

***Audit and Inspection of Local Authorities in England:
Five years after the Local Audit and Accountability Act 2014***

**Parliamentary Academic Fellowship report by
Professor Laurence Ferry to
Housing, Communities and Local Government
Select Committee**

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Author:

Laurence Ferry PhD, BA (Hons), FCPFA, SFHEA, PCAPL
Professor in Accounting at Durham University Business School
Member of the Senior Common Room, University College, Durham University
Parliamentary Academic Fellow 2018/19 with Housing, Communities and Local Government Select Committee

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Abstract

The Conservative-led coalition government announced the abolition of the Audit Commission in 2010. Following on, the *Local Audit and Accountability Act 2014* set out the new local audit regime. The purpose of this report to the Housing, Communities and Local Government Select Committee is to provide an update regarding the impact of this reform on audit and inspection for local government in England. This is to inform post-legislative scrutiny evaluation scheduled by the Ministry of Housing, Communities and Local Government for early 2020, and broader reviews of audit in the public and private sector that are ongoing. This report was produced through extensive documentation review and interviews with relevant parties as part of Professor Laurence Ferry's Parliamentary Academic Fellowship 2018/19. The main finding of this report is summarised as follows,

“Public audit should, and should be seen to, serve the public interest. Public audit is not just another professional service. The audit and inspection system is not broken in terms of what it does, but the question is whether it does the right thing. Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM) – economy, efficiency and effectiveness), nor whether it has contributed towards fairness in society (equity). This needs to be addressed.” (Ferry, 2019)

Underpinning this main finding are seven themes. These are: post-legislative scrutiny/evaluation of change; fragmentation; auditor independence; audit scope; inspection and service improvement; audit market competition and fees; and implications for accountability and democracy of the new regime. It is recommended that the main finding and themes are considered as part of any review. An executive summary and full report are provided.

Key Words: Audit, Inspection, Local Government, England

Executive Summary

Almost a decade has passed since the Conservative-led coalition government announced the abolition of the Audit Commission in 2010. This change was justified on the basis of giving control back to local government as part of a localism agenda, removing the vestiges of centralist monitoring, and saving costs of inspection. Nevertheless, it was an unexpected step as, despite criticisms around the scope and extent of some of the Audit Commission roles, it had arguably done a great deal of good for public services since it was established in 1982.

Over the next five years (2010-15), subsequent reforms led to ending the Audit Commission's inspection and assessment functions, outsourcing audits undertaken by its in-house practice and closure of the Audit Commission itself.

The *Local Audit and Accountability Act 2014* set out the new local audit regime. This included provisions for abolishing the Audit Commission and establishing new arrangements for the audit and accountability of local public bodies, including local government. In March 2018, the [RAND Europe report](#) was published into a methodology for assessing the impact of changes to the local audit regime, which was commissioned by the Ministry of Housing, Communities and Local Government (MHCLG).

The purpose of this report to the Housing, Communities and Local Government Select Committee is to provide an update on what has happened regarding the impact of reform on audit and inspection of local authorities in England. This is since the announcement in 2010 of the abolition of the Audit Commission and the subsequent *Local Audit and Accountability Act 2014*.

The report is intended to inform any potential evaluation and/or post-legislative scrutiny that the Committee may wish to undertake, which MHCLG has scheduled for early 2020 in accordance with the timeline recommended by RAND Europe. The report may also be important for informing broader reviews by other stakeholders and academia given recent concerns with public audit (Financial audit and whether VfM arrangements are in place) and inspection (Whether VfM is delivered and fairness is accomplished), which are often seen as interrelated, with inspection an extension of audit into performance (Campbell-Smith, 2009; Ferry and Eckersley, 2019; Murphy et al., 2019). For example, in December 2018 the [Kingman Review](#) criticised public audit specifically highlighting a prioritisation of cost over quality of audit in local government with a very clear risk of allowing weak and limited audit disciplines to prevail. The review called for all relevant responsibilities to be under a single regulatory body that can take an overview. Relatedly, a [Competition and Markets Authority \(CMA\) report](#) disapproved of current audit arrangements more broadly. Also in January 2019, the National Audit Office (NAO) raised further concerns around financial sustainability and local auditor reporting, while the [Smith Institute](#) in February 2019 called for a radical overhaul of public audit with more focus on Value for Money (VfM) and fairness in spending of local authorities. Most recently in early 2019, the Public Accounts Committee began to look at the audit of local public bodies.

To inform this report, an extensive documentation review of practitioner and academic literature was carried out and over fifty interviews with institutional players were conducted. The interviews quoted in this report should be read as personal opinions and not indications of the formal views of interviewees' organisations and institutions. The data was analysed and synthesised to determine a main finding and underpinning themes.

The **main finding** of this report is summarised by Ferry (2019) as follows:

“Public audit should, and should be seen to, serve the public interest. Public audit is not just another professional service. The current audit and inspection system is not broken in terms of what it does, but the question is whether it does the right thing. Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM) – economy, efficiency and effectiveness), nor whether it has contributed towards fairness in society (equity). This needs to be addressed.”

Underpinning this main finding, the report focusses on **seven ‘themes’** (*Highlighted below in bold*). Six of these themes were raised initially by the then Communities and Local Government Select Committee in 2011. They are still of significant importance to the proper functioning of the audit regulatory space and broader accountability under the *Local Audit and Accountability Act 2014*. The seventh theme relates to the implications of the new regime for accountability and democracy. As such it spells out key concerns that underpin the other six themes.

First, the Housing, Communities and Local Government Select Committee should carry out **post-legislative scrutiny** of the *Local Audit and Accountability Act 2014* to ensure the new audit and inspection regime is fit-for-purpose, together with an evaluation of the original business case for Audit Commission abolition.

Second, the new audit regime needs to overcome its **fragmentation**. The Kingman Review in 2018 concluded the current arrangements for local audit were failing and needed bringing together in one place. However, in passing the *Local Audit and Accountability Act 2014*, Parliament deliberately wanted to separate functions of audit, inspection and procurement so one body such as the Audit Commission did not have too much weight and control over the system. The arrangements would benefit from a more formalised and co-ordinated approach, with a suitable body (most likely the NAO) having the convening role. Beyond this, if more duties need brought together, it raises the question of how much responsibility the NAO can take on given its constitutional status as an organ of Parliament dealing with local public bodies, including local government, with independent democratic mandates. A key question is whether a separate body would need to be established for the inspection of VfM and fairness.

Third, as a principle to uphold **auditor independence**, local authorities should not be able to appoint their own auditors. This is because the public interest is for the audit to be conducted on behalf of the public and not the officers and councillors of a local authority. There should be a central system of audit appointment that is mandatory for local government. Any ‘voluntary’ choice undermines the public audit principle of auditor independence.

Fourth, in terms of **audit scope**, the audit should remain a fundamental part of the new regime but the inspection needs to be re-considered. The Audit Commission had both audit and inspection elements. This led to the perception of it being a regulator and not merely an auditor. However, this inspection element has now been lost following the Audit Commission’s abolition. Some sort of structured follow-up should now be reinstated. The NAO’s limited powers concerning inspection are arguably for good reasons as individual councils have a different constitutional status to Parliament than do central government departments. So, there may be merit in a separate body being created to comment on VfM and fairness in more detail, including commenting on individual local authorities.

Fifth, there remains an expectation/idea that audit should give a stamp of approval for an organisation, in other words an **inspection and service improvement** element, but this is not its purpose. Indeed, inspection and intervention were never part of the audit, but a separate function that has ceased. The Local Government Association (LGA) peer review system is a useful means of performance improvement, but it is voluntary and not intended to be a quasi-regulatory approach. The MHCLG should not rely on that as part of its accountability framework.

Sixth, the new audit regime failed to increase **audit market competition** for local government, and has contracted, with fewer suppliers including a reduced number of Big 4 firms; this is a concern for sustainability of a 'healthy' public audit market. The LGA subsidiary company Public Sector Audit Appointments (PSAA) Ltd has become a collective procurement vehicle for local authority audit. Almost all local authorities have opted into these arrangements. The cost of the new audit regime and **audit fees** are lower reflecting changes in activity and procurement efficiencies. However, this arrangement has also been criticised for focussing on cost rather than quality in audit procurement, even though PSAA increased the quality threshold. The current consensus is that quality should now be a higher threshold in future procurement exercises. Nevertheless, the problem is not necessarily the quality of the actual audit work being performed, but changes in audit scope that means less is done with the auditor now focussing primarily on work to give an opinion rather than client relationships. Overall, the audit market can deliver the current contractual commitments in the short to medium term, but fees should not go lower if there is to be investment in audit for a sustainable future.

Finally, public auditors and their independence continues to be pivotal for trust and the legitimacy of public finance and expenditure in an **accountable and democratic system**. However, there remains an expectations gap around what public audit does and for whom. Social media and social movements are having a big impact on public engagement with the audit and inspection process, which is a new dimension that needs addressed. The new regime provides a financial audit and an opinion on whether VfM arrangements are in place, but it does not say if there was delivery of VfM on behalf of its citizens and if equity is accomplished. A key question is how much inspection around VfM and fairness should be brought back into arrangements, and how.

Each of the seven themes of the audit and inspection arrangements in English local government raises complex and difficult questions to which there are no simple answers. The key cross-thematic questions are, what should be the future scope of audit? Should it be combined with benchmarking and comparison? Should inspection, to enhance public accountability and give a stamp of approval, be included? If so, should this be done by a new body or can, for example, the NAO or LGA take on this task? In what ways would any inspection need to reflect the democratic mandate of local authorities which gives them a different constitutional status compared to central government departments? Is the traditional audit requirement of 'financial conformance' inadequate as a guarantee of effectiveness because it only shows up problems when it becomes too late to take corrective measures?

Among key stakeholders, these questions have been giving rise to varied opinions on the best way forward. Future changes to local authority audit and inspection can be expected to require a degree of experimentation as well as leaps of faith. This report, therefore, seeks to present an unbiased and balanced view based on documentation and interviews, rather than the author's personal opinion. To this end, the report seeks to draw out key contradictions and convey the

ambivalences, with which future interventions into the local authority audit and inspection regime must reckon.

1. Introduction

Local government plays an important role in public services in England. Currently there are 343 local authorities, employing 1 million full time equivalent staff, with a total revenue expenditure for 2017/18 budgeted at £94.5 Bn, accounting for around a quarter of all public spending (LGIU, 2019). Almost everyone in the country pays some form of tax that funds local government directly or indirectly, and/or is a user of local government services that cover refuse collection, schools, adult social care, children social care, roads and leisure centres among other things.

Given the size and scale of English local government and its involvement with citizens' everyday lives, the financial stewardship, performance in delivering services and fairness in dealing with populations has significant impacts and implications for democratic society. Indeed, with so much money and valuable publicly funded assets at stake, how these resources are used and powers exercised are key concerns for accountability in democracy.

Thus, it is important there are appropriate audit and inspection arrangements in place.¹ For the purpose of this report public audit refers to financial audit providing an opinion on financial accounts and whether Value for Money (VfM) arrangements are in place. Inspection concerns whether VfM is delivered and fairness accomplished. Audit and inspection are often seen as inter-related with inspection an extension of audit into performance. (For further discussion, please see Campbell-Smith, 2009; Murphy et al., 2019; Ferry and Eckersley, 2019). In this context, VfM includes examination of economy, efficiency and effectiveness – commonly known as the 'Three E's' (See Hopwood, 1984). This was the approach followed by the Audit Commission and is the approach taken by the National Audit Office (NAO) (2013a). Economy is concerned with minimising the cost of resources used or required (inputs) – spending less. Efficiency considers the relationship between the output from goods or services and the resources to produce them – spending well. Effectiveness involves the relationship between the intended and actual results of public spending (outcomes) – spending wisely. Importantly, the Local Audit and Accountability Act 2014, s.20 (1) (c), defined VfM as a public body's "economy, efficiency and effectiveness in the use of its resources" (Sandford, 2019a, p. 11). However, besides these three 'E's, a fourth 'E' – equity - is applied in some places. Equity looks at the extent to which services are available to and reach all people that they are intended to – spending fairly. This is because some people may receive differing levels of service for reasons other than differences in their levels of need. Based on this discussion it can be seen that audit and inspection is arguably not just about proper financial stewardship, but raises questions of VfM (economy, efficiency and effectiveness) and fairness (equity) (Ferry and Eckersley, 2019).

The following report on '*Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014*' is produced by Professor Laurence Ferry as part of the Parliament Academic Fellowship scheme. The fellowship programme is run by the House of Commons in partnership with Research Councils and is intended to improve and promote linkages between the works of academics with Parliament. Laurence is a fellow from the 2018 intake of the scheme attached to the staff team of the Committee. He undertook research between January 2018 and July 2019 for this report.²

¹ Sharman (2001) in his report highlighted that accountability and audit are 'pillars of our democratic form of government since the earliest times.'

² Professor Laurence Ferry's Parliamentary Academic Fellowship is for 2 years from 01/01/2018 to 31/12/2019. This is one of the research projects completed as part of the Fellowship.

The purpose of this report to the Housing, Communities and Local Government Select Committee is to provide an update with what has happened regarding accountability of local government in England since the abolition of the Audit Commission announcement in 2010 and subsequent Local Audit and Accountability Act 2014, especially concerning the impact of reform on local audit and inspection.

To review the changes to the local audit and inspection regime has involved extensive documentation review of academic and practitioner literature. This provided an initial scoping report and themes. These themes were then followed up in over fifty semi-structured interviews of around one hour each with central institutional players. The data from both documentation review and interviews were analysed and synthesised to derive a main finding and underpinning themes. Please see Appendix 'A' for more details on the methodology.

The audit and inspection of local government in England has a long history. This goes back at least to medieval times, but more contemporary the District Audit Service was set up in 1844, originally as part of the Treasury, to ensure probity and proper stewardship of public money. It was incorporated into the then newly established Audit Commission on 1st April 1983. The Audit Commission grew in stature and was given responsibility for NHS audit work in 1990. Over the next two decades, the Audit Commission moved further beyond their audit role by embracing more inspection work. This led to a perception that they were both an auditor and regulator (Abu-Hasan et al., 2013).

In 2010, Eric Pickles MP (Secretary of State for Communities and Local Government) announced the abolition of the Audit Commission arguing that less central control was in accordance with the localism agenda of the Conservative led coalition government and that it would greatly reduce costs. Even so, this was an unexpected step at the time. Commentators have highlighted that although the Audit Commission had critics around the scope and extent of some of its roles (Abu-Hasan et al., 2013; Murphy et al., 2018), in general it had been seen as having done a great deal of good for public services since its hard fought for establishment in 1982 (Campbell-Smith, 2009; Sandford, 2016, p. 15; Sandford, 2019a, p. 15; Murphy et al., 2018). In 2015 the Audit Commission ceased to exist following the Local Audit and Accountability Act 2014 that set out the new audit and inspection regime. The NAO along with other bodies would pick up responsibility for local government audit. This was a fundamental reform to audit and inspection of English local government with significant impacts and implications for financial audit, VfM and fairness considerations.

In the initial aftermath of the announcement, following a comprehensive review of evidence, a report by the Communities and Local Government Select Committee (2011, 2011a) 'Audit and Inspection of Local Authorities' stated,

"Once new arrangements are in place, we recommend that the Government instigate a wide-ranging review of public sector audit and how it fits into the wider context of accountability for the expenditure of public money. Such a review should be carried out in close consultation with Parliament, in particular through the relevant select committees." (Paragraph 18)

Over the next five years (2010-15), the raft of subsequent reforms led to ending the Audit Commission's inspection and assessment functions, outsourcing audits undertaken by the Audit Commission's in-house practice and closure of the Audit Commission itself.

