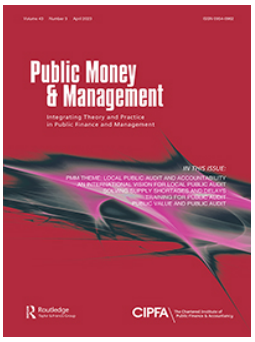

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Causes, consequences and possible resolution of the local authority audit crisis in England

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IMPACT
Audit as adjudication in England has narrowed and become under-resourced, with consequent delays in the delivery of audit opinions. Local authorities, subjected to resource withdrawals from central government, have sought to navigate control processes to generate new, sometimes risky, forms of income. The integrated nature of public audit in the devolved nations has meant that they have avoided these calamities. Stakeholders in England will need to be vigilant to help ensure that local audit does not continue to be subsumed within the interests of corporate auditing.

ABSTRACT
The article analyses the impact of audit reform in the local public sector in England by relating the concept of collibration to the territorializing, mediating, adjudicating and subjectivizing roles of accounting. It uses public domain documentation and interviews with senior actors to examine evidence of the existence of audit crisis in the local government sector in England, its causes and consequences. There is then consideration of possible resolutions, drawing on the Redmond Report of 2020, and navigating political constraints on their feasibility.

KEYWORDS
Accountability; audit crisis; audit market; audit quality; collibration; economization; local government; local public audit

Introduction

In this article, we examine the crisis in English local authority audit. The crisis is evidenced by the increasingly late publication of local authority accounts and the completion of their audits (NAO, 2021). The consequential weakening of one of the key pillars of local accountability is well documented (Redmond, 2020). There is a real risk that citizens could find themselves without the assurances provided by independent auditors acting in their interests if private audit firms exit the troubled local authority audit market to pursue more profitable business lines. This risk is far greater in England, where local public sector audit capacity no longer exists, than in the devolved nations of the UK (Scotland, Wales and Northern Ireland) where public audit models remain in place.

Our analyses of causes and consequences emphasize the institutional relationships in local authority audit. However, there is the broader context of audit practices across the economy coming under greater criticism and scrutiny, as evidenced by the Kingman Review (2018), the Brydon Review (2019) and the Competition and Markets Authority Report (2019). The Redmond Review (2020) of local public audit in England fits into a broader pattern of dissatisfaction with audit practice and audit firms. In the globalized and digitalized economy, audit has become more difficult, especially if the underlying problem is manipulation of financial results by senior management. The risks in the local government context are much less about financial self-aggrandizement and more about taking unacceptable risks with public money and public service resilience.

There is significant overlap between financial audit in the corporate and local public audit sectors, based on common standards and operating procedures. The main distinction between public audit and corporate audit is that the former has wider scope because it plays a fundamental role in securing accountability to a greater range of stakeholders. The focus of corporate audit is to give reasonable assurance that the financial statements give a true and fair view and that accounting has justifiably been done on the going-concern basis. Whether the business is operating efficiently is outside the scope of the corporate audit. In the UK, where government accounting is based upon modified International Financial Reporting Standards (IFRS), there is convergence between corporate and public audit in relation to financial certification and governance disclosures. The wider scope of local government audit manifests in confirmation of the management of public spending and procedures for achieving value-for-money (VFM).

From the 1980s to 2010, there was substantial growth in VFM audit, through which the auditor makes assessments about the performance of public entities. Such VFM work brings messages about public sector failings which decision-makers, whether elected or managerial, often find unwelcome. Tensions are exacerbated by the media being interested only in what can be portrayed as ‘disaster’ narratives, rather than stories of success. Pushback against what was perceived as auditor encroachment played a central role in the abolition of the Audit Commission (AC) (Communities and Local Government Committee, 2011), the subsequent local audit crisis and the political infeasibility of potential remedies.

Local audit plays a vital role in providing assurance to stakeholders that local government is operating effectively. There are few direct users of local government accounts and audit reports (Jones, 1992; Redmond, 2020), so accountability depends on intermediaries acting as agents of the wider public. However, the fact that audits are done on a reasonable timescale and confirm that the accounts give a true and fair view is a reassuring signal from the regulatory system. This reassurance has been lost: audits are increasingly late in England (only 9% met the 2020/21 deadline); distress signals about financial sustainability are no longer coming solely from under-performing councils; and the stewardship role of finance professionals is diminished without the timely external support of audit to help manage political pressures. What Hood et al. (1999) labelled 'regulation within the state' is creaking, with some English local authorities engaging in risky financial activities intended to be revenue-generating. Although Covid 19 has complicated the preparation of accounts and the conduct of audit, the crisis predates it. The financial vulnerability of local authorities grew during the austerity of the 2010s, manifested in terms of drastically reduced central government grants and tighter central controls over local authority taxation.

