

**EXPLANATORY MEMORANDUM TO
THE CODE OF AUDIT PRACTICE 2024**

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Ministry of Housing, Communities and Local Government and is laid before Parliament in accordance with the Local Audit and Accountability Act 2014.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

- 2.1 Jim McMahon, Minister of State for Housing, Communities and Local Government at the Ministry of Housing, Communities and Local Government confirms that this Explanatory Memorandum meets the required standard.
- 2.2 Rosie Seymour, Deputy Director for Local Government Accountability and Audit, at the Ministry of Housing, Communities and Local Government confirms that this Explanatory Memorandum meets the required standard.

3. Contact

- 3.1 Policy officials in the local audit team at the Ministry of Housing, Communities and Local Government can be contacted via email at localaudit@communities.gov.uk with any queries regarding the draft Code of Audit Practice.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

- 4.1 The draft Code of Audit Practice 2024 (the draft Code) sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014 (the 2014 Act).
- 4.2 The draft Code makes provision for the audit of relevant bodies in Schedule 2 of the 2014 Act. These bodies include local authorities, National Park authorities, fire authorities, police and crime commissioners, waste authorities and transport authorities.¹
- 4.3 Additionally, the draft Code makes provision for the audit of NHS bodies, as set out in Schedule 6 and Schedule 13(3)(1) of the 2014 Act.

¹ Schedule 2 bodies are in England with the caveat that under paragraph 29 relevant authorities include: *Any person or body exercising functions in relation to an area wholly in England or partly in England and partly in Wales—*
(a) which was originally subject to audit provisions contained in an enactment passed before the Audit Commission Act 1998, and
(b) to which the audit provisions of that Act applied by virtue of paragraph 4(1) or 7 of Schedule 4 to that Act immediately before the repeal of section 2(1) of that Act by this Act.

- 4.4 The 2014 Act makes the Comptroller and Auditor General (C&AG), supported by the National Audit Office (NAO)² responsible for the preparation and maintenance of the Code and gives the C&AG the power to issue guidance to auditors in support of the Code, to which auditors must have regard to when carrying out their work.

Where does the legislation extend to, and apply?

- 4.5 The extent of this draft Code is England and Wales.
- 4.6 The territorial application of this draft Code is England and Wales.

5. Policy Context

What is being done and why?

- 5.1 Effective local audit ensures transparency and accountability for public money spent on vital services, and builds public confidence.
- 5.2 As noted above, the Code of Audit Practice sets requirements for local bodies and NHS bodies. The changes in this draft Code seek to address a significant backlog of unaudited accounts affecting the relevant non-NHS bodies within the draft Code's remit.
- 5.3 For the 2022/23 financial year, just one percent of these local bodies published audited accounts on time. Without decisive action, the backlog will continue to grow. This would also severely hamper necessary fundamental reforms to repair the system.
- 5.4 On 30 July 2024, Jim McMahon, Minister of State in the Ministry of Housing, Communities and Local Government, published a Written Ministerial Statement (WMS) outlining immediate actions the Government – together with the Financial Reporting Council (FRC), the NAO, and organisations in the wider system – is taking to address this backlog and put local audit on a sustainable footing.
- 5.5 There are two central pillars of these proposals. Firstly, the Government has laid the Accounts and Audit (Amendment) Regulations 2024 to update requirements on local (non-NHS) bodies. The changes include requiring local bodies to publish outstanding audited accounts for financial years 2015/16 up-to-and-including 2022/23 by a statutory backstop date of 13 December 2024. A series of further backstop dates for subsequent financial years will enable the local audit system to recover. These are:
- Financial year 2023/24: 28 February 2025
 - Financial year 2024/25: 27 February 2026
 - Financial year 2025/26: 31 January 2027
 - Financial year 2026/27: 30 November 2027
 - Financial year 2027/28: 30 November 2028
- 5.6 The changes in the draft Code of Audit Practice, which alter requirements on auditors, comprise the second pillar of the proposals to tackle the backlog of local audits in England. These changes include, for example, introducing a requirement on auditors to issue their opinion in time for local bodies covered by the amended Regulations to publish their accounts by the relevant backstop date.

² The National Audit Office ("the NAO") is incorporated under section 20 of the Budget Responsibility and National Audit Act 2011 (c. 4) ("the 2011 Act"). Under paragraph 2 of Schedule 3 to the 2011 Act the NAO is required to provide resources for the Comptroller and Auditor General's functions.

5.7 All key local audit organisations support these bold measures, recognise their exceptional nature, and continue to share the conviction that this urgent and decisive action is needed. Taken together, these proposals aim to facilitate a return to timely, purposeful audits.

What was the previous policy, how is this different?