The Local Audit and Accountability Act 2014 set out the new local audit regime. This included provisions for abolishing the Audit Commission and establishing new arrangements for the audit and accountability of local public bodies, including local government.

In April 2015, the Department for Communities and Local Government (DCLG) (Now the Ministry of Housing, Communities and Local Government (MHCLG)) commissioned RAND Europe to look at a methodology to assess the new regime. Three years later, in March 2018, RAND Europe published its report, *'Assessing the impact of changes to the local audit regime: scoping and baselining study'*. The report stated that:

"2. The research was not an evaluation of the reforms themselves, but provides a description of the baseline for use in any future evaluation." (...) "3. (...) Conducting the potential evaluation would not only allow for an investigation of whether the policy objectives of the reform have been fulfilled, but can also generate wider valuable insights into sector developments which can be helpful for decision makers beyond measuring the reform impact." (Page 7)

With regard to practical challenges for a future evaluation, RAND Europe (2018) suggested,

"21. It is for DCLG and the Department of Health (DH) to decide when, if appropriate, to commission an evaluation, but we consider it could not be completed until there has been at least one year of audits for all bodies under the new arrangements. This means that a more complete evaluation would be unlikely until early 2020. There are, however, merits in collecting some data in advance of that, in order to validate expenditure in the interim years, undertake some interviews, and examine progress...." (Page 15)

Towards the end of 2018, the MHCLG confirmed that it intends to begin an evaluation in early 2020, in accordance with the RAND Europe timelines. Since the end of 2018, there have been a number of important regulatory reports published that have implications for the audit of local bodies, making an evaluation even more important. In December 2018, The Kingman Review (2018a) was damning of the Financial Reporting Council (FRC) role in the oversight of companies, but also public bodies, and called for a new independent regulator named the Audit, Reporting and Governance Authority (ARGA) to be established that is accountable to Parliament. In particular, it was critical of arrangements in local public bodies, specifically highlighting a prioritisation of cost over quality of audit in local government with a very clear risk of allowing weak and limited audit disciplines to prevail. The Review recommended that arrangements for local audit should be fundamentally re-thought, bringing together in one place all relevant responsibilities, so that a single regulatory body can take an overview. The Kingman Review also recommended that a separate body from the ARGA could develop a deeper expertise in the local public audit world. This would have a different and much more focused remit than the former Audit Commission with a clear objective to set the relevant standards, inspect the quality of audit work and oversee relevant professional bodies. It should also take on responsibility for appointing auditors for local public bodies and agreeing fees. In December 2018, the Competition and Markets Authority (CMA) (2018) was highly critical of the lack of competition in the corporate audit market and called for fundamental changes to the regulatory environment. This may have knock on effects for the audit of local public bodies. The forthcoming Brydon review (2019) into UK audit standards will consider quality and effectiveness of the UK audit market.

In January 2019, the NAO (2019a, 2019b) has also raised significant concerns around local auditor reporting and local authority governance, on top of earlier concerns on financial sustainability of local government (NAO, 2018). For example, the NAO (2019a) highlighted that auditors gave unqualified opinions on financial statements in 2015-16, 2016-17 and 2017-18 providing assurance local bodies are complying with financial reporting requirements. However, the NAO (2019a) at the same time raised serious concerns around local auditor reporting especially regarding VfM and lack of public interest reports. Indeed, under the new audit regime, there have only been three public interest reports to date for local government. Likewise, the NAO (2019b) highlighted significant concerns around local authority governance, which appropriate audit and inspection arrangements underpin. These issues extend the NAO's (2018) ongoing concerns around financial sustainability of local public bodies including local government. An evaluation of audit and inspection could form part of a broader look at overall financial sustainability, resilience and performance of local government.

In addition, the Smith Institute in February 2019 called for a radical overhaul of VfM and public audit (Walker and Tizard, 2019). In particular, they called for the NAO to have strengthened audit powers but with a separate body to examine VfM and comment on the fairness of spending by local authorities.

Furthermore, the Public Accounts Committee (PAC) in May 2019 (PAC, 2019) has specifically highlighted how the MHCLG relies heavily for assurance on external audit in terms of financial governance and VfM arrangements being in place at local authorities, but that some council chief executives, finance directors and heads of internal audit have expressed concerns to the NAO that the contribution of external audit to local authority governance has reduced recently.

The main finding of the report is that public audit should, and should be seen to, serve the public interest. Public audit is not just another professional service. The audit and inspection system is not broken in terms of what it does, but the question is whether it does the right thing. Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM) – economy, efficiency and effectiveness), nor whether it has contributed towards fairness in society (equity). This needs to be addressed.

Underpinning this main finding, the report focusses on seven themes and detailed findings for each. Six of these themes were raised initially by the Communities and Local Government Select Committee in 2011, which are still of significant importance to the proper functioning of the audit regulatory space and broader accountability under the Local Audit and Accountability Act 2014. The seventh theme relates to implications of the new audit regime for accountability and democracy.

A discussion of the seven themes of the report is set out in sections 2 to 8. For each theme, this includes the main findings, supporting documentation review and interviews. The conclusions are set out in section 9. An overview of the sections is as follows:

- Section 2 - Evaluation of the new audit regime and Audit Commission abolition;
- Section 3 - Fragmentation of public sector audit regulatory space and accountability under the new audit regime;
- Section 4 - Auditor independence;
- Section 5 - Audit scope;
- Section 6 - Inspection and improving services;
- Section 7 - Competition in the audit market and audit fees;

- Section 8 - Implications for accountability and democracy; and
- Section 9 - Conclusions.

2. Evaluation of the New Audit Regime and Audit Commission Abolition

2.1 Theme Findings

It is important that there is post-legislative scrutiny of the Local Audit and Accountability Act 2014 to ensure the new audit and inspection regime is fit for purpose in terms of financial audit, VfM and fairness considerations. In addition, there should be an evaluation of the business case for Audit Commission abolition with regards to a Gateway 5 - 'benefits realisation' review³ for a major project. This is because the abolition of the Audit Commission was part predicated on making savings, which were later estimated at £1.35Bn over 10 years (DCLG, 2014). However, no monitoring of savings has happened and no evaluation has so far been undertaken. RAND Europe (2018) established a methodology for an evaluation on behalf of the MHCLG's predecessor body, with a suggested evaluation timeline of early 2020.

The MHCLG have now announced the scheduling of a review for early 2020. This can employ the methodology created by RAND Europe.⁴ Most information could be collected in advance ready for any evaluation and post-legislative scrutiny.

Outside of post-legislative scrutiny, a broader review of the financial sustainability of local government (and other local public bodies in general) should consider the impact and implications arising from the new regime for audit and accountability arrangements.

2.2 Documentation Review

The abolition of the Audit Commission was partly justified on the basis that this would lead to savings, which were estimated originally at £50M a year (BBC, 2010).

The Communities and Local Government Select Committee (2011) suggested,

³ The Office of Government Commerce (OGC) 'OGC Gateway Review 5: operations review and benefits realisation guidance' highlights that major projects should be subject to a review to see how well it worked and to learn lessons. OGC Gateway Review 5: operations review and benefits realisation guidance https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/639906/ogc_gateway__process_review_5_operations_review__benefits_realisation.pdf

⁴ In April 2015, RAND Europe was commissioned by the Department for Communities and Local Government (DCLG) to undertake the baselining and scoping work for a possible future evaluation of the impact of reform of local audit in England. The research was not an evaluation of the reforms themselves, but provides a description of the baseline for use in any future evaluation. The underpinning research was undertaken between May 2015 and February 2016 through documentation review and interviews, with the final report in March 2018. The methodology includes a background to the project and the reform of local audit, theory of change for local audit reform, baseline data and description for a potential future evaluation, further issues for consideration in a potential future evaluation, and methodology for a potential future evaluation. More specifically the section covering the methodology for a potential future evaluation includes a background, documentary review, review of administrative data and data trends, local public body survey, interviews with partners of audit firms, stakeholder interviews, case studies of the audit of local bodies, cost analysis and comparisons with other nations' local audit arrangements.

“DCLG should demonstrate its commitment to transparency by reporting and monitoring annually for the next five years on the full savings and costs in respect of: the abolition of the Audit Commission and the tasks transferred to other bodies, and how these compare with costs under the existing system.” (Paragraph 24)

In the DCLG response (October 2011),

“8. The Government has said it expects to realise significant savings from disbanding the Audit Commission. It intends to publish a draft Impact Assessment before bringing forward legislation which will estimate the costs and savings from disbanding the Audit Commission, outsourcing its in-house practice, and transferring its functions as regulator and commissioner of local public audit services.” (...) “The Government does not believe monitoring and reporting on fees (and other costs/savings in the new system) on an annual basis to be practical as it would not provide sufficient time for the new local public audit framework to bed down and for the associated audit services market to settle.” (Page 6)

Against this background, the DCLG (2014) ‘*Local Audit and Accountability Act 2014: Local audit impact assessment*’, stated that it believed ending state provision of local audit services and increasing competition in the market would deliver greater VfM. In particular, it stated that the reform objectives were to secure greater local accountability and transparency, maintain competitive audit fees, and save £1.35Bn as part of the overall local audit reform programme already underway (DCLG, 2014, p. 46). Of this, nearly £759M⁵ was to be realised in the five-year period from 2012 to 2017 (DCLG, 2014, p. 7).

The DCLG (2014) impact assessment savings figure of £1.35Bn was considerably greater than the initial £50M per year that had been originally announced, and represented the estimated net benefit over the ten-year period from 2009/10. This included reductions in annual costs of the audit regime and factored in transitional costs over the period. It also featured reduced costs from scrapping the Comprehensive Area Assessment (CAA) regime, a decision pre-dating abolition of the Audit Commission (Sandford, 2013, p. 10).

The DCLG (2014) impact assessment savings differed in methodology from that proposed by the Draft Local Audit Bill ad hoc Committee (2013) (from now on referred to as the ad hoc Committee) who suggested,

“2. The Government should include in the impact assessment an assessment of the savings made from abolishing the Audit Commission in its residual form. In order to make accurate assessments of the total savings made by the draft Bill itself, the Government should use figures from 2011/12 as a baseline. Given uncertainties about the figures in the impact assessment and the cost of local body compliance, we recommend that a new financial impact assessment is published alongside the Bill.” (Paragraph 8)

The ad hoc Committee (2013) suggested using figures from 2011/12 as CAA and some other activities had ceased prior to the decision to close the Audit Commission, and thus were not indicative residual savings from the closure.

⁵ Indexed on 2011/12 prices.

RAND Europe (2018) in their report (Part 5), based on information from the impact assessment in 2014, indicated how costs and savings can be calculated at a future evaluation. For example, it highlighted that,

“The DCLG’s Impact Assessment⁶, published in September 2014, sets out in detail how savings looking forward can be estimated...” (...) “The Audit Commission closed in 2015 and its responsibilities transferred successfully to other bodies, leading to significant reductions in expenditure (according to DCLG’s impact assessment, from almost £249m (in 2009/10) to an estimated £87m in 2014/15).⁷ Following the transfer of staff from the Commission to private firms in 2012, statutory audit fees for 2012/13 audits were reduced by 40 per cent on 2011/12 levels for five years.⁸ Further retendering in 2014 of the remaining 30 per cent of work already carried out by private firms generated further savings. The Commission estimated these savings could amount to £440m between 2012 and 2020.”⁹

RAND Europe (2018) also highlighted a more complete evaluation has to wait until 2020 when there is at least one year of audits for all bodies under the new arrangements and individual local authority actual audit costs are known. Measuring savings could come from the actual audit fees for current contracts available in the individual council annual reports. Nevertheless, much of the information for post-legislative scrutiny and an evaluation could be collected in advance and so it should be possible for a reasonable turnaround time if planned and scheduled appropriately.

Walker and Tizard (2019) in the Smith Institute report suggest a review of the audit and inspection regime is necessary, calling for an inspection role relating to VfM and fairness that could consider how spending decisions affect different groups and geographic areas.

2.3 Interviews

A number of interviewees (MHCLG civil servants, NAO directors and Housing, Communities and Local Government Select Committee MPs and staff) strongly suggested that the primary consideration should be post-legislative scrutiny of the Local Audit and Accountability Act 2014 to ensure the new audit and inspection regime was actually achieving its intended outcome, lessons learned and improvements made where necessary. All other interviewees thought this worthwhile when asked. However, the majority of other interviewees had not been aware that the RAND Europe methodology had been established and was available online. Once they were made aware, they did expect MHCLG will use the RAND Europe methodology as a basis for post-legislative scrutiny. It was also accepted by interviewees that some parts of the new audit regime framework only came into effect in April 2018, and so the MHCLG doing a review in early 2020 was the appropriate time. Nevertheless, it was widely accepted that a lot of data gathering and analysis could be done in advance.

⁶ DCLG Local Audit and Accountability Act 2014. ‘Local audit impact assessment’. Online: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/349418/2014_FINAL_Local_Audit_IA.pdf (accessed 1 April 2016).

⁷ DCLG Local Audit and Accountability 2014. ‘Local audit impact assessment’, p. 21-30 and 34.

⁸ House of Commons Research Paper 13/56, p. 10. Audit Commission (unpublished): ‘In the public interest: Lessons from the Audit Commission’s work for other public bodies and those receiving our functions’. Audit Commission 2013-4 work programme and scale of fees, p. 5.

⁹ Audit Commission (unpublished): ‘In the public interest: Lessons from the Audit Commission’s work for other public bodies and those receiving our functions’, p. 5.

All interviewees when asked thought an evaluation of the business case for Audit Commission abolition could form a part of such scrutiny for learning lessons around change over a longer time-period. In this respect, the NAO rightfully highlighted abolition of the Audit Commission and creation of the new landscape was a major project, and so should be subject to a Gateway 5 - 'benefits realisation'. However, the general strength of feeling among interviewees for an evaluation was low given the passage of time and the perceived benefits of expending time and cost relative to post-legislative scrutiny. This was in contrast to a small number of interviewees that included PAC members, Labour councillors and MPs, and a couple of senior audit firm partners who would like a more detailed evaluation.

Outside of post-legislative scrutiny, a number of interviewees (Local government, NAO, CIPFA and academics) stressed that any broader review of the financial sustainability of local government (and other local public bodies in general) should consider the impact and implications arising from the new regime for audit and inspection arrangements.

3. Fragmentation of public sector audit regulatory space and accountability under the new audit regime

3.1 Theme Findings

For some commentators the Audit Commission was considered to be able to speak with one voice, which was a strength over the new audit regime that is more fragmented. This is because the Audit Commission role has been distributed over various organisations. During this time, accountability of the local government sector has become increasingly complex, against a challenging backdrop of austerity-localism and increased commercialisation (Andrews et al., 2019; Ferry et al., 2018). The Kingman Review (2018a) suggested that the current arrangements are failing local public audit due to a focus on cost rather than quality and fragmentation with a need for all functions to be brought together again under a single body. The NAO (2019a) has also highlighted concerns for audit and the NAO (2019b) more broadly stated local authority governance has weakened in recent years. However, in passing the Local Audit and Accountability Act 2014, Parliament deliberately wanted to separate functions all held within one body. This is because whilst the Audit Commission could speak with one voice that could have benefits in conveying a co-ordinated message, it was also perceived to have too much control and weight in the system and even interfering in policy. A debate is therefore necessary. Indeed at a minimum the arrangements would benefit from a more formalised and co-ordinated approach, with a suitable body (most likely the NAO) having the convening role. Beyond this if more duties need brought together it raises the question of how much responsibilities the NAO can take on given its different constitutional status to the Audit Commission regarding local public bodies such as local government.