The objective of this article is threefold: to establish what caused the local audit crisis; to analyse the consequences; and to evaluate potential remedies in the knowledge that the events of the last two decades rule out promising institutional reforms.

In the rest of the article, we establish the theoretical framing and describe the research method. We then provide evidence of the audit crisis, emphasizing extended delays and the increasing risks faced by local authorities. The causes of the audit crisis are discussed, its potential consequences and consideration of possible resolutions, together with assessments of their political viability. Finally, the main conclusions are summarized.

Theoretical framing and application

Local authority audit in the UK is situated within a long tradition of fiscal centralism, with local authorities having extensive expenditure responsibilities, but constrained taxation powers. Governments assert their right to control the size and shape of the UK public sector, with public audit in its various forms being a prominent part of regulation within the state.

Miller and Power's (2013) concept of economization, which operates in terms of four roles of accounting, provides a theoretical framing for analysing this complex system of financial control and accountability. *Territorialization* makes explicit what is 'government' by delineating its boundaries and determining what are recognized and measured as 'financial activities'. Territorialization has been intensified by the adoption of accrual accounting anchored on IFRS, thereby reinforcing the status of local authorities as economic entities whose performance is monitored in financial terms. Moreover, it creates the environment for stronger application of the three other roles of accounting: *mediation*, *adjudication* and *subjectivization* (Heald & Hodges, 2018).

Mediation refers to the way in which accounting links actors and organizations together. Accounting numbers are treated as comparable, even when the activities to which the numbers are attached are not comparable. For example, accounting plays a role in restraining spending on services, though environmental and social conditions vary considerably between local authorities. Mediation is facilitated by accounting, including auditing, because it provides an apparently consistent and objective basis for the implementation of policy and regulation.

Local authorities face multiple forms of adjudication, including their accountability to local electorates. The processes of local audit monitor conformity with the law and accounting standards. The broader canvas, which includes judgements about VFM, raises contested issues regarding the application of metrics and whose judgement should count most—that of elected councillors, their electorates, central government or auditors?

Subjectivization concerns the reaction of those exposed to such control processes, which might take various forms along a spectrum from compliance, through reluctant co-operation and then resistance, to outright defiance. The manner in which local authority leaderships respond to control pressures can have far-reaching effects when organizations are confronted by resource withdrawal and/or external performance management metrics.

The responses of local authorities are constrained by the hierarchical governance of the UK, where sovereignty and fiscal power reside with central government, and where the relationships between local authorities, central government departments, auditors, citizen-taxpayers and other stakeholders can be interpreted as a system of 'collibration' (Dunsire, 1990). Rather than setting detailed procedural and measurement rules, collibration operates as a governance mode by structuring processes so that outcomes result from the interaction of actors with different objectives and incentives. The balance of opposing forces can be altered, hopefully without destabilizing the whole system. Periodically, the actor with the capacity to act as 'ringmaster' tilts the balance of other actors in order to modify outcomes.

Collibration as a governance mode in UK central–local relations has to operate in the context of vertical fiscal imbalance, with taxation powers concentrated at the centre, and horizontal fiscal inequity, with taxable capacity and expenditure needs of local authorities differing greatly. Local authorities depend heavily on central government grants and fiscal equalization. Tensions also arise from the tendency of the party in government at the UK level to lose political control of local authorities to opposition parties which then claim a separate democratic mandate.

Massive disturbances have hit central–local government financial relations in England. Attention here focuses on two episodes which have affected local public audit. The first was the 1997–2010 Labour government's 'modernization' programme, which combined generous grant funding of local authorities with New Public Management (NPM) tools. Adjudication intensified in England through the AC's performance management systems, which brought auditors into less technical, more politically-exposed areas of local authority activity. The complex metrics, which inevitably translated into league tables, prompted resistance to scoring from local authorities, particularly on the part of low performers. The annual nature of this adjudication process limited the time that auditees had to respond constructively, and repeated tightening of requirements alienated local authority stakeholders, even in times of plentiful funding (Abu Hasan et al., 2013). Adjudication through audit intensified subjectivization, which was manifested in resentful compliance to the centrally-operated system, and damaged audit legitimacy.