5.8 The changes between the 2020 Code and the draft 2024 Code are as follows:

5.9 Chapter One

5.9.1 Paragraph 1.5 sets out when the draft Code comes into force.

5.9.2 Due to the possibility of this draft Code coming into force while work is ongoing for some NHS 2023/24 audits, paragraphs 1.5, 3.2 and 4.2 confirm that NHS audit work up to and including 2023/24 will be done in accordance with the 2020 Code. This means all NHS audits (including any signed off late or relating to earlier years) will be completed and reported on under the same Code.

5.9.3 Paragraph 1.15 encourages auditors to co-operate effectively where there is a change in the appointed auditor and defines the audit handover period.

5.10 Chapter Two

5.10.1 Paragraphs 2.13 to 2.14 introduce a new requirement on auditors to issue the audit report in time for the relevant authority to publish its accounts by the dates specified in the Accounts and Audit Regulations Amendments 2024. Limited exemptions to this requirement are also set out. These exemptions apply where:

- the auditor is considering an objection that may have a material impact on their opinion on the financial statements;
- in the auditor's judgement recourse to the Court could be required; or
- the auditor is unable to satisfy themselves as to whether there are significant weaknesses in the body's arrangements to secure economy, efficiency and effectiveness in its use of resources (except in relation to incomplete audits up to and including 2022/23 – requirements for those audits are set out in Schedule 4).

5.10.2 Once any conditions underpinning an exemption no longer apply, the draft Code requires auditors to issue their audit report as soon as practicable.

5.11 Chapter Three

5.11.1 Paragraph 3.2 sets out the relevant sections and versions of the Code (or draft Code) that apply, depending on the type of local public bodies and audit years.

5.12 Chapter Four

5.12.1 Paragraph 4.3 sets out the relevant sections and versions of the Code (or draft Code) that apply, depending on the type of local public bodies and audit years.

5.12.2 Paragraph 4.6 clarifies that the audit report on the financial statements should include the basis of the auditor's opinion. This paragraph also clarifies the process for reporting on value for money arrangements should further issues arise after the report on the financial statements has been issued.

5.12.3 Paragraph 4.7 amends the timing of the auditor's annual report so that it provides an

annual summary of the position of the audit at the time of issue, as opposed to a report that can only be issued upon completion of the audit.

- 5.12.4 Paragraph 4.8 states that the auditor should aim to issue their auditor's annual report to those charged with governance at a local NHS body no later than one month after the date on which they have issued their audit report on the financial statement. The 2020 Code required them to be issued at the same time.
- 5.12.5 Paragraphs 4.9 and 4.10 confirm the requirement for auditors of non-NHS bodies to issue their auditor's annual report by 30 November each year from 2024/25. Flexibility has been provided in 2023/24 given auditors' focus will be to clear the backlog of incomplete audits up to and including 2022/23 by 13 December 2024.
- 5.13 Chapter Five
- 5.13.1 Paragraph 5.5 requires the auditor to consider whether to exercise their additional public reporting powers where they have issued a modified audit report on the financial statements that is not solely as a result of any statutory publication requirements set out in Regulations.
- 5.14 Schedule Three
- 5.14.1 An entirely new schedule that sets out the auditor's work on value for money arrangements for incomplete audits of non-NHS bodies in relation to audit years prior to 2023/24. This represents a reduction in scope in comparison to Chapter Three, focussing primarily on financial sustainability and governance. The schedule also clarifies that the 2015 Code still applies to incomplete audits up to and including 2019/20.
- 5.15 Schedule Four
- 5.15.1 An entirely new schedule that sets out the auditor's reporting requirements for incomplete audits of non-NHS bodies in relation to audit years prior to 2023/24. The schedule also clarifies that the 2015 Code still applies to incomplete audits up to and including 2019/20.

6. Legislative and Legal Context

How has the law changed?

- 6.1 Some of the key differences between the draft Code and previous (2020) Code include:
- 6.2 a requirement for auditors of relevant authorities to discharge their statutory duties in relation to the accounts and issue their audit report in time for the accounts to be published by the specified date set out in the amended Accounts and Audit Regulations 2015. The draft Code also includes circumstances in which this would not be required (paragraphs 2.13-2.14);
- 6.3 changes to the current duties on value for money (VFM) arrangements to enable auditors to produce a single, multi-year commentary covering a reduced VFM arrangements scope for incomplete audits of relevant authorities except for NHS bodies up to and including financial year 2022/23 (Schedule 3 and 4). Additionally, from financial year 2024/25 onwards, the draft Code requires auditors of non-NHS bodies to produce their auditor's annual report by November each year, where they will set out the current status of the audit even where it is not complete. The draft

Code also makes limited changes to the timing of the auditor's annual report for NHS bodies. (paragraphs 4.3,4.6 – 4.10);

- 6.4 for all types of bodies covered by the draft Code, except for NHS bodies, a requirement for auditors to consider whether to exercise their additional public reporting powers where they have issued a modified audit report on the financial statements that is not solely as a result of any statutory publication requirements set out in Regulations (paragraph 5.5);
- 6.5 strengthening the existing duties for auditors to co-operate to facilitate the smooth transfer of engagements between audit suppliers as the new contracts begin for the audit of local public bodies (paragraph 1.15).