3.2 Documentation Review

A central concern on abolition of the Audit Commission was the possible fragmentation of the public sector audit regulatory space and proliferation of organisations involved. This may have consequential negative implications for broader public accountability.

Importantly, several functions of the Audit Commission continued after its closure and were distributed over five organisations being the NAO, Public Sector Audit Appointments (PSAA)

Ltd, FRC, The Cabinet Office and The Chartered Institute of Public Finance and Accountancy (CIPFA).

The NAO in particular took on a number of highly visible functions including responsibility for the Code of Audit Practice, standards and consistency; provision of information about audit; whistleblowing; and national VfM studies. For example, both the Select Committee (2011, Paragraphs 49 and 50) and the DCLG response (2011, Page 11) thought the NAO was best placed to produce and maintain the Code of Audit Practice and provide supporting guidance to auditors, plus the ad hoc Committee (2013) suggested “5. (...) *the C&AG (Comptroller and Auditor General at NAO) should report annually to Parliament on the effectiveness of the Code.*” (Paragraph 18). Following these proposals, the NAO took on responsibility for preparing and publishing the Code under the Local Audit and Accountability Act 2014 (Sandford, 2016, p. 10; Sandford, 2019a, p.10). The NAO reviewed local auditor reporting in England at 2018 (NAO, 2019a) and is developing a new Code of Audit Practice for 2020. Sir Amyas Morse (C&AG at NAO) suggests that this has given the NAO an “*opportunity to look at how the impact of auditor reporting can be improved so that it prompts appropriate responses and has greater impact*” (Morse, 2018).

Concerning the provision of information about audit, the NAO now publish information previously provided by the Audit Commission and are the owner of *Council Accounts: A Guide to Your Rights* often referred to as the guide to the electorate’s rights with regard to the audit of their local authority.

Regarding whistleblowing the NAO, as well as the appointed auditor, replace the Audit Commission and are now both a prescribed person for disclosures regarding local public bodies under the Public Interest Disclosure Act 1998 (Sandford, 2016, p. 7; Sandford, 2019a, p. 8), which followed the ad hoc Committee (2013) recommendation (Number 18 Paragraph 63).

Importantly building on its existing work, including in the health sector, the NAO now also carries out studies that consider the VfM of services delivered by the local government sector. Regarding VfM work, the Select Committee (2011) suggested that,

“Over the years the Audit Commission has produced some useful national value for money studies, but the programme has become excessive and not sufficiently linked to the needs of the sector. Not all the studies have proved helpful or, at £5 million a year, themselves provided value for money. We believe that a smaller, more selective programme would be better. It would be wrong for one part of public expenditure—local government—to be excluded from VfM assessment and the National Audit Office should ensure that local government services and expenditure are given due weight in its studies programme. Provided that the National Audit Office has, or acquires, the necessary expertise in local government matters, there may be some advantages to having a more unified approach to reporting on public expenditure across both local and central government.” (Paragraph 103)

However, while the Committee thought the proposal for the NAO to take on this role is workable they highlighted the different constitutional position concerning the NAO (Paragraph 104). Furthermore, any transfer of responsibility for national VfM studies to the NAO would involve a transfer of costs from DCLG to Parliament via the Public Accounts Commission (Paragraph 105).

In the Government response, DCLG (2011) stated,

“42. As we have noted, whilst we can see the benefits of a unified approach to the assessment of value for money, we currently envisage the decision to carry out any such work would be at the discretion of the Comptroller and Auditor General. It would be a matter for the Comptroller and Auditor General to secure funding for any such work from the Public Accounts Commission. The Government will factor the additional cost of any such work into its own assessment of the overall savings arising out of the policy to abolish the Audit Commission (Paragraph 105).”

Following on from this, the NAO took on a responsibility for VfM studies. There was an additional £1.7m set aside for the NAO to do this work. The NAO estimated they would do about six reports a year that would have a distinct status in the NAO rather than being published as House of Commons papers,

“The National Audit Office will not be undertaking the full range of types of studies that the Audit Commission did. The National Audit Office has estimated the costs of its studies at some £275,000 each and it expects to produce around six reports a year from 2014/15. This would be a significant reduction on the number of studies previously produced by the Audit Commission, which in 2009/10 was 16 studies with a budget of £5m (an average of £312,500 per study).” (Local Audit and Accountability Act 2014: Local Audit Impact Assessment 2014, Para 112).

RAND Europe (2018, p. 10) highlighted, *“The National Audit Office has taken over responsibility for the Code of Audit Practice and has fulfilled its role of reporting regularly on local service issues.”* The NAO have highlighted systemic challenges and potential solutions for local government during a period of difficult circumstances and limited resources (NAO, 2014a, 2014b, 2016, 2018), and supported successive Public Accounts Committee Chairs (Margaret Hodge MP and Meg Hillier MP) in a way that has sustained constant challenge and scrutiny of local government (Ferry and Murphy, 2018; Murphy et al., 2018).

Nevertheless, the NAO in comparison to the Audit Commission has a far more constrained role and fewer resources. The NAO did not get powers to examine individual local authorities or their VfM in the same detail (Sandford, 2013, p. 6). In part, this reflects an important debate on the role of audit and inspection and at what point VfM in its broader form crosses over into inspection and becomes more political. Such a criticism of politicisation was levelled at the Audit Commission. For example Sandford (2013, p. 6) highlights that Professors George Jones and John Stewart, writing in a pamphlet published by the Society of Local Authority Chief Executives (SOLACE), saw the Commission’s acceptance of the role of inspection as ‘... a fateful decision ... This decision turned the Audit Commission in effect into an agent of central government... [It] marked the end of its independence, which was confirmed as further tasks required by central government were placed on the Commission: inspecting local authorities’ performance, judging and scoring them’ (Jones and Stewart, 2012). In contrast, Sandford (2013, p. 6) highlights that some regarded Best Value as a natural partner to audit. For instance, Clive Grace, a former local authority chief executive, suggested ‘The shift towards an improvement agenda... was built into the founding statute of the Audit Commission in the early 1980s, placing powers and duties on the Commission to undertake studies at local and national level to assess, measure, stimulate and encourage improvement’ (Grace, 2005).

As well as the NAO taking on Audit Commission roles, an independent company, The PSAA Limited, created by the Local Government Association (LGA), took over Audit Commission responsibilities for management of audit contracts, grant certification, provision of information about audit, and analytical tools. The Local Audit and Accountability Bill had not initially

permitted appointment of a collective procurement body, but this was changed as a late amendment to allow such an arrangement in the Local Audit and Accountability Act 2014. The PSAA was responsible for overseeing the Audit Commission's existing external audit contracts with audit firms from 1 April 2015 until December 2017, or up to 2020 if extended. It managed the contracts and exercised statutory powers to appoint auditors, and set and determine fees. In addition, it initially had a role for housing benefit subsidy certification from 1 April 2015 until this rolled into Universal Credit or the audit contracts end. PSAA did not have a role in relation to the certification of other grant claims. Concerning provision of information about audit, the Audit Commission previously published 'Auditing the Accounts' reports that summarised results of auditors work. The PSAA now report on the results of auditors work as a summary¹⁰. Some of the Audit Commission's analytical tools, primarily maintained to support audit contracts, transferred to PSAA and continued until the end of current audit contracts.

The FRC is now responsible for oversight of the regulation of auditors of local authorities. This followed on from the Local Audit and Accountability Act 2014 that introduced new arrangements for regulating auditors of local bodies in England that mainly mirrored the pre-Audit Regulation and Directive legal framework for company audits, and the Local Audit (Delegation of Functions) and Statutory Audit (Delegation of Functions) Order 2014 whereby the FRC became responsible for oversight. Under these arrangements, local authorities appoint audit firms, which must be registered with a Recognised Supervisory Body (RSB) that has been recognised by the FRC for local audit. These audit firms are subject to regulation by the RSB. The FRC's Audit Quality Review team monitor the local public audits carried out by auditors through the new regulatory arrangements. This means the FRC now have oversight of the public sector regulatory space as they do in the private sector. However, this was despite the fact that the ad hoc Committee (2013) had raised concerns regarding the FRC,

"4. We are not convinced that the Financial Reporting Council understands the wider scope of public sector audit. (...) We recommend that the performance of the new regulatory framework should be addressed directly in the Government's post-implementation review." (Paragraph 17)

Apart from concerns about the FRC understanding scope of public sector audit, the Financial Times highlighted current concerns regarding an effective oligopoly in the private sector audit market. The concerns over lack of audit competition has led to an investigation into the effectiveness of its audit regulator, the FRC (Ford and Marriage, 2018). As competition in the local government audit market is also reducing, as measured by the number of different firms awarded contracts, this may increase pressures on the CMA to carry out a fundamental review. Indeed, Sir John Kingman (2018b) in his review of the FRC stated,

"5. We do not believe that the remit of the FRC should include public sector audit, actuarial standards and the monitoring and oversight of non-audit activities of the professional accountancy bodies. In our view these functions do not align with the FRC's future role of promoting confidence in the UK corporate sector, and would distract it from its core objectives."

The Kingman Review (2018a) in its final report highlighted that overall arrangements are not working for public sector audit. For example, the Kingman Review was damning of the FRC role in oversight of companies but also public bodies and called for a new independent regulator

¹⁰ For further details on PSAA report on auditors see <https://www.psa.co.uk/functions-up-to-2017-18/reports-on-the-results-of-auditors-work/>

named the Audit, Reporting and Governance Authority (ARGA) to be established that is accountable to Parliament.

The Kingman Review (2018a) also recommended that arrangements for local public audit should be fundamentally rethought, recommending all relevant responsibilities relating to the public audit process come under a single regulatory body that can then take an overview. The Review also recommended that this would be better undertaken by a separate body from ARGA that has (or could develop) a deeper expertise in the local public audit world. This single regulatory body would have a different and much more focused remit than the Audit Commission with a clear objective to secure quality in all aspects of public audit. This would include to set the relevant standards, inspect the quality of audit work and oversee relevant professional bodies. The single regulatory body should also take on responsibility for appointing auditors for local bodies and agreeing fees. The Review was critical of current arrangements in local public bodies, specifically highlighting a prioritisation of cost over quality of audit in local government with a risk of allowing weak and limited audit disciplines to prevail. The Competition and Markets Authority (2018) was highly critical of the lack of competition for audit services in the private sector and called for fundamental changes to the regulatory environment that has knock on effects for the audit of local public bodies. Concerns on audit and inspection only continued with the Smith Institute in February 2019 calling for a radical overhaul of local public audit. The Smith Institute suggested strengthening the audit role of the NAO, and the setting up of a separate body to examine VfM and fairness in public bodies including at a local level (Walker and Tizard, 2019). In addition, BEIS (2019) raised a number of issues in looking at the future of audit that need addressed. Furthermore, while the CMA and Kingman reviews looked at market delivery mechanisms for audit, regulation of providers and ultimate product, Brydon (2019) is undertaking an independent review into the quality and effectiveness of audit that looks at what product would be of value regardless of delivery and regulation mechanism. Even although this is focussed more on the private sector, it will have implications – even if indirect - for public service audit.

Further fragmentation in terms of the number of organisations involved in audit and inspection came as Audit Commission powers to conduct the National Fraud Initiative were passed to the Cabinet Office in April 2015 in keeping with the ad hoc Committee recommendation (Number 8 Paragraph 28). This matches data from around 1,300 organisations across the public and private sectors against data provided by other participants, and key data sets from government departments and other national agencies, to prevent and detect fraud. To preserve the legacy of the Audit Commission’s counter-fraud work they continued to publish relevant counter-fraud tools and outputs online with open access before the Commission closed at the end of March 2015, at which point CIPFA picked up this role.

The power to undertake Best Value inspections (not exercised by the Audit Commission since 2010) transferred to the Secretary of State for Communities and Local Government in 2014, and the National Archives were then responsible to preserve copies of the Audit Commission website, historic reports and information.¹¹ This is useful for maintaining research records that can inform contemporary practice, although not comprehensive (Ferry and Murphy, 2015; Murphy et al., 2018).

Outside of bodies picking up former Audit Commission roles, the ad hoc Committee (2013) suggested that the DCLG should play a more active role in monitoring,

¹¹ Copies of Audit Commission past reports can be viewed on National Archives website http://webarchive.nationalarchives.gov.uk/*/http://audit-commission.gov.uk/pages/default.aspx

“7. We recommend that, as part of the new arrangements, a publically accessible register be established by DCLG which identifies when a body has not appointed an auditor, when local bodies produce their accounts late and identifies where the auditor’s opinion on the financial statements or value for money conclusions was qualified. In addition to the publication of this information, analysis should be undertaken to provide departmental Accounting Officers with meaningful conclusions.” (Paragraph 25)

The DCLG however did not take a more active role regarding monitoring, because the localism agenda was looking to afford local authorities more freedom and less central control.

From this overview, it is clear that more organisations are now involved in the regulatory space of public audit, but additionally accountability has become more complex and under greater strain due to other external factors. For example, devolution, combined authorities and Local Enterprise Partnerships (LEPs) affect the complexity of local government accountability relationships.¹² Further strain on accountability comes from austerity cuts, financial and service sustainability concerns, and governance pressures as there are more risks, less resources to manage them and reductions in accountability capacity.

Thus, accountability concerns have resulted for reasons beyond merely abolition of the Audit Commission and more bodies involved in the audit regulatory space. The NAO (2019a) highlighted significant weaknesses in local auditor reporting and the NAO (2019b) carried out an evaluation of local authority governance to determine how well the new relationships function together, which included consideration of external checks and balances, where they expressed concerns.

Within this context, there have been various calls for Local Public Accounts Committees (LPACs) to be set up to help address accountability concerns. This is because it is argued they could help secure better VfM, reduce democratic deficit and help overcome scrutiny barriers (CfPS, 2018). There are various opportunities and challenges for how these would operate especially geographically and with overlap to existing structures, and they warrant further consideration (Ferry, 2017; Ferry and Murphy, 2018).

3.3 Interviews

A number of interviewees (NAO, FRC, CIPFA, Audit firm partners, PAC and academics) suggested that the overall consistency of approach from the Audit Commission made it easier to look across all local authorities, compared to the new audit regime. For example an audit firm partner highlighted that the Audit Commission set the code, performed 70% of the audit work through their own District Audit service and procured other audit firms that they could direct regarding audit and inspection work. The audit firm partner went on to state that the convening role which the Audit Commission’s auditors had in the local area has gone.

The interviewees however had different opinions across a wide spectrum on the level of fragmentation under the new arrangements. At one end of the spectrum, a couple of Labour

¹² For example, to strengthen arrangements the NAO have produced three reports on LEPs so far and helped bring about the Ney Review and improvements in assurance frameworks, even although LEPs are not public bodies themselves.

MPs and PAC members interviewed strongly felt that the Audit Commission abolition created a vacuum with its role spread over various organisations (NAO, PSAA formed by the LGA, FRC, Cabinet Office and CIPFA), most of whom already existed. This arguably fragmented the public sector audit regulatory space and made it more complex, especially under austerity. In this context, the Kingman Review (2018a) stated overall arrangements for local audit of public bodies are not working and suggested bringing together in one place all relevant responsibilities, so a single regulatory body can take an overview. In contrast, a couple of interviewees from the NAO highlighted the Kingman Review did not consider that Parliament in passing the Local Audit and Accountability Act 2014 had made a conscious decision to separate functions instead of them being all held within one body, which was seen as having too much control and weight in the system. They also suggested that fragmentation is a loaded word as automatically has connotations of things being wrong. They thought it more a case of diverging operational duties that did not require centralised oversight. Separate means you are clear on roles and responsibilities, but there is regular liaison and engagement between the NAO, FRC, PSAA and CIPFA, plus local auditors as the NAO does not itself audit local bodies, to share information, keep guidance up to date and ensure consistency.