The second episode started with the 2010 announcement, by the 2010–15 Conservative–Liberal Democrat Coalition government, of the future abolition of the AC, the immediate cancellation of its performance metrics, the privatization of all local authority external audits in England, and deep cuts in grant funding. This period of budget cuts was accompanied by the corporatization of services, particularly by local authorities with high grant and debt dependence (Andrews et al., 2020). Nevertheless, this was proclaimed to be an age of 'localism', with local authorities liberated from aspects of central control, though losing a large proportion of their resource base. Local audit narrowed in focus, and performance audit was eliminated, with a political imperative to cut audit costs. Notwithstanding ephemeral reference to members of the public as 'armchair auditors' who would scrutinize online council ledgers for waste and inefficiency (Ministry of Housing, Communities and Local Government and Rt Hon Lord Pickles, 2011), audit as adjudication narrowed and became dangerously under-resourced at a time when local authorities faced centrally-imposed resource shortage and more complex accounting due to corporatization and the introduction of IFRS. This combination of circumstances represented a major shift in the collibration shaping local public audit in England. How subjectivized English local authorities responded within a much less monitored system became an important cause of audit crisis. Although local authorities in the devolved nations also faced significant reductions in resources, institutional structures and political cultures provided some protection for local audit and avoided extreme cases of financial difficulty.

Methodology

This study is based on publicly-available information about local government financial reporting and audit. The evidence base consists of local authority accounts including audit reports and Public Interest Reports (PIR), coverage in professional magazines and on websites, pronouncements by regulators and professional bodies, and reports of parliamentary inquiries. These sources enabled us to gain understandings of the challenges facing local government finance teams, their auditors, professional bodies and regulators in the sector. Eighteen interviews were conducted between January and August 2022 with senior persons from local authorities, regulators, professional accounting bodies, auditors and those involved in parliamentary inquiries. The researchers conducted interviews on the basis that such discussions were confidential and the identity of interviewees would not be disclosed directly or indirectly, or their responses quoted. The interviews were valuable for testing our understanding of the issues and drew attention to further documentation in the public domain. We received consistent messages from interviewees, which are reflected in the findings presented later in this article.

Evidence of an audit crisis

Evidence of the crisis facing local government audit in England is discussed here and divided up into audit quality, regulatory matters, and the sustainability of the local public audit market.

Audit quality

Audit quality evades precise definition and cannot be fully understood in isolation from the financial reporting and governance ecosystem to which it belongs. The purpose of corporate audit is deemed to be 'to help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements' (Brydon, 2019, p. 22). However, public audit has broader purposes. For example, the Financial Reporting Council (FRC, 2021b, p. 4), in its quality review of major local audits (which include local authorities with annual income or expenditure of £500 million or more), states that 'High quality audit is essential to maintain stakeholder confidence by providing an independent, impartial view of a major local audit body's financial statements and arrangements in place to secure value for money'. Redmond (2020, p. 26) recognizes a quality audit as one where the needs of the users of the accounts are understood and where an effective risk assessment is informed by a proper understanding of local government. He extends this definition (ibid., p. 28) to include the output of the audit and the local authority's response to audit recommendations. The form and content of auditors' reports are important, as is their timeliness.

The FRC is responsible for the quality assessment of corporate and major public audits. It has defined the elements of a high-quality corporate audit (FRC, 2021a, p. 69), but it has not sought to adapt these for local public audit. The Kingman Review of the FRC (2018, p. 69) criticizes this 'one size fits all' approach, which does not recognize the particular context of public audit. Auditors may feel pressurized to meet the regulator's standards rather than the specific needs of local public audit stakeholders. Those needs are not met effectively by the current audit framework because there is no longer a body to act for local stakeholders when it comes to interpreting complex financial statements, identifying areas of risk and seeking resolution. More generally, Kingman (2018) criticized the local audit framework in England, noting that it was fragmented, underfunded and supervised by a regulator that was more attuned to corporate reporting and audit. Kingman suggested that there was less challenge and awareness of the work of local public auditors compared to that of the corporate auditor, and the knock-on effect of this would be reduced scrutiny of the local authority sector at a time when risks were rising.

Criticisms by the FRC of the quality of corporate audit often refer to a lack of professional scepticism, a complex audit skill which is defined and emphasized in auditing standards, but criticism of local public audit tends to focus on the gathering of sufficient evidence. However, the FRC's (2021b) conclusion that auditors should challenge and improve the evaluation of the assumptions used in investment property valuations shows that professional scepticism is just as important for local public audit. This area of high risk could have been highlighted by local auditors sooner and more effectively (NAO, 2020a).

The complexity of local authority accounts makes the role of the auditor as the agent of stakeholders, with the ability to interpret the financial statements on their behalf, particularly important. Being able to play that role relies on timely reporting as well as reporting on areas that matter to stakeholders (Redmond, 2020). A key indicator is therefore whether local audit opinions meet reporting deadlines, a process which requires the auditee to prepare accounts and the auditor to make their audit judgement. Almost all local authorities met audit deadlines in 2015/16 (97%) and in 2016/17 (95%) (NAO, 2021). From 2017/18, the reporting deadline was reduced from six months to four. This tighter deadline was met by a creditable 87% in 2017/18, but this fell dramatically to 57% in 2018/19. The problem was no longer a few laggards. The significant point is that this deterioration in timeliness preceded the onset in March 2020 of the Covid 19 pandemic, which would understandably disrupt accounts preparation and audits for 2019/20. Timeliness for 2019/20 was 45% against an eight-month deadline and 9% in 2020/21 (the year of maximum Covid 19 disruption) against a six-month deadline.

