



# Response to the Public Accounts Committee's inquiry into the timeliness of local auditor reporting

## Summary

The Public Accounts Committee has previously reported that the system of local government audit in England is close to breaking point. It is important to recognise that this also applies to the NHS.

There are many complex and intertwined factors leading to the issues in the NHS external audit market, similar to those being reported in local government. As explored in the HFMA's briefing on the NHS external audit market in 2022<sup>1</sup>, the increased level of audit regulation and shortage of supply of external auditors are the main reasons for the lack of response to tenders and increased audit fees. If public sector audit continues to be undervalued, less profitable than alternative sectors, time pressured and high risk, then there is the real danger that firms will choose to withdraw from the NHS market.

Delays to local government audit opinions are having a knock-on impact on the NHS, reducing the capacity for local NHS audits and potentially threatening the return to an earlier timetable for publishing the Department of Health and Social Care accounts.

As the professional body for NHS finance staff, this submission is based on the views of our members and draws on discussions at HFMA committees as well as research conducted over the last few years. Our key points are:

- NHS and local authority audits are interlinked, delivered by the same firms and audit staff.
- As a result of changes brought about by the Health and Care Act 2022, 2022/23 is a year of transition in the NHS requiring a three month audit of clinical commissioning group (CCG) financial statements and a nine month audit for integrated care boards (ICBs).

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<sup>1</sup> HFMA, *The NHS external audit market: an update on current issues*, August 2022



- As at March 2023, there remain a number of NHS organisations that have been unable to appoint an auditor for 2022/23 (covering providers, CCGs and ICBs).
- The key reasons for the issues in the NHS external audit market, and more widely, are the level of audit regulation and auditor capacity.
- Revisions to the UK international auditing standards (ISAs) 315 and 240, applicable from 2022/23 for the NHS and local authority audits, will further increase the level of work required by auditors.
- The key implications in the NHS are significant increases in audit fees and a lack of response to invitations to tender.
- The local government delays are also having an impact on the NHS, which relies on many of the same audit firms and staff. For example, fewer NHS interim audit visits is putting more pressure on the year-end audit and lack of overall capacity is, unsurprisingly leading to fewer bids for external audit contracts.
- We would recommend the Committee also questions senior officials at the Department of Health and Social Care (DHSC), as well as the Department for Levelling Up, Housing and Communities (DLUHC), the Department for Business, Energy and Industrial Strategy (BEIS) and the Financial Reporting Council (FRC) on the latest picture of local public audit.

## Detailed points

### Background

External audit is a statutory requirement and an essential part of the process of accountability for public money, providing an independent review of the financial statements and value for money arrangements (VFM) in place.

As a result of the Local Audit and Accountability Act 2014, all NHS bodies were required to procure and locally appoint their own auditors from 2017/18. Prior to this, only NHS foundation trusts procured and appointed their own auditors. Unlike local authorities, individual NHS bodies agree their own audit fee and contract length with auditors.

For 2022/23, there are eight audit firms appointed to NHS bodies. These include six large firms (BDO, Deloitte, EY, Grant Thornton, KPMG and Mazars) along with two firms newer to the market taking on five audits (Azets and Bishop Fleming).

### Reasons for issues in the NHS external audit market

There are many complex and intertwined factors leading to the issues in the NHS external audit market, with similar issues being reported in local government.

The main issues leading to this lack of interest in delivering public sector audits are explored in detail in HFMA's 2021<sup>2</sup> and 2022<sup>1</sup> briefings. These include surveys of finance directors and chief finance officers in England. In May 2022, 68% of respondents had significant or some concerns about the ability to appoint an external auditor in the future with some commenting that the market is approaching crisis point.

The key reasons for issues identified are:

- **Regulatory pressure:** Audit risk is increased by the significant regulatory pressure from the FRC on audit firms to deliver higher quality audits and to demonstrate much greater professional scepticism. For the audit of 2022/23 this is further increased with the revisions made to ISA 315 and 240.
- **NHS context:** Audit risk is also increased by the current NHS financial pressures, reorganisations and increasingly complex arrangements (such as NHS subsidiaries and collaboratives). For the audit of 2022/23, this will include 42 newly formed statutory ICBs, along with the final 3 month audit of all CCG accounts. There are also concerns about increased risk arising from pressures on the timetable for accounts preparation in terms of finance team capacity impacting on the quality of accounts and working papers.