Why was this approach taken to change the law?

- 6.6 The introduction of the backstop dates requires a change to auditors' duties under the Code of Audit Practice to enable them to issue an opinion for a relevant authority by a specific date. This will in turn ensure relevant authorities are able to comply with the proposed backstop dates. Given the scale of changes needed, it is deemed appropriate to prepare a replacement draft Code rather than altering the existing Code.³

7. Consultation

Summary of consultation outcome and methodology

- 7.1 To inform the C&AG's decision making in relation to the draft Code he established a Programme Board consisting of NAO representatives, observers from DLUHC (now MHCLG), an observer from the Local Audit Team at the FRC, and an independent expert member with local external audit expertise who is not currently working in the sector. The Programme Board supervised technical panels on various areas covered by the Code.
- 7.2 In addition to engaging with a number of stakeholders including audit firms and relevant government departments through the panels, Schedule 6 of the 2014 Act includes a duty on the C&AG to consult publicly when preparing a Code. The C&AG ran a public consultation on the draft text of the Code between 8 February and 7 March 2024. The consultation⁴ received 61 responses which was significantly more than were received for the 2020 Code (39 responses), indicating the level of interest in the issues.
- 7.3 There was no significant opposition to the proposed changes in the draft Code. Responses indicated a clear need from auditors for detailed guidance on implementing the proposals and that it must be co-developed with the FRC. There was also a clear desire from local bodies for the wording which will form the basis of auditors' opinions on the financial statements to make clear that local bodies should not be unfairly judged on disclaimed or modified opinions caused by the introduction of backstop dates that are largely beyond their control. Finally, respondents were clear that VFM assurance is particularly valued by authorities, even where this is late.
- 7.4 The NAO has published a summary of consultation responses on its website.

³ The Act requires the C&AG to use reasonable endeavours to ensure that the Code is replaced every 5 years. The last replacement code was published in April 2020.

⁴ <https://www.nao.org.uk/code-of-audit-practice-consultation/>

8. Applicable Guidance

- 8.1 The NAO will publish supplementary guidance for auditors on the impact of the backstop arrangements on audits of English local bodies.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

- 9.1 A full Impact Assessment has not been prepared for this draft Code because the overall impact on business, charities or voluntary bodies is unlikely to be significant. This draft Code has no impact in isolation, but is intended to work alongside the Accounts and Audit (Amendment) Regulations 2024 (which were laid before Parliament on 9 September 2024), and this section describes the combined impact of this draft Code and the regulations. A proportionate level of analysis has been produced for this combined impact and is summarised below in 9.2.

Impact on businesses, charities and voluntary bodies

- 9.2 Local public audit in England is provided by privately operated audit firms. There is no significant impact on business because auditors will be paid for the cost of work they undertake that arises from the changes, which will be a positive impact overall for the audit providers. The proposals have been consulted upon and extensively discussed with audit firms. Issuing a disclaimed or modified audit opinion and a subsequent return to being able to fully complete audits will require differing levels of work by auditors.
- 9.3 There is no impact on charities or voluntary bodies because they are not within the scope of the SI (they are not Category 1 authorities).
- 9.4 The draft Code does not impact small or micro businesses.
- 9.5 The impact on the public sector is that local public bodies in England will pay audit fees to restore full assurance on their accounts where auditors have disclaimed or qualified their opinions on previous accounts as a result of the backstop provisions. Work is ongoing to understand the financial impact and consequent action.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

- 10.1 The approach to monitoring this legislation is that Schedule 6 of the 2014 Act puts a range of requirements in place in respect of the C&AG's responsibility for the Code. These include duties to keep the Code under review and to use reasonable endeavours to prepare and publish a new Code approximately every five years.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

- 11.1 As set out above, the changes in the draft Code of Audit Practice are part of a wider package of urgent measures to tackle the local audit backlog. The replacement draft Code, in conjunction with the Accounts and Audit (Amendment) Regulations 2024, which amend the Accounts and Audit Regulations 2015, form the central elements of this package. The amendment regulations were laid on 9 September 2024.

11.2 This draft Code replaces the draft Code of Audit Practice 2024 laid on 9 September, which has been withdrawn. This was required due to the inadvertent omission of some information in Schedule 1, which aims to provide an accessible view of auditors' responsibilities. The schedule summarises (rather than reproduces) relevant sections of the 2014 Act and is not intended to be a substitute for consideration of the detailed requirements of the Act itself. The additional information included in the updated version of the Code can be found from the text that reads 'to refer the matter to the Secretary of State' on page 32 to the end of page 34. The updated instrument also includes minor clarifications to the laying powers described on page 3 and in paragraph 1.2 on page 8.

12. European Convention on Human Rights

12.1 As the Code of Practice is not a statutory instrument and does not amend legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").