The FRC (2021b, p. 7) reported that 'Based on our reviews, the quality of work to conclude on VFM arrangements across all firms remains high'. However, the VFM opinion scrutinized by the FRC was based on the old Code of Audit Practice, containing the requirement for a binary audit opinion on whether or not appropriate arrangements are in place to secure VFM. The VFM audit requirements of the old Code were heavily criticized by Redmond (2020) and many respondents to his Review. The new Code, applicable from 2020/21, extends the auditor's duties with the requirement for a commentary from the auditor covering financial sustainability, governance and the improvement of economy, efficiency and effectiveness (NAO, 2020b). These changes are likely to require an expansion of the scope of VFM audit work if the regulator's satisfaction with the quality of VFM work is to be maintained.

Regulatory matters

Delay in issuing audit opinions reduces the effectiveness of the assurance they offer. However, local government auditors have wider powers which are not constrained by the financial reporting and audit timetable and allow the auditor to raise concerns at any time via a PIR. Redmond (2020, p. 36) notes that only four PIRs had been issued since 2015; four further PIRs have been issued since publication of the Redmond Review. There is a perception that, without the protection previously afforded by the AC, auditors are less likely to issue PIRs, due to potential legal risks to the firm.

The issues covered by those PIRs have been specific to those councils, but the previous audit framework was able to pick up and address risks which had the potential to affect the whole sector. This ability has been reduced since the abolition of the AC. The National Audit Office (NAO) carries out some sector-level studies, but it reports to Parliament and not to individual local authorities or local stakeholders. This means that there are risks that local issues are not reported and therefore do not inform individual local authorities and their auditors. For example, the AC had published the results of an investigation into the potential loss of nearly £1bn by English local authorities when the Icelandic banking system collapsed in October 2008 (Audit Commission, 2009). That report was considered by the Communities and Local Government Committee (2009) which noted the detailed work carried out by AC personnel, who visited a sample of authorities as well as gathering data from the appointed auditors.

In contrast, when the NAO investigated the practice by local authorities of investing in commercial property, the focus was on the stewardship role of the Ministry of Housing, Communities and Local Government (NAO, 2020a). This reflects the fact that the role of the NAO is to report to Parliament on central government actions, not on local authorities. Local authorities spent £6.6bn on commercial property from 2016/17 to 2018/19 to generate income, often by borrowing at lower than market rates from the Public Works Loan Board (PWLB). In its analysis, the NAO relied on a commercial property data set, as the data held by the Department for Communities and Local Government was insufficiently detailed. The NAO was unable to commission work from the auditors or compel local authorities to provide data. The NAO highlighted the risks of commercial yields failing to meet expectations and/or debt servicing costs exceeding estimates, but placed a caveat on its report, as it did not assess VFM or consider whether excessive risk had been incurred by local authorities (NAO, 2020a, p. 6).

The Housing, Communities and Local Government Committee (2021, p. 27) concluded that 'Commercial investment appears to pose no clear threat to local government financial resilience overall'. In contrast, the Committee of Public Accounts (2016, p. 5) had earlier expressed concern that the Department 'appears complacent about the risks to local authority finances, council taxpayers and local service users resulting from local authorities increasingly acting as property developers and commercial landlords with the primary aim of generating income'.

The Chartered Institute of Public Finance and Accountancy (CIPFA) and the UK government subsequently tightened guidance to discourage borrowing to 'invest for yield', though the guidance is not mandatory and there was no immediate reduction in the scale of commercial property investment (NAO, 2020a, p. 11). Local authorities in the devolved nations also follow the same borrowing guidance; they have not copied the pattern of commercial property investment seen in England, indicating differences in subjectivization.

If the Chief Financial Officer (CFO) of an English local authority believes that their authority's expenditure is likely to exceed its available resources, they are legally required to issue a notice under Section 114 of the Local Government Finance Act 1988. This has the effect of stopping all expenditure on everything but essential services, so it is clearly something which would only be done in extreme circumstances. By the time the CFO gets to that stage, it would be likely that other means of balancing the budget have been tried and it is difficult to imagine a scenario where the external auditor would have been unaware of the situation. The auditor might already have reported the warning signs to the council, or at least to its audit committee, and potentially issued a PIR. In 2000, the CFO of the London Borough of Hackney issued a Section 114 notice and there were no further notices for nearly 20 years. In recent years, there have been Section 114 notices issued by Northamptonshire County Council, Nottingham City Council, Slough Borough Council and the London Borough of Croydon.