It was strongly felt by interviewees directly involved in the new audit regime (NAO, FRC, LGA, PSAA, CIPFA and CFPS) and audit firm partners that the new arrangements need a more formalised and co-ordinated approach, including a standard system with a suitable body having the convening role. These interviewees thought that the NAO would arguably be best placed to do the convening role, as they have responsibility for the Code that, along with partnership working, is central to the MHCLG accountability parts of the landscape.

On a broader issue, interviewees were broadly split along no clear organisational lines or job roles on whether it was better to have two audit bodies – such as the NAO and Audit Commission (or replacement in the future), or just the NAO. Some historical examples of strengths and benefits were provided. For example, a disadvantage of having two or more bodies was that it would be more difficult to broker a joint piece of work as it added more compliance, governance and clearance. Different bodies also have competing responsibilities for separate parts of the system and so maybe parochial. In addition, it cost more. In contrast, it was recognised that historically two bodies (Audit Commission and NAO) did give a competitive dynamic to learn from one another making things sharper, with better analysis and having a precision.

Pragmatically it was felt by those involved in the new audit regime, audit firms, PAC and academics that there needed to be broader responsibilities for the NAO to improve public audit. This comprised becoming responsible for local bodies audit including local government, which would be akin to the Audit Commission but just for audit and not inspection. However interviews with technical specialists from the NAO highlighted local government has a different constitutional status than central government departments which could cause issues if the NAO was to undertake an inspection role regarding local authorities.

4. Auditor Independence

4.1 Theme Findings

As a principle of the public audit model to uphold auditor independence, public bodies should not be able to appoint their own auditors (Sharman, 2001). As part of the public interest

argument, this is so auditors can report independently to the public without fear from management and/or elected politicians to take away their audit contract. In breach of the public audit model principle, local authorities were given new powers to appoint their own auditors under the Local Audit and Accountability Act 2014. This was part of localism to give local authorities more control over their affairs, but also raised concerns around auditor independence regarding appointment and removal of auditors, public interest reporting and objection to accounts. Indeed under the new regime there have been very few public interest reports coupled with growing concerns that issues raised by auditors are not being addressed. However, in practice, few local authorities have exercised their rights. Instead, almost all local authorities have opted to procure their auditor through the PSAA Ltd, which is operated by the LGA that represents local government. From the perspective of auditor independence, local government should be able to opt in to some form of a central system. However, regardless of who provides a central procurement of audit, a majority of interviewees thought that a local authority should not be able to appoint their own auditor as it undermines the public audit principle of auditor independence. In contrast, there was a minority supporting self-appointment. This was because it supports the localism agenda and merely mirrors private sector company practice that relies on the safeguard of an audit committee.

4.2 Documentation Review

Serious concerns around auditor independence have been raised around local appointment of auditors by councils' themselves. Historically, for instance, issues were raised by the Layfield Committee in 1976 and Heseltine in setting up the Audit Commission in 1983 (Heseltine, 1987, p. 37; Campbell-Smith, 2009; Sandford, 2016, p. 9-10; Sandford, 2019a, p. 10-11), and by Lord Sharman in 2001 more broadly for government (Sharman, 2001; Sandford, 2013, p. 7). This is part of the 'public interest' argument: Auditors could operate and report independently to the public without fear that management or elected politicians could take away their audit contract in such circumstances. For example, in the case of local government the local auditor should be able to operate and report independently for the benefit of citizens including local electors and taxpayers without the fear of upsetting management and councillors that could threaten their contract. Indeed the Communities and Local Government Select Committee (2011) deemed such a move for local authorities to self-appoint their auditor to be potentially in contravention of the Sharman principles, and strongly suggested that there would need for adequate safeguards. Their report stated:

"The Government is proposing a departure from the established practice that public bodies should not appoint their own auditors." (Paragraph 37)

"The legislation will have to provide clear and uncontestable protections for assuring the independence of audit committees and auditors." (Paragraph 38)

"Audit committees must be chaired by independent persons of proven competence, and should have a majority of independent members.... The law should require full transparency for audit committee proceedings." (Paragraph 39)

The DCLG response (2011) was,

"10. (...) our initial view (as proposed in the Future of Local Audit consultation) is that requiring the appointment of an auditor to be undertaken by the full council on the advice of an independent audit committee seems the most practical and effective way of ensuring auditor independence. Transparency in the appointment process will also be an important part of ensuring auditor independence." (Page 8)

Indeed Sandford (2013, p. 14) highlights that despite the historic concerns around auditor independence, the government suggested independent auditor panels¹³ could mitigate such risk at each council and so their policy of ‘localism’ could further materialise with councils empowered to appoint their own auditor. As an additional safeguard, the audit relationship was now governed by private sector ethical standards and so the engagement of an audit partner was for five years although the firm could be re-appointed, with further ethical standards around conflict of interest for non-audit services (Sandford, 2013, p. 15-16; Sandford, 2016, p. 10; Sandford, 2019a, p. 11).

Regarding auditor independence, the ad hoc committee (2013) had suggested that given the problems of local appointment, a capacity be retained limited to procurement of audit (Number 10 Paragraph 37). When considering the market in appointment of auditors and audit fees they went further stating,

“14. Given the potential problems associated with many hundreds of separate procurement processes, we recommend that the Government reconsider the current proposals in the draft bill for the local appointment of auditors and retains a capacity limited to the procurement of audit. (...) We recommend that the NAO is well placed to take on this responsibility.” (Paragraph 47)

The ad hoc Committee (2013) went on to suggest that if there was to be local appointment of auditors by local authorities and no central capacity, then they welcomed bulk procurement of audit and retaining maximum flexibility so that local bodies could undertake a variety of joint procurement arrangements (Number 12 Paragraph 43). Indeed, in relation to the audit market they stated,

“27. While we recognise that there would be scope for achieving economies of scale through joint procurement in the new regime, we also consider that substantial economies could be realised through central purchasing and appointment. This reinforces our view that a central procurement capacity should be retained. However, should the Government maintain its commitment to local appointment, we recommend that local bodies be encouraged and supported in jointly procuring audit in an effort to secure more competitive fees than could be achieved if each individual body appointed its own auditor. We consider the LGA to be well placed to potentially play an active role in facilitating this process.” (Paragraph 90)

Ultimately, through the Local Audit and Accountability Act 2014, the Government made local authorities appoint their own auditors. Almost all councils have opted to be part of the LGA’s PSAA procurement exercise for appointing and managing audit rather than directly do their own appointment¹⁴ (De Widt et al., 2019). Nevertheless, local appointment of auditors by local authorities remains a risk in the audit arrangements for local government. A useful comparison with the NHS could be undertaken. This is because after the transitional PSAA arrangements

¹³ An auditor panel at the local authority could be used to appoint the auditor. If a local authority has an audit committee they can do the job of the auditor panel to appoint the auditor. However, most local authorities ultimately went with the PSAA and so did not require either an auditor panel or an audit committee to appoint their auditor. For further details see CIPFA (2015) Guide to auditor panels, at <https://www.cipfa.org/policy-and-guidance/publications/g/guide-to-auditor-panels-pdf>

¹⁴ PSAA was highly successful in attracting eligible bodies (including local authorities) to join the scheme; 484 out of 494 bodies (98%) opted-in to the scheme (De Widt et al., 2019).

ceased from 1st April 2017, the NHS did not establish a central procurement body and so bodies have sought to appoint their own auditors. The audit procurement process in the NHS has therefore been patchier.

The use of PSAA Ltd to manage audit procurement, after the initial transitional arrangements, appears to have created another monopoly of audit appointments, but this time by the LGA, a body representing local government. De Widt et al. (2019) suggest this has worked satisfactorily, but nevertheless others have expressed they would like to see a public body again doing the role. For example, in the Municipal Journal, Peters (2018a) reported,

“Mr Whiteman (CIPFA CEO) said he was ‘uneasy’ that public sector bodies were appointing their own auditors and told The MJ that council auditors should be appointed by an independent body. He continued: ‘It gives an extra safeguard to the public that auditors are safe to speak out without fear of losing their audit contract. ‘Public Sector Audit Appointments has done a good job as a procurement club but I would one day want to see a public body, such as the National Audit Office, appointing auditors.’”

Other initial concerns regarding auditor independence were around public interest reporting and objections to accounts. The Select Committee raised concerns around arrangements for public interest reporting to continue without additional safeguards given the abolition of the Audit Commission as overseer and guarantor of public interest reporting represents a fundamental change to this aspect of local auditor appointment. They set out several proposals (Paragraph 44). The Government response from the DCLG (2011) stated,

“13. (...) our initial view is that it will be important for the audit committee to have a role in mediating between the audited body and the auditor in relation to Public Interest Reports.” (...) “We also believe it is important, when moving to local appointment, that an auditor continues to feel able to undertake his role, including his duty to report in the Public Interest, without any hesitation or uneasiness. We have heard concerns that the new direct contractual relationship between the auditor and the local public body could lead the auditor to feel uneasy about making a report in the public interest. Our consultation document set out a number of safeguards around the unreasonable dismissal of an auditor by a local public body....” (Pages 9-10)

The ad hoc Committee (2013) stated,

“16. (...) We recommend that the Bill should include provision for an auditor to raise a Public Interest Report (PIR) without prior reference to the audited body’s auditor panel or audit committee.” (Paragraph 60).

By 2018, there had only been three public interest reports in local government, and none in the NHS, during the new audit regime. In the Municipal Journal, Peters (2018b) reported,

“Speaking at a Public Accounts Committee hearing, (CIPFA) chief executive Rob Whiteman, said external auditors were not using their public interest reporting requirements enough and suggested CIPFA would work with them to ensure that they understood their duties.”

Apart from the concerns with public interest reporting, in the Municipal Journal, Peters (2018a) reported, Sir Amyas Morse (C&AG at NAO) said,

“Auditors tell us that little action is being taken as a result of qualifications or concerns raised with those charged with governance, which suggests the indifference at Northamptonshire CC described by the inspector may not be unique to that council.”

The problems around inaction by local authorities to auditor comments and governance were confirmed in later reports (NAO, 2019a, 2019b).

With regard to right of objection, the Select Committee (2011) suggested that, “*The statutory right of the public to object to accounts should be replaced by more proportionate arrangements.... (But) public’s rights to inspect accounts and to ask questions of the council would remain*” (Paragraph 46). Sandford (2016, 2019a) highlights that the NAO has published ‘Council Accounts – a guide to your rights’ for members of the public wishing to make use of their legal rights regarding local authority and public body accounts. Under these rights, local electors can inspect local authorities’ accounts and documents relating to accounting records, for a period of a maximum of 30 days. Importantly, they can still lodge an objection to any item within the accounts that the auditor must investigate. However, the Local Audit and Accountability Act 2014 stated that was unless regarded as being repetitive, frivolous, or of disproportionate cost.

4.3 Interviews

Those involved in the new audit regime (NAO, LGA, PSAA, FRC, CIPFA and CfPS), audit firm partners, PAC and academics felt that the independent appointment of auditors for all local bodies is a fundamental principle of public audit. They also felt that the principle should have not been breached whereby local authorities could appoint their own auditors. After all, the public interest is for the audit of a local authority to represent the public and not the officers and councillors.

These same interviewees had very different levels of feeling on whether the principle should be reinstated. They highlight that despite the changes to auditor independence, in practice for the moment at least there have not been any issues and there are audits being undertaken compliant with statutory obligations and the Code. They thought the reason is because the PSAA (that is a separate part of the LGA in terms of management and has its own board) provided a paid selective procurement system for local government audit nationally, with less than ten out of the 353 local authorities in England not opting in. Local government interviewees (Officers, councillors, SoLACE and LGA) widely regard it as a good thing that local authorities as a sector went with the PSAA. This allowed a form of quasi-independent appointment and economies of scale.

Nevertheless, there were some concerns around potential risks. For example, the NAO and one of the leading audit firms highlighted a lack of public interest reports as a sign that auditor independence was not as robust as in the past. Although the audit firm also stated that reputational risk, large fines and a need to uphold professional standards meant they would not want to take an undue risk of not issuing a public interest report if it was necessary.

The principle of auditor independence under a public audit model remained widely supported and the preferred arrangement, but there were alternative views. A minority of interviewees (a Conservative MP, local authority that procures its own audit and was happy with such arrangements, and a former audit partner) felt strongly that local bodies should be able to appoint their own auditors. This was for various reasons, including that it was part of the localism agenda, aided local choice, could work well with an effective audit committee, and the public audit model undermined the benefits of the market. In addition, it was highlighted that in the private sector company management usually through an audit committee appoint the

auditor to represent shareholders, and so why in the public sector can the management of a local authority through the audit committee not be trusted to appoint the auditor to represent the public. These interviewees did not mention that the resulting dependence of private sector auditors, who should be working for the shareholders and not company management, has been a key point in recent critiques of company audits. The equivalent argument in local authority audits would concern whether auditors can work in the interest of citizens if they are beholden to local authority functionaries.

5. Audit Scope

5.1 Theme Finding

The Audit Commission had both audit and inspection elements to their regime. The additional responsibilities around inspection saw inspectors ask auditors for information to support assessments in the inspection regimes (Comprehensive Performance Assessment (CPA) and Comprehensive Area Assessment (CAA)). The inspection regimes led to scoring and rankings of local authorities in league tables (Abu-Hasan et al., 2013). This inspection regime led to the perception of the Audit Commission being a regulator and not merely an auditor.

Under the new audit regime, the inspection element has gone and the main savings in audit fees alongside procurement efficiencies are undoubtedly due to the change in audit scope that has fundamentally changed to be more risk based. The concentration is now mainly on financial resilience with a reduced VfM role. For example under the new audit and inspection regime the local auditor now only assesses whether VfM arrangements are in place at a local authority, rather than under the Audit Commission regime that required as part of inspection making a judgment on whether VfM is actually being delivered by a local authority.

Some sort of structured follow-up is missing. It raises questions on the extent to which audit is needed and for what purposes. The scope of the audit should therefore be reviewed in terms of the NAO and individual local authority auditor roles. A potential area to consider is theme based auditing, embracing some tightly focussed sector benchmarking studies to aid comparisons and mutual learning across local government. However, it would be important to ensure that these benchmarking were relevant and did not multiply into an excessive number of studies due to time and cost trade offs. Individual local authority auditors could also pass up to the NAO their conclusions on VfM arrangements under the Code. VfM assessment of local authorities by their individual auditors in terms of whether it provides 'added value' could be re-evaluated. In particular, consideration may be necessary on whether the audit needs to focus not merely on financial resilience but also on service resilience and fairness, especially given the strain on even statutory services under austerity.

However, the NAO's limited powers concerning inspection are arguably for good reason as individual councils have a different constitutional status to central government departments. It could be argued the NAO should have their powers around audit and overall view on VfM strengthened, but a separate body be created to comment on VfM and fairness in more detail. This could address some of the constitutional and operational concerns, but would have an associated cost and time that needs to be considered.

5.2 Documentation Review

The debate about how much VfM work should be undertaken goes back at least to the 1960s and District Audit, and indeed has encountered different views as to its usefulness at different points in time (Campbell-Smith, 2009).

