audits by BDO of 2021/22 and 2022/23 have not yet started. Both BDO and Council officers are clear this delay is not a reflection of the Council's financial management.

1.4. The Council will have a new auditor, EY, for 2023/24. Initial engagement by officers with EY has begun.

1.5. The Government and Parliament have been considering the national audit backlog and after a protracted period have now organised for key stakeholders to be consulted on actions deemed necessary to clear the backlog and stabilise the position.

2. The Consultations on Clearing the Backlog

2.1. To clear the backlog the Government has identified three key stakeholders.

- Financial reporting Council (FRC). They regulate external auditors. There is need for temporary and ongoing changes to that regulation, effectively an easing and changing of focus.

- Chartered Institute of Public Finance Accountants (CIPFA). They adapt on behalf of Government international accounting standards for use in local government and determine the format and content of statement of accounts. The intention is to simplify and reduce application of some of the standards which will reduce the amount of time spent on audits. Initially the proposals seek reduced accounting requirements for plant, property and equipment valuations and reduction in pensions disclosures requirements.

- Government via Department of Levelling Up, Housing and Communities (DLUHC) and National audit office. The regulation regarding the production and audit of accounts including deadlines, is made under a statutory instrument. This requires statutory amendment in the form of the introduction of mandatory back stop dates whereby audits are signed off even if not complete.

2.2. Due to the timing and technical content of the consultations, officers will respond and will not refer the consultations to committee.

3. Proposed changes needed to clear the audit backlog.

3.1. The proposals will not be finalised until the summer, given there is need for statutory changes. It is expected that all stakeholders will have to act upon the consultation as it currently stands and only adjust their approach should any changes become known.

3.2. The process to clear the backlog will have three phases:

- Phase 1. All outstanding audits and accounts for the years ending 2022/23 will be signed off by auditors, almost completely regardless of whether an audit is complete by 30th September 2024.

- Phase 2. All the accounts will be signed off by auditors as follows.
  - Year ended 31 March 2024: 31 May 2025*
  - Year ended 31 March 2025: 31 March 2026
  - Year ended 31 March 2026: 31 January 2027

- Year ended 31 March 2027: 30 November 2027
- Year ended 31 March 2028: 30 November 2028

*as part of the consultation it is expected the completion of the 2023/24 accounts audit will not end on the 31st May but is likely to be slightly later. This reflects recognition in the consultation of the heavy workloads in local authority finance teams in producing accounts at that point and the external auditors' commitments to NHS audits.

- Phase 3. This concerns increasing audit capacity and making changes to accounting standards to reduce the complexity of local government accounts. Though this process has now started, officers view this as longer-term action which they expect will be subject to future consultations, so this report does not cover phase 3 in any detail.

3.3. As auditors are effectively being asked to simply stop on a backstop date and produce a report on the accounts no matter the amount of progress on the audit, they will in many instances not be able to state the accounts represent a true and fair view. Instead, the audit opinion could reflect the following scenarios:

i. Disclaimed due to the backstop; as none or no substantial audit work has taken place by the backstop date.

ii. Partially Disclaimed due to the backstop; there are parts of the accounts where insufficient audit work has taken place to prove those figures. The auditor may provide assurance on specific parts of the accounts.

iii. A complete audit which signs the audit off as complete and the accounts are materially correct, or:

iv. Qualified. An audit has been undertaken and shown the accounts are materially incorrect.

3.4. It is the intention with the introduction of backstops dates is that in the first years, that many if not most audits will be disclaimed or partially disclaimed until the backlog is fully cleared and timely audits are taking place.

3.5. The s151 has spoken to BDO and understands they are highly unlikely to undertake any substantial audit work and will publish at the end of September 2024 a disclaimer of the accounts.

3.6. EY have not yet given their view of 2023/24 audit process, but Council officers will encourage a pragmatic approach. That is, they use a Partial disclaimer for 2023/24. This because EY will as a new auditor have more work to do in the first year of the audit which is made worse by the lack of audits by BDO.

3.7. It was intended to have external audit presence at the Committee meeting to explain from the auditor's perspective the approach to the audits. However, due to the timing of the meeting it is now not possible. So, a meeting between EY, the Chair and the s151 officer is being arranged.

3.8. BDO did offer to send a representative to the committee, however, after consultation by s151 officer with the Chair, it was felt there is little value in BDO attendance. This was in the light of BDO stating that they would be undertaking no substantive audit work before the end of their contract. There will be opportunity later in the year to bring BDO to the committee on production of the audit disclaimer.

3.9. The s151 welcomes the proposals as they demonstrate realism over the time it will take to normalise the audit process. However, there are number of concerns members should note:

- The timing of the consultation makes it unclear how some accounting issues should be dealt with in the 2023/24 accounts, especially valuation of operational property, plant and equipment assets. Even though the accounts need to be practically completed by early May for publication at the end of May, the consultation from CIPFA does not close until the 28th March.

- The changes still rely on auditors, CIPFA and FRC to prioritise timeliness over perceived accuracy. Previous experience of officers has been that external stakeholders suggest using estimation of some figures to ensure speedy closure but when it came to the audit, there is lack of acceptance of the estimation and demand to use the latest information which was unavailable at the time of publication.

- The lateness of audits has in past also enabled the auditor to have a current view of matters such as pension funds which is vastly different to prevailing circumstances of when the accounts were closed. This has led to time consuming discussion and restatements of accounts. The long backstop dates may continue this problem.

- When audits are not finished on time the wording of the external auditor disclaimer, could be problematic for an authorities including the City Council. The disclaimer needs to make clear Chelmsford accounts or financial management are not being demeaned by the use of disclaimer by the auditor. The consultation does express that auditor should not be assigning or implying blame to authority when the audit has not finished because of the backstop.

4. Value For Money (VFM) Assessments

4.1. The consultation does propose changes to the annual VFM assessments, these are improvements as:

- VFM will now be expected to be published every November, instead of the current 3 months after completion of an audit. They will be separate process to the statement of account audits.

- VFM assessments for the unaudited years are expected to be published in one document. This will cover only the issues relevant to those years.

- VFM work will take a higher priority. This is because the VFM assessment will be more focused on the health of the Council's finances. Given the much-reported difficulties most authorities are in it should provide greater clarity on the causes of those difficulties.

5. Fees for Audit Work

5.1. The consultation does provide comfort that audit fees will be determined by the amount of work done by the auditor. Fees will be scrutinised by independent Public Sector Audit Authority.

5.2. In the case of disclaimer where no substantive audit is undertaken there will be standard fee determined by Public Sector Audit Authority.

5.3. For the years BDO have not undertaken audits, the Council can expect to make a substantial saving against budget.

6. Conclusion

6.1. The consultation and proposed changes should enable local authority audits to restart.

6.2. The process of clearing the backlog and re-starting effective auditing is a likely outcome from the changes. There are however risks that external stakeholders fail to take this opportunity to make the changes sustainable.

6.3. The s151 officer will report on audit progress, as necessary.

List of appendices:

None

Background papers:

Nil

Corporate Implications

Legal/Constitutional: None

Financial: As detailed

Potential impact on climate change and the environment: None

Contribution toward achieving a net zero carbon position by 2030: None

Personnel: None

Risk Management: None

Equality and Diversity: None

Health and Safety: None

Digital: None

Other: None

Consultees
None

Relevant Policies and Strategies:
None