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<sup>2</sup> HFMA, *The NHS external audit market current issues and possible solutions*, February 2021

- **Auditor capacity:** The level of audit risk increases the amount of audit testing required in an already constrained market. There is a small pool of public sector auditors working on audits with tight and competing deadlines. The requirement to separate external audit and non-audit services has further reduced the pool of staff. Due to independence rules firms may choose not to tender for an NHS audit to avoid limiting opportunities for non-audit work. With the increased partnership working and system-wide responsibilities of the ICB brought about by the Health and Care Act 2022 and some integrated care systems (ICS) aiming to procure audit on a system-wide basis, this is now more of a risk as auditors may want to do consultancy work for the ICS, or partners within the ICS, which would compromise their independence. There are also significant recruitment and retention issues in public sector audit, which is perceived as more challenging, undervalued and less beneficial to an individual's career progression.
- **Fee levels:** NHS audit fees cannot be seen in isolation. Following a reduction in audit fees as NHS bodies were required to procure their own auditors from 2017/17, fees relative to the corporate sector have been low, impacting on the attractiveness of the contracts.
- **Audit tendering process:** Inclusion of non-relevant items in tender documentation, high weighting given to cost rather than quality and inappropriate terms and conditions can all indicate a lack of understanding of, and value given to, the external audit and may deter bidders. Likewise, a tight timescale to complete the tender, particularly during peak audit times, or insufficient time between the tender and audit start date does not allow appropriate time for staff planning and orderly handover.

### Implications of the issues in the NHS external audit market

The level of audit risk and lack of auditor capacity impacts on both the fee and relative attractiveness of the audit engagement. There are concerns in the NHS that a lack of those responding to tenders for external audit market contracts is impacting on choice, delivery and cost.

Over recent years we have increasingly heard from our members that they are finding it difficult to appoint an external auditor, with little or no interest being shown in invitations to tender for external audit services. Some members have also reported that their auditor has resigned or has declined to extend the current audit contract.

With the combination of an unattractive audit market, a lack of auditors with the necessary key audit partner status for NHS audits and no statutory provisions for the appointment of 'an auditor of last resort', there is an increasing risk that a situation will arise where an NHS organisation is unable to appoint an external auditor. At present, there are a small number of NHS bodies yet to appoint an auditor for 2022/23.

Audit fees are going up for new contracts, with some HFMA members reporting a tripling or quadrupling of audit fees from previous years. Considering the downward pressure on fees since the end of the Audit Commission, some may argue that current fee increases seek to reverse this.

### Timeliness of local audit reporting

The NHS audit market cannot be viewed in isolation. The same auditors often undertake NHS, local government, housing, education and charity audits; and the issues faced span much of the public and third sector. The audit timeframes are interlinked.

While the delays in completing local government audited accounts have implications for local accountability, they also have impacts elsewhere. For example, local audit delays were partly responsible for the late certification of the 2019/20 whole of government accounts and in 2021/22 also contributed to the late publication of central government accounts that had material pensions valuations. In some cases, 2021/22 NHS audits were delayed because they were waiting for audited local government pension scheme information.

The local government delays are also having an impact on the NHS, which relies on many of the same audit firms and staff. As reported by the National Audit Office<sup>33</sup>, delays in one sector disrupt the firms' audit planning and delivery for the others. For example, fewer NHS interim audit visits is putting more pressure on the year-end audit and lack of overall capacity is unsurprisingly leading to fewer bids for external audit contracts. The reduction in capacity also impacts on the aim to return to an earlier timetable for publishing the DHSC accounts.

The HFMA is pleased that the proposed system leader role, as part of plans to strengthen the local audit framework, include coverage of both local government and health audits. However, it is important to recognise that national proposals to improve the situation will take time to develop and then have an impact.

Up until now, the audit reform agenda in the UK has largely focused on local authorities, with the NHS at the periphery. Given the need for solutions that address the whole of local audit and the fact that local audit departments within firms typically do local authority and NHS (with the same Code of Audit Practice and registration and quality regulation arrangements), there is a need for the NHS to more closely work with DLUHC and the systems leader. As well as the plan to question senior officials at DLUHC, BEIS and the FRC on the latest picture of local public audit, we would expect this to also include the DHSC.

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<sup>33</sup> NAO, *Progress update: timeliness of local auditor reporting on local government in England*, January 2023

## About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For over 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are 'fit for purpose' and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA's Academy which was launched in 2017 and has already established strong learner and alumni networks.

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