In order to ensure that authorities can continue to deliver services, the new Code of Audit Practice (NAO, 2020b, p. 17) requires auditors to comment on financial sustainability by reporting on how authorities plan and manage their resources. This first applied to the financial year 2020/21 and it is too early to assess the effectiveness of this enhancement to the VFM opinion.

Sustainability of the local public audit market

Since the abolition of the AC, all local public bodies in England have been audited by private audit firms following the NAO's Code of Audit Practice. Although English local authorities were allowed to appoint their own auditors from 2015/16, almost all of them use the services of Public Sector Audit Appointments Ltd (PSAA) which issues block contracts to private audit firms; PSAA is a company limited by guarantee whose ultimate parent is the Local Government Association.

There is evidence of a fragile and malfunctioning local public audit market in England, with audits being under-resourced and characterized by an ageing workforce, and perceived within firms as being less prestigious than private sector audit (Redmond, 2020; Touchstone Renard, 2020). Watson (2019) interviewed auditors who transferred to private firms from the AC but continued to audit the same councils as before. She found that the auditors were doing less work, though meeting minimum regulatory standards, and had a greater focus on client satisfaction as opposed to taxpayer interests. However, Redmond (2020) found that many local authorities were not satisfied with the quality of their audits because the audit team did not have sufficient understanding of the sector and the audit did not focus on the areas of greatest value to stakeholders. Some local authorities felt that the auditors applied an inappropriate corporate audit mindset, supporting the Kingman (2018) view that there was insufficient differentiation between corporate and local public audit.

Several of our interviewees suggested that the fragility of the local audit market is accentuated by the operational logistics faced by firms who use the same staff to carry out the audits of both local authorities and NHS bodies, which have a common financial year end of 31 March. The challenge is compounded when audit completion deadlines are tightened and by the absence of a regulator to co-ordinate audit delivery across these sectors.

Causes

Causes are complex because the difficulties in local audit are multifaceted. Some insight into relative importance is provided by the experience of England compared to Scotland, Wales and Northern Ireland. Changes in economization and collibration in England were marked: mediation was modified by the power shift between central and local government whereby adjudication's performance metrics were dropped in favour of unprecedented resource reductions and rhetoric about 'localism'. A less supervised financial environment and drastic cut-back decisions for English local authorities affected subjectivization, with some local authorities adopting highly risky responses.

First, the period since 2010 has been exceptional in terms of the depth of local authority spending reductions, which confounded the standard assumption that only small year-on-year reductions in real-terms spending were achievable. Harris et al. (2019) calculated that English local authority spending fell by 20% in real terms and 25% in per capita terms over the period 2009/10 to 2019/20. Such calculations are necessarily incomplete because institutional changes, such as the transfer of many schools to academy trusts, impede data comparability. It was an explicit decision of the 2010–2015 Coalition government that English local authorities would be more harshly treated than central government—in part reflecting functional priorities in relation to health spending. The Scottish Government used its expenditure-switching discretion to soften the impact on local authorities (Eiser et al., 2019), though local government still suffered greater resource reductions than health and central government. The scale of reductions, at a time of population increase and demographic ageing, damaged local authority capacity. In this context, care is needed in differentiating what are, in part, problems of financial management and reporting from those directly attributable to audit practices.

Second, the years of austerity in the 2010s followed a period of remarkably fast public expenditure growth in the 2000s, an alternation of feast and famine which is a characteristic of UK public expenditure and which is challenging for local government to cope with when demand for services is increasing. The Treasury focus in the 2010s was on achieving large expenditure reductions. This led to the neglect of service-quality comparisons after the 2010 announcement of the future abolition of the AC; to varying functional composition of cuts (education faring much worse than health); and to divergent geographical impacts. This harsher context, notwithstanding the rhetoric about localism, led to subjectivization responses which in some cases would undermine the sustainability of particular councils.

Third, the adverse experience of English local authorities owes much to factors such as the population size of England and the social and spatial distance between local authorities and Whitehall departments. The overriding objectives of government policy in 2010 were to remove the apparatus of performance management and reduce audit costs. This would be achieved by eliminating the Comprehensive Area Assessment, abolishing the AC, contracting out all local authority audits to private firms, thereby privatizing the AC's District Audit function which had provided in-house audit capacity dating back to 1844 (Coombs & Edwards, 1990). This differentiated England from the devolved nations, which have maintained in-house audit capacity. The decision to allow English local authorities to appoint their own auditors ran counter to the previously accepted recommendation of the Sharman Report (2001) that public entities should not be able to do so. The cost-reduction objective was achieved, with audit costs falling 42.25% in cash terms from 2015 to 2019 (Redmond, 2020, p. 33). Lower audit costs meant less financial audit, unless the claims of private audit superiority in terms of costs were justified, as well as a narrower conception of public audit. What also disappeared were the AC's sectoral and thematic studies which, *inter alia*, provided early warning of emerging problems.

