



## Department for Levelling Up, Housing & Communities

**Sarah Healey**  
Permanent Secretary

**Department for Levelling Up, Housing & Communities**  
Fry Building  
2 Marsham Street  
London  
SW1P 4DF

Dame Meg Hillier MP  
Chair  
Public Accounts Committee  
House of Commons  
London  
SW1A 0AA

Tel: 030 444 2785

Email: [PSPerm.Sec@levellingup.gov.uk](mailto:PSPerm.Sec@levellingup.gov.uk)

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Dear Dame Meg,

### **Treasury Minute – Thirty-Fourth Report of Session 2021/22**

In its *Thirty-Fourth Report of Session 2021/22*, the Committee requested a detailed timetable and overarching plan of the work being undertaken to address the problems with local government audit. We committed to write to you to keep you updated with actions the Department is taking to reform the local audit system.

Since my arrival in the Department, I have been struck, as my predecessor Jeremy Pocklington was, that we face a system wide set of challenges in this area. Some of those challenges are shorter-term, particularly the need to address the backlogs that have grown in recent times; others, as set out in the Redmond Review, require a longer-term solution. The National Audit Office's (NAO) most recent update report, published on 25 January 2023: *Progress update: Timeliness of local auditor reporting on local government in England* sets out that the backlog of audit opinions remains significant and pervasive.

To make substantial and sustained progress in delivering high quality, relevant and timely local audit, we need all bodies to work closely together, despite their necessarily different priorities.

The Department has been very active in this work both in terms of its system leadership and direct immediate responsibilities. This letter sets out our most recent steps, building on the body of work on which we have published material and updated the Committee in the past.

#### **1. System leadership: an MOU between the Department and the Financial Reporting Council**

Since the Committee was last updated by the Department in December, the Department has taken considerable steps with the Financial Reporting Council (FRC) to prepare for the transfer of system leadership between the organisations, which will happen in shadow form ahead of legislation to establish the Audit Reporting and Governance Authority (ARGA). On 2 March 2023 the Department published a Memorandum of Understanding which has been agreed between the DLUHC and the FRC, setting out the new role that the FRC will take in the next phase of work, once the transfer of system leadership is made. This MOU is attached here. It sets out the core roles of the FRC as: leading a coherent and coordinated response to challenges arising across the system; facilitating stronger governance across the framework;

leading work to bolster competition, capability and market supply; overseeing the collective work to define the entire quality framework for local audit; and reporting on the local audit system. The MOU is also the product of consultation with a wide range of key partners including the NAO, HM Treasury and the Chartered Institute of Public Finance and Accountancy (CIPFA).

I am pleased to say that the FRC regard its new role as a key priority and in September Neil Harris started in post as Director of Local Audit. The FRC also plans to recruit a Non-Executive Director with local government experience to represent local audit at the board level.

We expect full shadow arrangements to start later this year once we and the FRC have completed overall readiness assurance and a handover of the interim system leader role we have held since July 2021. We will then issue the first Remit Letter setting out our policy priorities and the FRC will publish a response setting out the actions it plans to take. Remit Letters will be published annually, or by exception where required, throughout the shadow period. This will adhere closely to the governance and accountability mechanisms planned for ARGA and provide for full transparency on the expectations placed on the FRC.

I will of course continue to act as Accounting Officer for local audit and maintain responsibility for the core local government accountability framework and the effectiveness of the local audit system framework. DLUHC will remain responsible for adherence to the Best Value duty, stewardship, local government financial reporting requirements (with CIPFA LASAAC responsible for preparing the Local Authority Accounting Code) and policy decisions. DLUHC will also continue to retain oversight of local audit procurement once ARGA is established.

## **2. Steps to improve timeliness in dealing with infrastructure assets**

There has been considerable feedback from the sector that the valuation of certain assets, particularly local authority infrastructure assets such as roads, has become a source of delay in producing audited accounts.

While the valuation of assets is of course important, given the pronounced issues of timeliness the Department has taken steps to ease the burden of valuation of such assets on auditors and local bodies, pending a longer term look at this issue. On 30 November 2022 the Department therefore laid a Statutory Instrument to provide a temporary override of the requirements on valuing infrastructure, such as roads and coastal defences, that were causing delay.