The Communities and Local Government Select Committee (2011) recognised concerns around protecting public funds and securing VfM, but also contention around the nature and extent of work. They suggested,

“Public sector audit needs to be proportionate and risk based. Its primary purpose is to protect public money but it should also be adaptable for legitimate local needs and provide value in its own right. The code of audit practice needs to reflect these principles. (...)” (Paragraph 56)

“The nature and extent of value for money work prescribed in the code of audit practice is contentious. On balance, we favour the proposal that a council prepare an annual report of its arrangements for delivering value for money, showing what it is trying to achieve and the measures that it is using to improve performance. The auditor should be required to review and provide reasonable assurance on the annual report. This would be a more limited but realistic requirement than requiring auditors to judge whether the council is delivering value for money. Additional value for money work should be an optional, not mandatory, part of the code.” (Paragraph 57)

The Government response from DCLG (2011) was,

“19. We welcome the Committee’s view (...) a slight majority of respondents indicated a preference for leaving the high level scope of audit unchanged i.e. including a requirement to look at the arrangements for value for money. (...) The Government is considering carefully how to ensure a proportionate and/or risk-based approach to local value for money audit work. The Government consulted on proposals to pass responsibility for the Code to the National Audit Office and, should this transfer happen, the content of the Code will ultimately be a matter, following full consultation, for the Comptroller and Auditor General.” (Page 12)

The ad hoc Committee (2013) stated,

“19. The scope of the Audit Commission’s work on VfM expanded over time at the request of the Government. While we received conflicting evidence about the value of the Audit Commission’s work in this area, we are disappointed that the Government failed to undertake a review of the Commission’s Value for Money work prior to its termination.” (Paragraph 69)

Following the ad hoc committee (2013), over subsequent years’ the savings of the new audit regime were realised partly by a reduction in the scope of audit that focussed more on financial audit, with much lower VfM work and the scrapping of performance improvement and intervention based work. For example, there are now no inspection, performance improvement and intervention aspects under the new audit regime, VfM arrangements are not the same as under the Audit Commission and not as strong despite efforts to try and bolster these in other ways by the LGA and MHCLG (Ferry and Murphy, 2018; Murphy et al., 2018).

Importantly the NAO has provided an overview of financial sustainability and VfM, despite operating under a much more constrained remit than the Audit Commission and with far fewer

resources. As a result, they do not have the powers and capacity to apply the same detailed scrutiny (Ferry and Eckersley, 2015; Ferry and Murphy, 2018; Murphy et al., 2018).

For instance, under the Local Audit and Accountability Act 2014, the NAO as a working assumption expect to perform up to six thematic VfM studies across local government as a sector per year. The NAO can request additional resources to help with these extra duties regarding VfM and consult with the PAC on what the VfM studies should cover. These initiatives accord with the ad hoc committee (2013) recommendations (Number 21 Paragraph 72 and Number 22 Paragraph 76). However, this level of studies remains much less than the Audit Commission.

The NAO is also more constrained than the Audit Commission in that it cannot investigate individual local authorities. This partly reflected concerns from local government that the NAO could otherwise extend detailed Parliamentary accountability to individual local authorities (Sandford, 2016, p. 15; Sandford, 2019a, p. 16). It is also part of the much longer and critical debate around when VfM in its broader form crosses over into inspection and becomes political, a criticism often directed at the Audit Commission and that the NAO would have to manage should it take on a wider remit.

Whilst the NAO have not carried out the same VfM study on an annual basis, they have done a vast array of related work stretching over the time period that address financial and VfM issues. For example, the NAO did not start reporting on financial sustainability of local authorities until 2013. Since then they have, however, produced a number of reports including Financial Sustainability 2013, Financial Sustainability 2014, and Financial Sustainability 2018 (NAO, 2013b, 2014b, 2018). They have also undertaken complementary work such as the impact of Funding Reductions 2014 (NAO, 2014a), Financial Sustainability of Capital Expenditure and Resourcing 2016 (NAO, 2016), local auditor reporting in England 2018 (NAO, 2019a) and local authority governance (NAO, 2019b).¹⁵ In addition, various data visualisations on related issues were prepared over this period. Furthermore, the NAO could have proposed to the C&AG at any point that they had to do more of these studies had they thought it necessary. Overall, it is therefore debateable whether, even despite the risks apparent due to austerity, the NAO have been able to perform detailed enough reviews of financial sustainability and VfM on a regular basis.

In comparing and contrasting different models of public audit in the UK, the Auditor General for Scotland, Caroline Gardner, highlighted that there is no direct link in England between local auditors and the national audit agency, which *'may limit the potential for auditors to provide an early warning system when issues start to emerge at one or more authorities'* (Gardner, 2018). However, it is possible for individual local auditors to feed VfM opinions up to the NAO for a national picture. In this context, Sir Amyas Morse (C&AG at NAO) has said, *"But the NAO itself could also make more of local auditors' findings and reporting to inform our national reporting. That's something I am interested in exploring further."* (Morse, 2018). This is something the NAO (2019a) report into local auditor reporting also outlines, and the NAO are looking into its viability. Such a situation fits in with an ad hoc Committee (2013) response of the draft Bill,

"23. We recommend that the Bill include a provision to confer on the C&AG an additional power to instruct auditors to collect consistent information on his behalf."

¹⁵ Note also that the NAO has carried out similar reports on police and fire authorities, and possibly other bodies.

The Secretary of State should provide detail on how auditors will be reimbursed for this additional work.” (Paragraph 78)

Beyond the important questions of reimbursement, the NAO’s use of auditors to create data sets for VfM comparisons raises much broader issues that go to the core of the relationships between local authorities as democratically elected bodies, their auditors, and the NAO as an organ of Parliament. Of particular concern would be the political accountability for the choice of comparative measures and their uses.

There were always concerns that VfM work would be stripped back too far and there is an increasing call for strengthening VfM arrangements (Ferry et al., 2015; Ferry and Murphy, 2015, 2018; Murphy et al., 2019; NAO, 2019a), including strongly from both local government (PAC, 2019) and the audit profession (Russell, 2018) although not back to ‘full-blown’ inspection levels (PAC, 2019). The NAO (2019a) have highlighted how under the new audit regime there is no direct consequence for a local authority of having a non-standard VfM report, whereas under the Audit Commission regime it would have affected the local authority scored assessment. Some local authorities now take little notice that they have a non-standard VfM report, which needs to be addressed. However, the level of VfM audit and when that becomes inspection would have to be carefully determined as while local government want more focus on VfM they do not want detailed inspection at this point in time. For example, CIPFA (2018) proposed a Financial Resilience Index that has caused much debate (Sandford 2019b), from positive responses of assisting benchmarking to negative responses around reintroducing table rankings. Sarah Howard, Grant Thornton Partner, stated to Public Finance before the CIPFA annual conference that,

“There’s an appetite to shift the focus back to work on value for money, financial standing, financial sustainability, work that looks at the longer term. That’s a debate that hopefully CIPFA could host, but you’d need the Financial Reporting Council, local government, the National Audit Office, Public Sector Audit Appointments and the firms at the table.” (Russell, 2018)

The NAO (2019b) have also highlighted calls for further VfM work as part of the audit arrangements in their report on local authority governance with attention to external checks and balances,

“16 Auditors concluded that in 2017-18 nearly one in five single tier and county councils did not have adequate arrangements in place to secure value for money. (...) while levels of qualifications are lower amongst local authorities than some other public sector bodies, the level of qualified conclusions is unacceptably high (...). 17 Over half of the section 151 officers from single tier and county councils responding to our survey indicated that they wanted changes to be made to external audit. (...) This included requests for a greater focus on the value-for-money element of the audit (26%)”. (Pages 10 and 11)

Walker and Tizard (2019) in the Smith Institute report went further highlighting the need for both VfM and equity in audit arrangements. They stressed the importance of audit in delivering a more equal society stressing that some communities in the country feel wronged as spending has not been mapped effectively. In addition, they stated that government spending decisions failed to register public experiences, neglecting fairness, including issues of gender, ethnicity and geographical balance. In comparison they argue, before 2010 the Audit Commission was regarded as an enforcer of a centrally driven performance regime, but its demise ended local value for money studies and the collection of reliable data. Now they argue no one considers systematically the equity dimensions of council revenue raising or spending. Comparative

assessment of local authority performance, even for local authority themselves, is much more difficult, as are ways to share experience. Furthermore Walker and Tizard (2019) suggest a new body could be established, or an existing body given responsibility, for an inspection role relating to VfM and include fairness. This could then look at how spending decisions affect different groups and geographic areas. However, this would not necessarily be local government specific and more related to public money in general. There could also be a Public Interest Appraisal Unit to evaluate VfM before making spending decisions. This could complement the NAO that assesses government-spending decisions afterwards. It was debateable however at what level of government this would operate and for what value and kind of decisions.

However, if more VfM studies were required, both on a national basis and on an individual council level, there would be questions around funding, who would do them, the serious lack of activity data and information needed for benchmarking (Ferry and Murphy, 2015, 2018; NAO, 2018).

5.3 Interviews

The former Audit Commission staff, new audit regime bodies (NAO, CIPFA), audit firm partners, local government and academics highlighted that the Audit Commission had both audit and inspection elements to their regime and it is the inspection element of audit scope that has fundamentally changed under the new audit and inspection regime.

Regarding audit, the NAO highlighted that the scope of what local auditors do under the new regime of the Local Audit and Accountability Act 2014 are designed in the same way as under statute for the Audit Commission regime. This includes the local auditors giving an opinion on the financial accounts and conclusion on proper arrangements being in place for ensuring economy, efficiency and effectiveness otherwise known as VfM.

In terms of the inspection element of audit scope, all interviewees recognised this has changed. The Audit Commission model was a performance assessment framework (CPA and CAA) applied to all local authorities. The performance assessment gave a score for individual local authority (overall scores and individual elements for use of resources including VfM, services, corporate and direction of travel). These scores were used for ranking local authorities in league tables. The reporting was therefore on much more than the current financial audit opinion and whether arrangements were in place for VfM. Interviewees had mixed opinions on how effective the performance frameworks had been. There was criticism highlighted by interviewees including local government, MHCLG, CIPFA, PAC, audit firm partners and academics that the Audit Commission performance frameworks did not take adequate account of local circumstances and were relatively expensive compared to the new local audit regime. The same interviewees recognised that the Audit Commission performance framework had led to more benchmarking and improvements (See Abu-Hasan et al., 2013; Murphy et al., 2019 for further balanced debate on this area). The Audit Commission interviewee along with those from local government including the LGA, CIPFA, NAO, PAC and partners in the audit firms all suggested that the inspection element led the Audit Commission to be seen as a regulator and not merely an auditor, which ultimately undermined its position especially with its support base in local government and hastened its demise. However, local government also highlighted that the dismantling of inspection is the reason why local authorities perceive public auditors now do less. Such views motivated the question of the degree of audit and inspection required.

Under the new audit and inspection regime, the inspection element of audit scope has led interviewees from CIPFA, NAO, PAC and partners in the audit firms to question whether some form of structured follow up is now missing. For example, individual local authority auditors could pass up to the NAO their conclusions on VfM arrangements under the Code so a sectoral overview could be made. Interviewees (CIPFA, NAO, Audit firms, MPs) also mentioned a small number of focussed theme-based auditing studies could be undertaken. This would be similar to benchmarking studies that the Audit Commission carried out looking across the sector. However, some of these interviewees also cautioned that the Audit Commission undertook too many benchmarking studies and that they had limited relevance.

The NAO summarised some of the concerns. Firstly, there is a gap for inspection style commentary on individual local authorities. This is because the NAO has responsibility for the Code, guidance to auditors and enhanced powers around studies, but unlike the Audit Commission can only look at groups and not individual local authorities. Secondly, whilst the NAO have statutory powers to report on all local authorities and groups of local authorities, it cannot demand responses to its recommendation. As a result, the NAO could report more on VfM, but the effect that it has would be constrained. Thirdly, for VfM, the NAO can comment on efficiency but not effectiveness of the local government sector. The NAO focus is on the Department – MHCLG. Fourthly, the C&AG of the NAO has matters of interest to all local authorities and groups of local authorities, but the NAO cannot assess an individual local authority and so cannot do any marking and ranking through league tables.

Nevertheless, both the NAO and audit firm partners point out that the limited powers of the NAO concerning inspection of individual local authorities are for good reasons. This is because the purpose of the NAO is to look at central government departments, not individual councils who have different constitutional status. Indeed, locally elected bodies are accountable to their electorates, but the NAO is a Parliamentary body and government departments are accountable to Parliament. There was also the political decision not to give equivalent powers of the Audit Commission to any successor body.

To overcome concerns, interviewees from audit firms, CIPFA and LGA argued that the NAO should have their powers around audit and VfM procedures strengthened, but a separate body be considered to be created to comment on VfM outcomes and fairness in more detail for all public bodies including individual local authorities. This is something for further consideration on basis of costs and benefits against the purpose of the functioning of the audit and inspection regime.

6. Inspection and improving services

6.1 Theme Findings

A review of performance management regimes in English local government is needed. Indeed, a dispassionate review under policy environments of centralism and localism remains well overdue. This is especially the case given the changes to the public sector audit and inspection regulatory space and increased complexity of public accountability.

There remains an expectation from the public that there needs to be some form of a stamp of approval for a local authority, in terms of performance. Interviewees suggested the financial audit and conclusion on VfM arrangements being in place under the new audit regime do not

seem to meet the expectations of the public, as this is not their purpose. As a result, it needs to be much better communicated to the public what audit is for and that the inspection and intervention that led to scored assessments were never part of the audit, but a separate function that has ceased.

The LGA's sector-led performance management has provided some support, but it is optional with no formal mechanisms to identify poorly performing local authorities. It is there as a voluntary means of the sector improving itself and is not designed to be a substitute for the Audit Commission inspection process. So, the MHCLG should not put undue emphasis on this for assurance in their accountability system.

A serious lack of comprehensive, consistent data for comparing local authorities is also an ongoing problem. The emphasis has been on local reporting against local objectives with maximum transparency, but there remains a need for a broader perspective so benchmarking data can help lead to service improvements on a national level. Despite recommendations by the Select Committee (2011), the adequacy of comparative performance data has not been reviewed since the new arrangements bedded in. CIPFA (2018) have suggested a financial resilience index, but this has had mixed reactions. Concerns around variation, failure and intervention continue under the new local audit regime, arguably to a higher magnitude than under the Audit Commission regime. Ultimately, a more robust data and information base is required.

An inspection element of local government overseen by the NAO may cause issues constitutionally and operationally, so the question remains whether there is a need for a separate body that could draw on a rigorous comparative data set to undertake inspection to complement the audit.

6.2 Documentation Review

Concerns about inspection and its role in the improvement of council services are intertwined with audit scope issues. Under austerity the focus has often fallen on financial sustainability and resilience rather than service sustainability and VfM (Ferry et al., 2015; Ferry and Murphy, 2015, 2018; Murphy et al., 2018).

The Select Committee (2011) specifically highlighted the need for a review of performance management regimes,

“The “command and control” system has an appealing logic: ministers set objectives and targets, local government devises the delivery methods, and an inspection service reports and drives improvement. Yet this has proved to be highly controversial and its benefits uncertain. There has not been a proper examination of issues relating to performance management, inspection and how to drive improvement in local government. A rigorous, dispassionate review of public sector performance management regimes, including targets, indicators, inspection methods and their alternatives, is long overdue.” (Paragraph 78)

Such a dispassionate review of performance management under policy environments of centralism and localism that pulls together academic and practitioner work scrutinised by a select committee or other independent body remains overdue. It also brings in wider issues such as whether the Audit Commission crossed a line from promoting VfM to doing something

deemed as inspection with political overtones, which undermined the foundations of the organisation (Campbell-Smith, 2009; Sandford, 2013; Ferry and Murphy, 2015, 2018).