Consequences

Cumulative causation has led to less financially resilient local authorities, manifesting in weakened financial capacity (some take unprecedented financial risks) and audit delays (reducing accountability). The effects have operated at several levels: local accountability has been reduced, VFM damaged, early-warning systems decommissioned, and there have been delays in completing local audits, contributing to the late publication of the Whole of Government Account (2019/20 was not published until 6 June 2022).

Without the surveillance role of the AC, comparative information on the large number of English local authorities largely disappeared from the public domain, imposing greater responsibilities on the UK government's Department for Levelling Up, Housing and Communities, whose predecessors suffered large budget cuts in the 2010s. The capacity of a Whitehall department to monitor England, given its population size and complex local government structure, can be overestimated. In contrast, Scotland and Wales are much smaller and their local government structure is single-tier, while local authorities in Northern Ireland only account for a very small percentage of public expenditure. The austerity of the 2010s did not bring changes to collibration in local audit in the devolved nations as it did in England (Ferry & Ahrens, 2022), where adjudication lessened and no one accepted system leadership responsibility.

Given the UK's centralization of taxation, local authorities are vulnerable to changes in the level and structure of grants. What happened in the 2010s was unprecedented in terms of the depth of spending cuts and the extent to which individual English local authorities were differentially impacted. There was rhetoric in the 2010s about local authorities becoming entrepreneurial and imitating the private sector. The abolition of the AC had disturbed the collibration of central–local fiscal relationships. Local authorities sought to increase revenue derived from non-tax, non-grant sources, and in some cases these activities included borrowing from the PWLB to invest in speculative property ventures outside their own geographical jurisdiction. Prominent examples have been Spelthorne District Council in Surrey and Thurrock District Council in Essex, which accumulated liabilities far beyond the credible capacity of their council tax base should asset values fall. Other councils, such as Bristol City Council, Nottingham City Council and Warrington Borough Council created or invested in energy supply companies that later collapsed.

These strategic responses to resource shortage and uncertainty can be interpreted through the lens of Miller and Power's (2013) notion of subjectivization, whereby economic agents under intense pressure devise counter-strategies mixing compliance and resistance. Without the AC's sector-wide reviews, the first line of defence is local audit. In cases of concern the AC had used PIRs to flag up problems and underwrote the costs of conflicts. Audit firms now absorb all of the risks associated with reporting on their local authority clients, including reputational risks.

Local public audit has been entangled in the more assertive style of audit inspection conducted by the FRC which is awaiting delayed Westminster legislation to replace it with the Auditing, Reporting and Governance Authority (ARGA). These developments have made audit firms more nervous about inspection of local audits (Mazars having been fined) and have increased dissatisfaction among auditees who believe that too much audit time is now devoted to asset valuations.

Possible resolution

The consequences of a weakened local audit system are materializing, notwithstanding the preferences for 'less audit' reported by Redmond (2020). This section considers the potential of various resolutions to the challenges facing the local audit sector, with particular reference to England. This includes consideration of the extent to which preferred solutions may lack political feasibility. Path dependence is a powerful factor in central–local government relationships, intensified in the UK by the absence of a written constitution, which means that so much depends on convention rather than on law. Elected local authorities have extensive expenditure responsibilities but limited and increasingly constrained own revenues. This vertical fiscal imbalance provides central governments (the UK government for England and the devolved administrations) with powerful tools of grant reduction and restrictions on existing local tax powers. In terms of effective power, an already fiscally centralist England became more so, with more subdued developments in the devolved nations.

With pre-2010 collibration having been broken up, a Conservative government in the 2020s was never going to re-establish an audit surveillance body bearing any resemblance to the AC. This is evidenced by the government's response to the Housing, Communities and Local Government Committee (2021) report, which rejected the recommendations that local authorities should not be allowed to choose their auditors and that a stand-alone system leader should be created to identify systemic issues across local government (Department for Levelling Up, Housing and Communities, 2021). The lack of stakeholder support for the AC at the time of its announced abolition (Communities and Local Government Committee, 2011) suggests that the return of centrally-managed performance audit would not be welcomed by English local authorities. 2010 was a 'critical juncture', a structural break generating a new track of path dependence. Accordingly, the settled arrangements of Scotland, Wales and Northern Ireland are not transferable to England.