These regulations came into force on 25 December, after our last communication with the committee. We have encouraged any authorities affected by the issue to close outstanding accounts as soon as possible.

Our key partners are also progressing their work to consider the correct treatment of assets and financial requirements on local authorities. Last week HM Treasury issued a consultation on the future treatment of non-investment assets including Plant, Property and Equipment. This builds on the commitment made in our December 2021 publication to progress this work across government, and is informed by HM Treasury's thematic review into the issue and feedback from the Financial Reporting Advisory Board. It is of course too early to say the outcome of this consultation.

## **3. Workforce and capacity**

Sir Tony Redmond's review highlighted that within the private market there were insufficient auditors with specific local audit skills, with many leaving the profession following the privatisation of the market. As you know, the FRC has previously revised the Key Audit Partner (KAP) guidance (*Guidance for Recognised Supervisory Bodies on the approval of Key Audit Partners for Local Audit*) which was published in June 2022 and has reduced the barriers to entry of potential KAPs.

The Department has taken two key steps on strengthening workforce since our previous correspondence:

- We have completed market testing on our proposal to establish a new Technical Advisory Service and progressed our work to develop a new Local Audit Qualification to allow experienced auditors to switch to local audit. Our market testing on the Advisory Service has suggested that we may need to consider alternative approaches to maximise effectiveness and work with the new entrants in the sector to understand their needs. On the latter, we expect to launch procurement for the Local Audit Qualification shortly. This proposal has very widespread sector support.
- Following the announcement of a free trade agreement (FTA) with the EEA-EFTA countries (Iceland, Liechtenstein and Norway), we have developed draft provisions to amend the Local Audit and Accountability Act 2014 to ensure a route for EEA-EFTA auditors to enter the local audit profession in England. Through a targeted consultation with regulators, launched by the Department for Business and Trade in January, we are consulting on these provisions, which if taken forward will enact the requirements of the FTA in respect of the recognition of professional qualifications. This will be a positive development which will assist in identifying new individuals to enter the sector.

These interventions of course sit in the context of PSAA's successful procurement in a challenging market, which means that audit firms themselves, with the contractual certainty of their position for the next 5 years, are now building their own workforce pipelines and skills. CIPFA/LASAAC<sup>1</sup> are also exploring developing a new performance audit qualification, anticipated to be offered globally and which focuses on developing expert level methodological and analytical skills for the sector.

#### **4. Further action to strengthen the local government accountability framework**

In February, the Local Government Finance Settlement 2023/24 confirmed that additional resources of £5.1bn is being made available to councils. This is an increase in local government funding of 9.4% in cash terms for the coming year. Our engagement with councils and their representatives in recent months has indicated that this settlement has provided stability for the coming year. We, of course, continue to engage closely with the sector – both with individual councils and sector bodies – to help understand the position for different authorities and to identify where there may be a need for government to act to help manage issues at local level.

The Department has made considerable progress over recent years in applying increased levels of scrutiny and assurance in the sector. We have taken a series of measures to strengthen our stewardship of the sector and assessment of risk, including learning from the small set of authorities that have experienced financial and governance failure. A good example is our work with HM Treasury to manage the Public Works Loan Board process to

limit access to finance where authorities invest primarily for profit. The Department is currently putting in place new powers through the Levelling Up and Regeneration Bill that will allow direct and timely intercession with authorities that take on excessive risk through imprudent borrowing and investment decisions. These powers will provide the government a flexible range of interventions, such as mandating external reviews or actions to directly reduce risk such as capping debt or requiring asset sales. In advance of these powers coming into force, we have engaged with a small set of authorities that are outliers with respect to indebtedness, to better understand their position and what actions are needed.

I am copying this letter to the Chair of LUHC Select Committee and the Comptroller and Auditor General. The Department will also place a copy of this letter in both House libraries.

A handwritten signature in black ink, appearing to read 'Sarah Healey', with a stylized, flowing script.

**SARAH HEALEY**