The Government suggested that sector-led arrangements were in keeping with localism and giving more control to local authorities, but the Select Committee (2011) highlighted issues around sector-led performance management,

“We welcome the LGA’s proposals for sector-led performance management. However, they suffer from the limitation that they are optional and there is no formal mechanism to identify poorly performing local authorities, who may choose not to participate. It remains to be seen how vigorously and effectively they are implemented. The Government should clarify its position on sector-led arrangements and whether it intends to provide any further policy or legislative framework.” (Paragraph 84)

The ad hoc Committee (2013) also voiced concerns,

“24. We are concerned that as a result of the draft Bill there a vacuum surrounding Value for Money work for individual local bodies which sector-led organisations, including the LGA, are expected to fill. This places a substantial amount of responsibility on the LGA which is essentially a membership organisation and is primarily accountable to its members, rather than directly to the taxpayer.” (Paragraph 81)

“25. We consider that the effectiveness of the LGA’s peer-led improvement work is undermined by that organisation being a membership body, and the absence of a formal mechanisms to identify poorly performing local authorities who may, or may not, choose to participate.” (Paragraph 82)

“26. We recommend that the NAO should undertake a review of the effectiveness of the LGA’s sector-led approach one year from the commencement of the scheme.” (Paragraph 83)

As of 2018, the LGA’s sector-led improvement has provided some mitigation (Sandford, 2019b). However, as it is optional and without formal mechanisms for identifying poorly performing councils there remains a significant systemic risk to financial and service sustainability (Murphy and Jones, 2016; Ferry and Murphy, 2018; Murphy et al., 2018; Sandford, 2019b). Walker and Tizard (2019) echoed such concerns. They argued that the peer challenges are not mandatory, but instead are organised through informal networks of officers and members with no certified results. Indeed they suggest that some local authorities do not participate and others will not publish results or that they might water down critical comments.

In addition, the Select Committee (2011) highlighted concerns around the lack of performance indicators and public reporting under the new arrangements,

“It now seems inevitable that there will be a lack of comprehensive, consistent data on which authorities can be compared. There are calls to reinstate some limited form of national indicators to allow comparison between councils. This may seem attractive but it is unclear how it would avoid the problems and anomalies of the previous indicator sets. We consider that the emphasis, at least for now, should be on comprehensive local reporting against local objectives with maximum transparency. Nevertheless the need for a broader perspective will remain. We recommend that the need for and adequacy of comparative performance data be reviewed two years from now, once the new arrangements have bedded in.” (Paragraph 88)

The ad hoc Committee (2013) echoed these concerns,

“20. We are very concerned that the draft Bill makes no provision for comprehensive like-for-like value for money comparisons which would enable informed judgements about whether taxpayer money had been spent effectively. The Bill should be redrafted to include a systematic process to enable benchmarking and like-for-like comparisons between public bodies in the new regime.” (Paragraph 70)

At 2019, there remains a serious lack of activity data to benchmark local authorities, although the LGA have commendably attempted to establish benchmarking data profiles and CIPFA maintain a reduced form of subscription service. Also for the myriad of data that is available there is a lack of capacity and capability to utilise data, such as annual accounts, MHCLG statistics and transparency transactions to make, create and communicate meaningful information (Ferry and Murphy, 2015, 2018; Murphy et al., 2018, NAO, 2018; PAC, 2019).

Lately CIPFA have suggested a financial resilience index for the local government sector. However, this has already been criticised (Ferry and Eckersley, 2019; Sandford, 2019b). On the one hand for not having comprehensive service resilience data to consider VfM for a balanced view. On the other hand that it could lead to ranking and game playing.

The Select Committee (2011) set out concerns around variation, failure and intervention,
“It would be idle to pretend that intervention by central government in the conduct of local authorities is never going to be necessary. It should therefore be well-regulated and based on clear and transparently-applied criteria—preferably statutory. (...) It should do so in close consultation with the local government sector, including the Local Government Association, but mindful of the fact that the LGA is a voluntary membership body which may not itself be capable of identifying or dealing with all cases of serious service failure.” (Paragraph 93)

Concerns around variation, failure and intervention have been raised by academics and practitioners (Ferry et al., 2015; Ferry and Murphy, 2015, 2018; Murphy et al., 2018; CfPS, 2018; NAO, 2018). For example this includes concerns around a series of serious failures relating to accountability (Rotherham), governance (Grenfell Tower), and financial management (Northamptonshire) with many additional councils believed to be at risk to financial and service sustainability pressures (NAO, 2018). Nevertheless, such failings were also evident under previous Audit Commission arrangements and are not merely down to the new audit and inspection regime.

6.3 Interviews

The inspection and service improvement regimes, CPA and CAA, were specific parts of Audit Commission work, which was highlighted by a number of interviewees who had worked previously for the Audit Commission. These interviewees that included staff at the NAO and partners in audit firms suggested that the strength of the Audit Commission regime was that it could identify issues from the national reports that were then followed up locally. With CAA, the Audit Commission could also look at all money in an area and what you get for it, which was powerful. This helped the Audit Commission to identify when intervention might be necessary. However, whilst CIPFA, audit firms partners, local government and academics thought the Audit Commission performed its audit role well and that benchmarking and performance management had led to service improvements there were concerns that the inspection regime grew too quickly, became burdensome and was expensive. Indeed,

interviewees from across the spectrum and especially those speaking on behalf of local government stressed that the CPA and CAA were highly contentious and ultimately intrusive on local authorities.

What is often not appreciated, as the NAO and audit firm interviewees point out, is that the inspection and intervention were never part of the audit, but a separate function within the audit and inspection regime that has been done away with. Auditors were not just meeting their statutory obligation, but also Audit Commission responsibilities, which is one reason why people think auditors now do less. There is still a Best Value duty on local authorities that gives the Department (MHCLG) grounds for intervention when necessary, but this is not a top-down all-encompassing inspection regime. This is not widely understood including by the Department (MHCLG), local authorities and citizens, for example.

It is therefore important to be clear that it is the inspection regime that has gone. The extent to which it is needed was an issue raised by all interviewees. Firstly, there remains an expectation/idea that audit should give a stamp of approval for an organisation, by including an inspection element to the overall regime. The financial audit and conclusion on VfM do not seem to meet these expectations. There is an expectations gap due to the confusion around audit and inspection and the blurring of these in minds of citizens, local government, the Ministry (MHCLG) and MPs. Secondly, the landscape has fundamentally changed since the abolition of the Audit Commission and there is no desire of local authorities for a return to the old scoring systems. This is because scoring changes the relationship that the auditor has with the audited body. The Audit Commission was both an auditor and a regulator through its inspection role, and the scored assessment systems that it oversaw are widely regarded as part of the cause of its ultimate downfall. Nevertheless, there are still lots of inspection activities linked to communities and local government, although these are not undertaken by auditing bodies. For example, inspections are taken where there are risks such as vulnerable children and adults that are covered by Ofsted and the CQC. Inspection as an instrument of governance makes these things visible. They get more attention and maybe disadvantage invisible services in terms of resource allocation practices. Nevertheless, it is a public policy choice about what to inspect. Thirdly, the lack of formal required inspection in the overall regime also raises the question of what should be done when a 'whole' organisation is not functioning adequately. Who picks that up? The sector-led approach of the LGA is an important place for peer review, although as it is voluntary it is not always used by those who may need it most. It is not designed to be a substitute for the former Audit Commission inspection process. MHCLG should not put too much weight on that in the accountability system. Given the lack of statutory inspection at present to identify local authorities in trouble, it is a case of sending in the commissioners after the event unless a local authority highlights a significant problem themselves. Indeed, in some cases local auditor concerns were ignored and no action taken. Fourthly, the evidence base and research capacity are not as extensive as they were under the Audit Commission regime. The fragmented accountability is exacerbated by disjointed and missing data from different accounting formats used by local authorities for financial and service data, and incomplete data relating to performance indicators, VfM and financial resilience.

As pointed out earlier in this report, interviewees from the NAO and audit firms highlighted that an inspection element of local government in the NAO would cause issues operationally as local authorities are constitutionally separate from central government. A key question that emerges from this theme, in combination with the previous theme, is, therefore, whether there is a need for a separate and much more independent body to undertake inspection to complement the audit infrastructure.

7. Competition in the Audit Market and Audit Fees

7.1 Theme Findings

The Audit Commission was abolished partly as a means to increase competition in the public sector audit market, but the opposite seems to have occurred. The new audit regime has failed to increase audit market competition for local government, which now has actually fewer suppliers including fewer Big 4 firms, than prior to the reforms. For example, the Audit Commission had 70% of the market through their District Audit Service with 30% tendered to the private sector. All audits are now undertaken by the private sector. However, there are now only five firms providing public audit services to local government, rather than ten under the Audit Commission regime (including its own District Audit Service). The situation is arguably an oligopoly. Two firms (Grant Thornton and Ernst and Young) dominate the oligopoly, with the third firm (Mazars, who incorporate much of the former Audit Commission in-house audit team) some way behind. Of the Big 4 audit firms only two (Ernst & Young and Deloitte) have a foothold in the market, with one of them (Deloitte) having less than 10% of contracts. The other two (PWC and KPMG) have no contracts. It is debateable why Big 4 firms have not put in bids (PWC) and not been successful in the local government bidding process (KPMG), but arguably the significantly lower audit fees have not been attractive and being an auditor could also limit non-audit fee income available from local authorities. More generally, the public audit market for all local bodies (including local government, police, fire services and NHS) has ten firms operating as public auditors, although only nine with contracts. However, for the NHS as an example the level of competition at a local level varies significantly with some audit firm incumbents not tendering for contracts. The lack of audit market competition is also a serious concern in the private sector. Here the Big 4 audit firms dominate with 98% of FTSE 350 audits. This has led to Grant Thornton (the fifth largest firm) saying they will no longer tender for new contracts. The CMA has also highlighted their concerns with the lack of competition.

The cost of the new audit regime and audit fees are lower, reflecting changes in activity and procurement efficiencies, but benefits have also been lost. In particular there is criticism that the auditor now focusses primarily on work to give an opinion only. In addition, the PSAA have been criticised for focussing on cost not quality in audit procurement, even although they increased the quality threshold compared to the Audit Commission audit procurement regime. It is widely thought that quality should now be higher in any future audit procurement exercise, focussing on the value of audit more than just the cost. Nevertheless, the problem is not quality of audit work carried out for giving an audit opinion, but more the change in audit scope (covered in section 5) and the significant reduction in time devoted to client relations, governance and risk management among other things.

Overall, the public audit market is sustainable in the short to medium term, but if there is to be more focus on the value of audit than cost then fees may not be able to go lower to enable investment in public audit methodology, staff, training and technology for the future.

7.2 Documentation Review

A major reason for abolition of the Audit Commission was that the government wanted to increase competition in the regulatory space of public sector audit. The Communities and Local

Government Select Committee (2011) explicitly highlighted the potential problem of ‘domination by the few’ in the public audit market and the challenges to overcome,

“Unless the Government can crack the problem of the very limited competition in the audit market in the UK, it will be open to the accusation that the abolition of the Audit Commission is not a measure to save public money but merely a mechanism to transfer public money into private hands. For local auditor appointment to work, the local government audit market must be opened up to wider competition that provides local authorities with a genuine choice of audit firms. This will require active management and learning from developments in the private sector, such as the outcome of the OFT’s¹⁶ current review. DCLG should work with other appropriate bodies, including DBIS¹⁷, Competition Commission, FRC, the LGA and professional accountancy bodies to deliver a more open and competitive local government audit market.” (Paragraph 61)

The government response by DCLG (2011) was,

“20. In the short-term, the number of firms supplying local public sector audit will be determined by the outcome of the process to outsource the work of the Commission’s in-house audit practice.

21. While the outcome of the procurement process cannot of course be guaranteed in advance (as it depends on the behaviour of potential bidders and a process which is strictly determined by law), the Government asked the Commission to design a fair and competitive process which should allow a range of firms to bid for work and aims to maximise value for money for the public purse as a whole.

22. The Government is working with its partners to refine the new approach to regulation of local public audit with a key aim being to ensure an open and competitive local public audit market where eligibility criteria etc, are proportionate and do not provide barriers to entry.

23. The Office of Fair Trading is best placed to consider any structural issues about the wider audit market, which could impact on the supply of local public audit in future. The local public sector audit market is only a tenth of the overall market for audit services.” (Pages 13-14)

Nevertheless, at the draft Local Audit Bill stage barriers to entry were already being highlighted that would make a competitive public service audit market difficult to achieve (Sandford, 2013, p. 11). Indeed, the ad hoc Committee (2013) stated,

“29. We are concerned that the provisions in the draft Bill will not produce an open and competitive audit market as envisaged by the Government which is an aim that we support. The Bill should not result in contracts being awarded to a small number of audit firms. We recommend that the Government consult further appropriate bodies including the Competition Commission, FRC, LGA and professional accountancy bodies in order to amend the Bill so that effective competition can be realised.” (Paragraph 96)

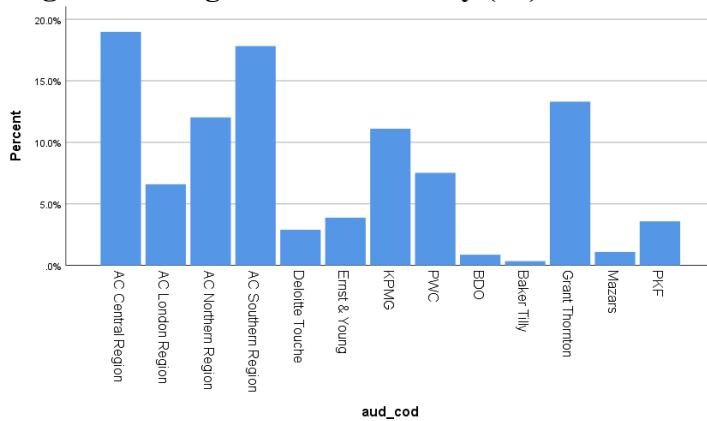
Sandford (2016, p. 9; 2019a, p. 10) highlights that a small number of firms dominate the local audit market in England. He also sets out the critical differences concerning regulation of private sector and public sector work including VfM in the latter case.

¹⁶ Office of Fair Trading (OFT)

¹⁷ Department for Business, Innovation and Skills (DBIS)

However, the level of competition that materialised following abolition of the Audit Commission has not previously been analysed, and it appears that competition has actually reduced in terms of the number of firms delivering audit contracts. At the time of abolition of the Audit Commission there were ten firms active in the public sector audit market place for local government, including the Audit Commission’s own District Audit Service that was broken down across four regions. Diagram 1 shows this level of competition in terms of market share. The Audit Commission District Audit had 70% of contracts and so the other nine firms accounted for 30% of provision.

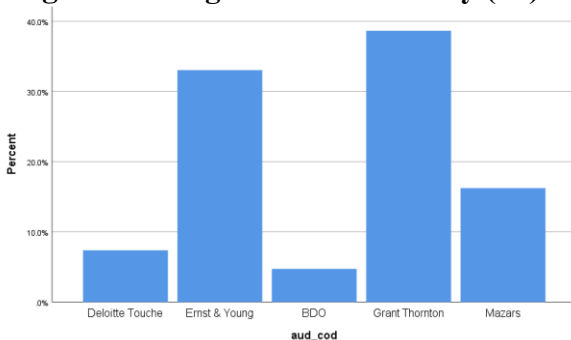
Diagram 1 - English local authority (all) auditors’ market share 2008-12



Source: Municipal Year Book Analysis

As can be seen in Diagram 2, under the current PSAA audit arrangements in 2018, the number of firms in the market had reduced to only five. GT and EY dominate the market, with Mazars (which subsumed the Audit Commission’s in-house audit team (Sandford, 2016, p. 11)) increasing their share but some way behind in third place. Surprisingly only two of the Big 4 audit firms have a presence, and for one of these it is less than 10%.