The recommendation in Redmond (2020) for the creation of a new body, the Office of Local Audit and Regulation, to oversee and regulate most aspects of local government audit in England has been rejected by the UK government (Ministry of Housing, Communities and Local Government, 2020). The Government's approach has been to create ARGA as a new regulator to replace the FRC. The role of ARGA will be to regulate and encourage competition in the corporate audit market, with the intention that one of its divisions will operate as system leader in the local public audit market (Ministry of Housing, Communities and Local Government, 2021). Ensuring that local public audit is sufficiently ring-fenced within ARGA, so that it is not seen as subordinate to its corporate audit responsibilities, will be an important feature of this institutional structure. Local public audit stakeholders will need to be vigilant if ARGA is not to follow the same path as the FRC.

Financial certification audit raises different issues from performance audit. The obvious point is that effective local public audit requires sufficient resourcing. A return to directly-employed local auditors appears to be off the political agenda in England. It is therefore vitally important to ensure that the market is profitable for private firms and is also career-rewarding for their employees. The risk of market exit by private firms is severe, as evidenced by events in the Netherlands (de Widt et al., 2022). Furthermore, what happens in England might have repercussions for the willingness of private audit firms to continue their local public audits in the devolved nations.

In respect of the 2017 PSAA procurement of audits for the period 2018/19 to 2022/23, the division of local authority audits into only six bundles, which were not regionally based, appears to have limited the number of audit firms able and prepared to bid for contracts. Those that did compete appear to have done so largely on the basis of lower fees rather than higher quality. One firm was excluded because of its higher-priced bid, irrespective of quality issues (Redmond, 2020).

The PSAA had a new procurement strategy for the 2022 invitation to tender for the five years beginning 2023/24, seeking to support market development by having ten national lots and three development lots. (The results of this tender process were not available when this article was finalized.) When designing future audit bundles, the PSAA could consider using smaller lots on a regional basis that would make it viable for audit firms to enter the market and build up capacity, perhaps in a single region rather than having personnel spread over the whole of England. This would enable access to the market by smaller firms with a strong regional base. Crucially, competitive bidding should not lead to under-resourced, low-quality audits.

The person responsible for signing off the audit report on behalf of a firm is the Key Audit Partner (KAP). Each audit firm and nominated KAP is required to have recent experience of undertaking local authority audits. The current arrangements produce two unsatisfactory results. First, the requirement acts as a barrier to firms wishing to enter the market. Second, Redmond (2020) reports that about 35% of registered KAPs work for firms which do not currently hold audit contracts with the PSAA, suggesting a waste of experience of persons otherwise eligible to undertake such work. Amending the current KAP arrangements, both to encourage new participants and enable those already qualified to move into the market, has been accepted by the UK government, though the Committee of Public Accounts (2022) has criticized the lack of urgency.

The NAO took on the role of preparing the Code of Audit Practice following the announced abolition of the AC. There are sensitivities in the involvement of the NAO, given its role in servicing the Westminster Committee of Public Accounts, in terms of the separate democratic accountability of English local authorities. The local audit arrangements in Scotland were structured in the light of parallel sensitivities, hence the role of the Accounts Commission as overseer of Audit Scotland's local authority remit. The local government role of Audit Wales and the Northern Ireland Audit Office have not been controversial in this regard. When ARGA is established, it will take over the production of the Code of Audit Practice from the NAO and will produce overview reports on England.

Despite these limitations in the institutional structure of local public audit, some important improvements have been made in the regulatory framework. These include an amended CIPFA Prudential Code (2021), tightening of the criteria of the PWLB, and the revision of the Code of Audit Practice (NAO, 2020b).

Institutional difficulties have been seriously underestimated in the English context. Required to confirm that the annual budget is legal (Section 25) and with the power to issue Section 114 notices if their authority is insolvent, CFOs are likely to find the internal political pressures intolerable, thereby delaying remedial action. Moreover, without the protection of the AC, auditors are in an exposed position when local authorities take no notice of their warnings.

Given the large number of English local authorities, informal channels between audit firms and any system regulator, which are available in the devolved nations, cannot be relied upon in England. One reason for the reluctance of auditors to issue PIRs is that such escalation is time-consuming and may involve reputational costs. Some kind of interim warning is necessary. Similarly, it is career-threatening for a CFO to issue an adverse Section 25 report or Section 114 notice. The Housing, Communities and Local Government Committee (2021) recommended that intermediary mechanisms be created to enable auditors and/or CFOs to report issues to the full council and to scrutiny committees without resorting to a PIR or a Section 114 notice, but the UK government is not taking up this proposal (Department for Levelling Up, Housing and Communities, 2021).