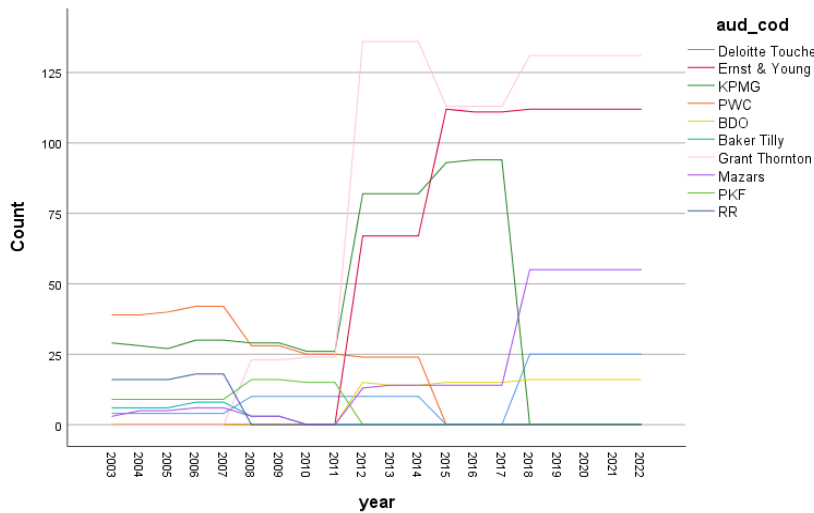
Diagram 2 - English local authority (all) auditors’ market share 2018-22



Source: Municipal Year Book and PSAA Analysis

Competition has therefore greatly reduced, and not increased, the number of firms awarded contracts for audit of local authorities following closure of the Audit Commission. Indeed Diagram 3 illustrates over the past 20 years the thinning out of the number of private sector firms winning public sector audits for local government, despite a large increase in work, from 30% to 100% of the market, now made available to them.

Diagram 3 - English local authority auditor firm contracts (all) 2003-22



Source: Municipal Year Book and PSAA Analysis

These findings with regard to competition in the local government audit market also raise concerns around what is happening in other parts of the public services such as the NHS, Police and Fire. This is an important regulatory issue. The Audit Commission could have spoken on this with one voice as they oversaw audit for all local public bodies (Local government, NHS, Police and Fire). However, now the Audit Commission is abolished and their role is spread across many organisations so a single voice is not possible. Ultimately, the issue of public audit market competition may fall to the CMA.

More broadly, the problem with audit market competition in the public services is symptomatic of a much larger problem with audit competition in the private sector (CMA, 2018; Kingman Review, 2018a). For example, as the Financial Times have reported, the FTSE 350 is dominated by the Big 4 audit firms (PWC, KPMG, EY and Deloitte) to such an extent that Grant Thornton (the fifth biggest player) announced it would no longer bid for new contracts, and instead is going to focus on core markets (Marriage and Ford, 2018). Grant Thornton is the largest provider of local government audit.

Following closure of the Audit Commission, greater competition was expected to reduce audit fees and that these would be made transparent along with non-audit fees. For example, the Select Committee (2011) stated,

“Developing a fully competitive market will be an important element in achieving lower overall audit fees—a key design principle of the Government’s proposals. All local authorities should be required to publish annually their audit fees, showing separately the cost of the mandatory (code) audit and any additional audit or consultancy work. The figures should be published in a consistent way that allows comparison and analysis.” (Paragraph 69)

The Government response from DCLG (2011) stated,

“29. Councils are already required to publish spend, tenders and contracts for goods and services over a value of £500¹⁸. Invoices from providers of audit and consultancy services would similarly need to be published. The Code of Recommended Practice for Local Authorities on Data Transparency has now been published. This is a short, high level document – guidance – setting out a principle-based approach to releasing local authority data for re-use.” (Page 16)

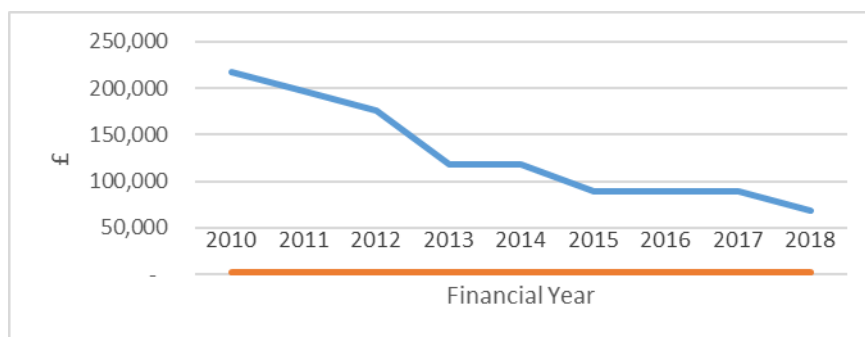
However, whilst audit fees have reduced for various reasons (see diagram 4 below and subsequent discussion), the link between audit and non-audit fees is more difficult to ascertain. This is because, while data on audit fees is separately disclosed in local government annual statement of accounts, this is not the case for non-audit fees unless provided by its own auditor and neither is such data easily discernible from the online transparency data without specialist skills and contextual knowledge.

The ad hoc Committee (2013) suggested that,

“28. Given the uncertainties surrounding the level of future audit fees, we recommend Government conduct a post-implementation review following both the first and second self-appointment exercises.” (Paragraph 91)

Diagram 4 shows that average scale audit fees have reduced significantly from 2010/11 to 2018/19. The large initial drop in fees is due to the reduction in audit scope exemplified by scrapping of the CAA, with later savings due to reductions in statutory audit fees paid to private audit firms.¹⁹

Diagram 4 – English local authority auditor average scale audit fee (all) 2010-2018



Source: Audit Commission and PSAA website analysis

The Local Audit and Accountability Act 2014 followed the Government desire for local authorities to appoint their own auditors, but most local authorities signed up with the procurement process of the PSAA who have argued that they have accomplished efficiencies in the setting of audit fees (PSAA, 2018). The process has afforded local authorities a structural

¹⁸ The Department for Communities and Local Government (February 2015) in the Local Government Transparency Code recommended that local authorities go further than the minimum publication requirements set out in Part 2 and publish details of all transactions that exceed £250 instead of £500. See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/408386/150227_PUBLICATION_Final_LGTC_2015.pdf

¹⁹ In some local authorities the actual audit fee may be different from the scale fee for various reasons, but in the vast majority of cases this is not significant. The sector trend for actual audit fees therefore remains downward as for scale fees.

arrangement; in contrast, the NHS has not had the same joined up position.²⁰ However, the Audit Commission provided a blanket procurement of audit for local government and the NHS, so it is arguable that the PSAA has merely mirrored that function for local government. In addition, the reduction in fees is likely to be due to the change in audit scope, as well as procurement efficiencies.

The NAO (2019b) in their study of local authority governance, indicated that some local authorities had concerns over the level of audit fees,

“In our focus groups, heads of paid service, section 151 officers and internal auditors raised concerns that the contribution of external audit to local governance had been reduced recently. Frequently, they linked this to the reduction in the audit fee paid by authorities. Among respondents from single tier and county councils to our section 151 officer survey, 25% thought their audit fees for 2017-18 were ‘too low’. However, 68% thought their audit fees for 2017-18 were ‘about right’, and 3% thought they were ‘too high’.” (Page 11)

Finally, audit competition, fees, scope and independence have an integrated relationship that needs to be considered holistically.

7.3 Interviews

The Select Committee Chair, MHCLG, NAO, LGA and PSAA, and audit firm partners highlighted during interviews that part of the intention of the process concerning Audit Commission abolition in 2010 was around increasing competition by encouraging new entrants to the local public audit market (Indeed this is specifically also mentioned in the Select Committee 2011 reports), as there were concerns whether a sufficient number of audit firms would be available to audit organisations in the sector. However, this failed. Instead, the situation polarised in local government down from nine suppliers for just 30% of the market contracted out between 2008-2012 to just five suppliers for 100% contracted out between 2018-2022 (See diagrams 1 and 2 above). In the local government audit market, only two of the Big 4 players now provide services. Nevertheless, as the NAO and PSAA suggested it is important to look at local audit generally (including health) rather than only local government bodies. In the public audit market, auditors have to be registered. There are ten firms operating as public auditors (BDO LLP, Deloitte LLP, Ernst and Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP, Moore Stephens LLP, Scott Moncrieff, and Cardens Accountants LLP)²¹. All of them currently have local audits, except the tenth firm (Cardens LLP) that is a small regional firm and not appointed. This illustrates the difficulty for smaller firms to break into the market. So looking more broadly than local government there is competition in the public audit market. However, seven of these ten firms were local auditors under the previous Audit Commission arrangements (BDO, Deloitte, Ernst and Young, Grant Thornton, KPMG, Mazars, and PricewaterhouseCoopers).

²⁰ De Widt et al. (2019, paras 44 and 45) state, PSAA got reductions of 23% in existing audit fees to apply for at least 3 years. Similar reductions were achieved by non-opted in bodies, but they would incur additional costs in letting and managing their own contracts. The 80 NHS Trusts that were required to appoint new auditors for 2017/18 following end of PSAA’s role regarding NHS bodies, managed to obtain an average reduction of 19%, but again would have letting and managing of audit costs. So, they argue PSAA obtained a bigger reduction for opted in bodies.

²¹ The local auditor register can be found at: <https://www.icaew.com/technical/audit-and-assurance/regulation-and-working-in-audit/local-public-audit-in-england/local-auditor-register>

The PSAA, NAO, CIPFA, MHCLG, audit firm partners and local government recognised that the cost of overseeing the audit regime is lower in its new form. This reflects not having to cover the central cost of the Audit Commission, the scrapping of inspection and performance management frameworks and an overall decrease in activity. It also is due to efficiencies in the procurement process. However, along with the benefits gained from reduced costs of audit, the interviewees also recognise that there have been benefits lost from the reduced activity. For example, the level of governance, risk management and client service is less.

The Kingman Review (2018a) criticised PSAA for focussing on cost not quality in the audit procurement process. There was a general feeling among audit firms that this was the case. However, the PSAA stressed that they actually increased the quality threshold compared to cost from 50:50 to 60:40 in the bid process criteria compared to the previous Audit Commission arrangements. In addition, the PSAA highlighted that they were reflecting the serious financial situation facing local government that was encountered significant budget cuts so needed to make efficiencies including in audit fees. Nevertheless, audit firm partners, NAO, CIPFA and the FRC thought the quality threshold should be higher in future audit procurement exercises, with some audit firms suggesting at around 70% or greater.

Despite the concerns around the procurement process, interviewees including the NAO, PSAA, CIPFA, FRC and local authorities did not generally think there was a problem with the quality of the audit work itself to reach an audit opinion on the financial accounts and conclusion on VfM arrangements being in place. It is accepted that this is difficult to judge as a non-expert. Instead the concern is that the auditor now primarily focusses their work to give an opinion, with very little time for other issues such as client relations, governance, risk management, answering questions, giving advice and attending meetings. The questions therefore become how much audit would a local authority need for an opinion and conclusion, and what would a local authority be prepared to pay as an audit fee for any additional work.

In terms of whether the public audit market is sustainable, audit firms with contracts that were interviewed highlighted that they can deliver their contracts or would not have bid. In that sense, it is sustainable. However, for various interviewees, including audit firms with and without contracts, NAO, CIPFA, and FRC there are concerns that margins are now too tight for a sustainable market. This is because the pressure on fees is affecting the ability for firms to invest in new technology, methodology, and ways of doing things, training of new staff and ensuring a future cadre of staff to do such work. Audit firms could also diversify to more profitable lines of business. They could move away from local government work to take on other public and private audits. These are also risks that the PSAA and local government commentators such as LGA, SoLACE and local authorities themselves are aware.

If the aim were to attract more competitors into the public sector audit market, fees would have to go up according to not only the audit firms but the NAO, CIPFA and FRC as well as PSAA. Interviewees from the audit firms, CIPFA, NAO and PSAA recognised that the Big 4 decreased their presence in the local government audit market, in contrast to the FTSE 350 for private companies where they have further consolidated their position to almost all of the market. These interviewees also recognised that mid-tier firms such as Grant Thornton and Mazars have increased their share of the local government market. In addition, all of these interviewees thought there seems little chance of attracting smaller firms to the public sector audit market, as they would need to demonstrate the specialist expertise for this work.

The PSAA, as well as NAO, CIPFA, FRC and audit firms thought that the local public audit market is sustainable in the short to medium term, but the general feeling from the NAO, CIPFA, FRC and audit firms was that there was risks to sustainability if fees went any lower than they are now. The PSAA are well aware of the risk to the sustainability of the audit market and are thinking about this aspect and planning potential mitigations. Audit partners at one firm specifically observed that fees are probably manageable for the audit of bigger local authorities, but that some of the fees that are being set are not adequate particularly for the audit of smaller bodies. This needs addressed.

8. Implications for Accountability and Democracy

8.1 Theme Finding

Public auditors and their independence continues to be pivotal for trust in public finance and expenditure in an accountable and democratic system. The role that trust in public finance plays in a democratic system underpins the concerns articulated in the seven foregoing themes. However, there remains an expectations gap around what public audit does and for whom. In terms of improving accountability of local authorities to local people, it is important it is very clear what powers are available, where money is spent and what they got for it. However the arrangements for informing VfM and fairness are not adequate from an accountability and democracy perspective under the new audit regime compared to the Audit Commission. The question is how much of that inspection around VfM and fairness is necessary to bring back, and how.

8.2 Documentation Review

Public audit is important to build and maintain trust in the democratic system (Ferry and Eckersley, 2015; Ferry and Murphy, 2018; Murphy et al., 2019). This is well highlighted by Steve Freer (Chair of PSAA Ltd and a former Chief Executive of CIPFA) (2019),

“The audit of local public bodies matters. It is a vital check and source of assurance in our systems of local democracy and public accountability. (...) It is easy to slip into the mindset that local audit exists for the benefit of management and (in the jargon of auditing standards) those charged with the governance of relevant public bodies. On the contrary its primary purpose is to work on behalf of local electors and taxpayers for whom it provides a level of assurance about whether organisations are managing their affairs and stewarding public money appropriately.”

There was a strong case made during the Select Committee review in 2011 that in line with the Localism agenda the stripping back of inspection and performance assessment by central government could be regarded as revitalising local democracy and devolution. This is because under the new local audit and inspection regime, savings from the Audit Commission abolition were to be realised through lower professional audit fees and a more emboldened set of “armchair auditors” (Ferry et al., 2015). These armchair auditors would be proactive citizens who would challenge public service bodies through the increased data made available from the FOI Act and Data Transparency Act. It is highly debateable whether armchair auditors manifested themselves in such ways, at least initially. Citizens have many things to do in their everyday life that detracts from them spending time going through local authority data. Even if citizens are willing to do this, it would take a range of specialist skills to analyse the extensive datasets available and context based knowledge to interpret and communicate the subsequent

information (Ferry et al., 2015; Ferry and Eckersley, 2015a). Indeed specialist firms have collected the data, but this is, generally, only available for a subscription fee and so is more accessible to those with funding such as the media for reports and multinational companies who have the expertise to do the analysis and use it in bidding for contracts (Eckersley et al., 2014). Nevertheless, during the same time period of austerity-localism, there have been grassroots groups and social movements challenging local government especially around budgeting, which has increased through the use of the internet, mobile phones, Twitter and Facebook to share data and organise protests. In turn this has seen local authorities adopt a range of consultation and reporting practices (Ahrens and Ferry, 2015, 2018; Ferry and Ahrens, 2017; Ferry et al., 2019).

In-house analysis within civil service departments has substantially reduced under a combination of localism and austerity budget cuts, especially within the MHCLG (Ferry and Murphy, 2015, 2018; Murphy et al., 2018). Indeed Sandford (2019a), commenting on the NAO (2019a) findings regarding local auditor reporting, stated,

“The use of comparative data (...) is related to but distinct from VFM. Following the closure of the Audit Commission, no public body is responsible for collating data from across local authorities and providing any form of comparative analysis. Government departments take different approaches to the data produced by auditors.”

The Kingman Review (2018a) explicitly recognised an audit expectations gap ‘now’ exists and recommended a piece of independent work should be done to explore the issues. Importantly, the Kingman Review (2018) also recognised important differences between local authority audit and private sector audit. This included that auditors of local government report not only on the financial statements, but also on arrangements for securing VfM and financial sustainability. Also auditors of local government carry out their work on behalf of the public, yet in comparison to the lines of accountability in companies between the directors, audit committee and shareholders, there is substantially lower awareness and challenge of the auditors’ work in the public sector. In addition, the FRC’s enforcement powers in relation to local audit are meaningfully different due to public interest considerations.

With regards to the audit expectations gap, the Smith Institute (2019) highlighted concerns around a lack of VfM and fairness in external audit arrangements (Walker and Tizard, 2019).

The PAC (2019) ‘*Local government governance and accountability*’ highlighted that, “*The Department (MHCLG) does not know why some local authorities are raising concerns that external audit is not meeting their needs.*” The PAC (2019) in their report continued to highlight concerns around VfM,

“The Department places great reliance on the work of external auditors, particularly in relation to value for money arrangements. It recognises that the importance of this work is heightened as council activities become more varied, complicated and commercial. However, a number of key representative organisations and councils told us that they had concerns about external audit. For instance, a quarter of finance directors at councils with responsibility for social care services for vulnerable people would like more value for money work from external audit, and the same proportion feel that audit fees are too low relative to the risk faced by their local authority. The Department believes the focus of external audit on whether arrangements are in place means that some local authorities are concerned that they no longer have sufficient assurance that their organisations are working effectively or that value for money decisions are being made. It has committed to addressing this ‘expectations gap’ as

part of its review of external audit. The Department has not yet decided whether this will be an independent review or carried out by the Department itself.”

The PAC (2019) went on to recommend that the MCHLG proposed review of independent auditors should be conducted independently and assess if external audit is providing an effective service and meeting the needs of local authorities. If there is an expectations gap underlying local authorities’ concerns with external audit, then the MHCLG should identify how these unmet expectations can be met.

Academics have highlighted that addressing the expectations gap with external audit may involve VfM and fairness considerations (Ferry and Eckersley, 2019).

8.3 Interviews

All interviewees on being asked agreed that the audit and inspection regime has important implications for accountability and democracy, although this was interpreted in different ways.

The MHCLG (and some Conservative MPs) acknowledged that changes to inspection and performance assessment by central government as part of Localism were an attempt to revitalise local democracy and devolution, and that this had led to a different view of what audit and inspection should entail.

Nevertheless, the MHCLG thought public auditors continue to be regarded as a pivotal element for trust in public finance and expenditure, which was a view supported by MPs, Councillors, local authorities, LGA, those involved in the new audit regime (NAO, CIPFA, PSAA and FRC) and audit firms. As an audit partner highlighted, *“If a local authority is attacked for wasting money it is powerful to be able to point to the fact that the auditor has been appointed through an independent process to provide their opinion on finances and their conclusion on VfM arrangements.”* The MHCLG also stated that external audit is an important part of their accountability system for local government.

However, the audit firms, NAO, CIPFA, PSAA and FRC highlight that there now is an expectations gap with external audit. It is a perennial complaint because people who are not auditors expect and think that audit does a great deal more than it really does. For example, some of the audit firms and the NAO highlighted that through the use of transparency data and FOI requests plus social media some social movement groups have more recently began to ask auditors for information, but often there is an expectations gap in terms of what auditors do and can provide. In terms of improving accountability of councillors to local people, as CfPS and academics highlighted, it is important that mechanisms are put in place so local people have the tools to scrutinise use of powers, funding and expenditure.

The audit community acknowledge that an important part of the expectation gap is that the focus of the audit and inspection regime has become financial sustainability especially due to austerity, but there is now a need for more VfM work. MPs, local government, the PAC and academics thought accountability in a democratic society has to be broader with consideration of performance in terms of whether VfM is delivered and fairness accomplished that were seen as issues requiring renewed thought. The FRC highlighted that integrated reporting could be considered. The MHCLG are aware of all of these concerns and confirmed to the PAC that they will address the expectations gap as part of its forthcoming review of external audit (PAC, 2019).

9. Conclusions

Based on the above analysis, the following conclusions are set out for consideration. In considering these, one should, as highlighted in the introduction, bear in mind the complexity and difficulty surrounding audit and inspection arrangements in English local government. In seeking to put a balanced view from documentation and interviews that may inform post-legislative scrutiny, this report has identified areas of ambivalence on the best way forward. Nowhere is this more so than on the question of the scope of audit. The problem of inaction and late noticing of problems clearly suggests that ‘financial conformance’ is inadequate as a guarantee of effectiveness. Therefore, performance in terms of VfM does need to be addressed more comprehensively. Even though there seems to be widespread support for including benchmarking and comparison, no consensus has emerged on how this should be done. Firstly, there is much scepticism about inspection to enhance public accountability (the ‘stamp of approval’) as this would indicate a return to a top down performance management regime. Secondly, there is no consensus on which body should be given this task (e.g., an independent body, NAO, LGA, or others). Thirdly, there is considerable concern over how the democratic mandate of local authorities should best be squared with legitimate VfM oversight concerns. In view of the complexity of the arguments and the diversity of opinions, this report looks to put a balanced view based on documentation and interviews, rather than the author’s personal opinion.

9.1 Main Finding (Section 1)

The main finding of this report is that public audit should, and should be seen to, serve the public interest. Public audit is not just another professional service. The audit and inspection system is not broken in terms of what it does, but the question is whether it does the right thing. Currently, for local government, it is known what local authorities have spent (financial stewardship), but not what local government got for it (Value for Money (VfM) – economy, efficiency and effectiveness), nor whether it has helped fairness in society (equity). This needs to be addressed.

Underpinning this main finding, the report focusses on more detailed findings for the ‘seven’ main themes as follows.

9.2 Evaluation of new audit regime and Audit Commission abolition (Section 2)

It is important that there is post-legislative scrutiny of the Local Audit and Accountability Act 2014 to ensure the new audit and inspection regime is fit for purpose, together with an evaluation of the business case for Audit Commission abolition. The MHCLG have announced that a review is scheduled for early 2020. The methodology created by RAND Europe can be employed. Outside of post-legislative scrutiny, a broader review of the financial sustainability of local government (and other local public bodies in general) should consider the impact and implications arising from the new regime for audit and accountability arrangements.

9.3 Fragmentation of public sector audit regulatory space and accountability under the new audit regime (Section 3)

The new audit regime is more fragmented compared to the Audit Commission. The Kingman Review (2018a) suggested that the current arrangements are failing for local audit and need brought together in one place. However, in passing the Local Audit and Accountability Act 2014, Parliament deliberately wanted to separate functions. A debate is therefore necessary. Indeed at a minimum the current arrangements would benefit from a more formalised and co-ordinated approach, with a suitable body (most likely the NAO) having the convening role. Beyond this, if more duties need to be brought together it raises the question of how much responsibility the NAO can take on given its constitutional status regarding local public bodies such as local authorities. If a separate body was established should it cover all public bodies, only local public bodies or only local authorities? This would cut across central government departments and so need wide support.

9.4 Auditor independence (Section 4)

As a principle to uphold auditor independence, local authorities should not be able to appoint their own auditors. The public interest is for the auditors to represent the public and not the officers and councillors of a local authority. The principle of independent appointment of auditors for all local bodies was breached under the new local audit regime. In practice, however, most local authorities adopted the central procurement arrangements of the PSAA. From the perspective of auditor independence, it makes sense for all local authorities to be able to opt in to a central system. However, it is highly debateable whether this should be a 'voluntary' choice as it undermines the fundamental principle of auditor independence in public audit.

9.5 Audit scope (Section 5)

The Audit Commission had both audit and inspection elements to their regime. The additional responsibilities around inspection extended the auditors work to give a qualitative assessment that led to rankings and league tables. This led to the perception of the Audit Commission being a regulator and not merely an auditor. The inspection element has gone. Some sort of structured follow-up is now missing. This is why some people think auditors now do less and raises the question as to what degree do we need it. However, the NAO's limited powers concerning inspection are arguably for good reason as individual councils have a different constitutional status to central government departments. The NAO should have its powers around audit and overall view on VfM strengthened, but consideration should be given to create a separate body to comment on VfM and fairness in more detail for individual local authorities. This may help to overcome some of the constitutional and operational concerns of the NAO having too broad a role.

9.6 Inspection and improving services (Section 6)

There remains an expectation/idea that audit should give a stamp of approval for an organisation, in other words an inspection element. The financial audit and conclusion on VfM do not seem to meet these expectations, as this is not their purpose. However, contrary to popular belief, the inspection and intervention were never part of the audit, but a separate function that has ceased. The sector-led approach of the LGA is there as a voluntary means of the sector improving itself and is not designed to be a substitute for the Audit Commission

inspection process. The MHCLG should not therefore attach too much weight on that in the accountability system. An inspection role of the NAO would cause issues constitutionally and operationally, so the question becomes whether there is a need for a separate body to undertake inspection to complement the NAO audit.

9.7 Competition in the audit market and audit fees (Section 7)

The new audit regime has failed to increase audit market competition for local government, which now has fewer contracted suppliers, including fewer Big 4 firms, than prior to the reforms. The cost of the new audit regime and audit fees are lower reflecting reduction in audit scope, changes in activity and procurement efficiencies, but benefits have also been lost. There is criticism of PSAA focussing on cost rather than quality in audit procurement, even although the PSAA increased the quality threshold compared to the previous Audit Commission regime. The quality component of the procurement bid process should be higher. Nevertheless, the problem is not quality of audit work provided, but more the constrained scope and that the auditor now focusses primarily on work to give an opinion than client relations, governance and risk management. Overall, the public audit market can deliver contractual commitments in the short to medium term, but if the audit is to be seen to provide value then it is highly debateable whether fees can go lower if there is to be a sustainable future in terms of investment in public audit methodology, staff, training and technology.

9.8 Implications for accountability and democracy (Section 8)

Public auditors and their independence is pivotal for trust in public finance and expenditure in an accountable and democratic system, but there is an expectations gap around what public audit does and for whom. Arrangements for local people to be informed about VfM and fairness are not in place. Social media is leading to engagement by more citizens with the audit process, but sometimes auditors are being asked to provide information that is not their remit. The new audit regime provides an opinion on financial audit and conclusion on whether VfM arrangements were in place. However, it does not say if there was delivery of VfM or if fairness has been achieved. This is something that is lost from an accountability and democracy perspective under the new local audit regime. The question is how much of that inspection around VfM and fairness is necessary to bring back, and how.

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Appendix A Methodology

1. Background

The purpose of this report to the Housing, Communities and Local Government Select Committee is to provide an update regarding the impact of the reform to audit and inspection of local authorities in England following the Local Audit and Accountability Act 2014 that followed the announcement made in 2010 to abolish the Audit Commission. The report will also inform post-legislative scrutiny evaluation, which has now been scheduled by the MHCLG for early 2020. In addition, the report will also inform broader reviews of audit in the public and private sector that are ongoing. Furthermore, the report will provide a reference point for future studies.

2. Project

The project was led by Professor Laurence Ferry as part of his Parliamentary Academic Fellowship, which is for 2 years from 01/01/2018 to 31/12/2019. The fellowship programme is run by the House of Commons in partnership with Research Councils and is intended to improve and promote linkages between the works of academics with Parliament. Laurence is a fellow from the 2018 intake of the scheme attached to the staff team of the Housing, Communities and Local Government Select Committee. The report on *'Audit and Inspection of Local Authorities in England: Five years after the Local Audit and Accountability Act 2014'* is one of the research projects completed as part of the Fellowship. He undertook research for this report between January 2018 and July 2019.

3. Research Methods

Professor Laurence Ferry met with the Chair and the Clerk of the Committee on a quarterly basis to discuss progress and emerging themes and comment on draft papers and the final report. He also presented his work to the Committee on a six-monthly basis to update on progress and gain their input. Experts were consulted as necessary. In this regard, particular thanks for advice are due to Aileen Murphie (Director of MHCLG and Local Government Value for Money at the NAO), Mark Sandford (House of Commons - Parliament Librarian) and Ron Hodges (Emeritus Professor in Accounting at Birmingham University, and the adviser to the select committee in 2011 when audit and inspection arrangements was reviewed following the announcement to abolish the Audit Commission). In addition, many thanks to Richard Slack (Head of Department and Professor in Accounting at Durham University) and Thomas Ahrens (Professor in Accounting at UAEU) for their advice over the course of the project and copy editing.

To review the changes to the local audit and inspection regime involved extensive documentation review of academic and practitioner literature, and observation of regulatory practices. This provided information for an initial scoping report and themes that was presented to the Chair and MPs on the Select Committee in January 2019.

The themes were followed up with over fifty of the most senior respondents from the main organisations and institutions involved in audit and inspection of local government in England, and those with other expertise deemed useful, through semi-structured interviews of around one hour each, or in a few cases written correspondence. A summary is provided in Table 1:

Table 1 – Semi Structured Interviews

Local Government (9)	Operational side of work – LA Officers (4) Operational side of work – Councillors (3) SoLACE – MD (1) LGA – Head of Improvement (1)
Civil Service (3)	MHCLG – SCS for Audit and Inspection (3)
Audit / Scrutiny Regulators – New Audit Regime (8)	NAO – Directors and Manager (3) PSAA - CEO and Chair (2) FRC – Non-Executive Board Member (1) CIPFA – Director (1) CfPS – CEO (1)
Audit Regulators – Prior Audit Regime (1)	Audit Commission – Performance Specialist (1)
Audit Firms (11)	Audit Firm Partners –GT, Deloitte, KPMG, Ernst and Young, PWC, BDO, Mazars x 2, plus Former Chair Cipfa and Senior Partner PWC (9) Operational side of work – Auditor and Non-Audit Specialist (2)
Parliament (20)	Select Committee MPs - Labour (4) Select Committee MPs – Conservative (2) MP Constituency office - Operational side of work office manager and case worker (2) Select Committee Staff – Current staff x 6 and Former Committee Clerk x 1 (7) Select Committee Advisers (2) Parliament Library (1) PAC - Current and Former Chairs (2)
Academic (6)	Professor in Public Management (2) Professor in Accounting (3) Senior Research Fellow in Public Policy and Management (1)
Total	58

The data from documentation review, observation and interviews were analysed and synthesised to derive a main finding and seven underpinning themes.

The final report was presented to the Chair and MPs on the Select Committee in July 2019. The published report will go to the Secretary of State for Housing, Communities and Local Government for a response as part of the post-legislative scrutiny.