Given the binding political constraints, delivery of effective performance audit for English local authorities is problematic. Local elections with low turnouts and heavily influenced by national political cycles, are an insufficient basis for local accountability. Abu Hasan et al. (2013) reported widespread acceptance by local authority finance staff of the AC's annual Use of Resources (UoR) assessments which were part of the Comprehensive Performance Assessment and then of the Comprehensive Area Assessment. The UoR assessments had kept a focus on financial reporting and financial management capacities across the sector and, if they had continued throughout the 2010s, there would have been ample early warning of emerging financial distress and risks to financial sustainability.

In respect of the strategic risks to local authorities, the reputation of the whole sector can be damaged by the publicity which attaches to the conduct, poor financial control and failure of a small number of them. Greater transparency through comparative data, published in good time and supported by strong local audit practices, is essential for restoring the health of the local authority sector. The reflex reaction of UK governments is to further centralize power and control, including the removal of functions from local authorities. Even if there had been local authority support, the Redmond institutional proposals would probably not have been implemented. The risk now is that central government will fill the regulatory vacuum, with there being no buffer between local authorities and central government.

Conclusion

The theoretical framing derived from Miller and Power (2013) and Dunsire (1990) advances our understanding of why the local audit crisis has developed. What are represented as audit failures in many circumstances are the working out of broader regulatory failures and the destabilization in England of collibration processes which hold together an unbalanced system of central–local relations. Important evidence on what have been the major factors is provided by the contrasting experiences of Scotland and Wales, where local authorities, unlike Northern Ireland, have broadly the same range of expenditure responsibilities as in England (Ferry & Ahrens, 2022).

The AC intensified adjudication over English local authorities in the name of performance improvement during fiscal plenty in a way that became strongly resented, particularly as political control of English local authorities had shifted from Labour to Conservative and Liberal Democrat. Collibration can be conceptualized in terms of the balance of power in contested arenas; power was perceived to shift too much towards central government, with destabilizing effects. What came next was a dramatic shift from what was perceived as unacceptable micro-management to hitherto unimaginable reductions of real resources which differentially affected local authorities. Funding reductions in local resources occurred in Scotland and Wales, but these did not have the same central–local conflicts as England, with the result that existing collibrations were not disrupted to anything like the same extent.

The post-AC arrangements for England embodied a very narrow conception of local public audit and were inadequately resourced. This was not an accident, but the working through of the post-2010 political mood which was, in part, a reaction against the Labour Government's use of local audit for regulatory control of English local authorities. The prevailing mood prioritized reducing audit costs, notwithstanding the very small proportion of total local authority expenditure they represented and the fact that audit fees in the corporate sector were increasing. Strikingly, reduction in audit costs is still claimed as a benefit of the 2014 Act (Ministry of Housing, Communities and Local Government, 2021), without recognition of the link between fee reduction and audit crisis.

In contrast to England, the integrated nature of public audit meant that the devolved nations avoided these calamities. They maintained responsibility for their public sectors as a whole, not buying into the 'liberation from central control' rhetoric which was propagated in England in the early 2010s. Their retention of public audit capacity made their local audit provision less vulnerable to threatened or actual market exit by private firms.

In England in the 2010s, liberation from what was seen as oppressive control by the AC led to an unfounded confidence in voluntarism rather than statutory or regulatory mechanisms. Audit as adjudication, which had earlier expanded in intensity and reach, narrowed and became under-resourced and under-valued. Borrowing for yield should not have been allowed under the CIPFA Prudential Code (originally, CIPFA, 2004), but adherence was not mandatory and there developed a permissive interpretation that speculative investments qualified within the Code when their proceeds were intended to fund local public services. In the context of withdrawals of central government funding, such innovations provide illustrations of subjectivization, as local authorities sought to navigate new forms of control processes.

Audit and corporate governance reform for the business sector was dropped from the 2022 Queen's Speech, reportedly on the grounds that it was 'boring' and not a 'wedge issue' which would differentiate the Johnson Conservative Government from opposition parties (Pickard & Parker, 2022). In terms of claims on parliamentary time, this might be further sidelined by the cost-of-living crisis and the UK General Election expected in 2023 or 2024. This delay in setting up ARGA, which will also have responsibility for local public audit, extends the regulatory paralysis.

The unanswered question in relation to English local authorities is whether a package of piecemeal changes, in the absence of the structural recommendations of Redmond (2020) due to political infeasibility, can address the audit crisis. There are many highly competent people working on local audit but they are unable to address systemic weaknesses because of factors outside their control. Without reform, will there be yet more central government intervention in local authorities and might private audit firms exit the market, leaving some local authorities without an auditor, with detrimental consequences for citizens, service users and council taxpayers?

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