

**SUBJECT: REDMOND REVIEW INTO THE OVERSIGHT OF LOCAL AUDIT AND THE TRANSPARENCY OF LOCAL AUTHORITY FINANCIAL REPORTING**

**DIRECTORATE: CHIEF EXECUTIVE AND TOWN CLERK**

**REPORT AUTHOR: JACLYN GIBSON, CHIEF FINANCE OFFICER**

## **1. Purpose of Report**

- 1.1 To provide the Audit Committee with a summary of the Redmond Review into the effectiveness of local audit and the transparency of local authority financial reporting, the recommendations made to the Government, along with the Government's response and the potential implications for the Council.

## **2. Executive Summary**

- 2.1 On 8 September 2020 the Government published the results of an independent review, led by Sir Tony Redmond, into the effectiveness of local authority financial reporting and audit. Local authority accounts are complex and the review highlights a number of potential weaknesses with the current local audit framework and makes recommendations to address these.

- 2.2 The Review identified four key themes for change:

- Local Audit Arrangements
- Current Fee Structure for External Audit
- Governance Arrangements
- Transparency and reporting.

- 2.3 The Review contains 23 recommendations over four categories:

- External Audit Regulation
- Financial Resilience of local authorities
- Smaller Authorities Audit Regulation (Not Applicable to the City Council)
- Transparency of Financial Reporting

- 2.4 The response of the Ministry of Housing, Communities and Local Government (MHCLG) was published on the 17<sup>th</sup> December 2020. Whilst some recommendations have been agreed, others are being considered further with a full response to be made by spring 2021.

- 2.5 This briefing note summarises the key findings and recommendations within the report, as well as potential implications for the Council.

## **3. Background**

- 3.1 In July 2019, MHCLG commissioned a review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014. Sir Tony Redmond was appointed to undertake the review due to his experience in the Local Government sector and former role as President of the Chartered Institute of Public Finance and Accountancy (CIPFA).
- 3.2 A Call for Views was launched in September 2019 and received 156 responses and more than 100 interviews were carried out. The report arising from the review was published on 8th September 2020.
- 3.3 The Review was carried out in the context that Local Government in England is responsible for 22% of total UK public sector expenditure making it essential that local authority financial reporting is of the highest level of transparency to allow taxpayers to understand how their money is being spent. The Review examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It also considered whether the current means of reporting the Authority's annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of the authority are sound.
- 3.4 The key findings of the review, summary of recommendations, Government's response and potential implications for the Council are set in this report.

#### 4. Key Findings and Recommendations of the Review and MHCLG Response

- 4.1 The key findings of the Review can be summarised into four themes:
  - **Local Audit arrangements** – The most significant finding is the lack of coherence in local audit arrangements including in the approach to procuring audit services. There were serious concerns regarding effectiveness of local audit which is in part due to the current fee structure
  - **Current Fee Structure** – The Review estimated that the cost of External Audit is 25% less than it should be and as a result the quality of auditors has reduced. There is also concern auditors do not have the experience or knowledge of local authorities. Evidence was considered that 40% of local authority audits were not completed by the 31 July deadline for 2018/19.
  - **Governance arrangements** – The Review questioned whether Audit Committees understand the issues to question and challenge in an effective way and noted that there are relatively low number of independent Audit Committee members and little communication between Audit Committee and inspectors with no formal exchange of views. There seems to be no real relationship between Audit Committee and Full Council with very few audit reports going to Council. The Review questions the role of three statutory officers (Head of Paid Service, Monitoring Officer and Section 151 Officer) in relationship to Audit and in particular whether they engage with auditor together on an informal or formal basis. The Review noted that Internal Audit is not currently utilised effectively by External Audit as the Audit code of practice does not require them to liaise with the Internal Audit function. The

Review also noted that there is not always sufficient expertise amongst staff involved in completing the year end accounts process.

- **Transparency and reporting** – The Review concluded that the current arrangements do not enable the general public to understand the statement of accounts and found that more can be done to improve the transparency of what local authorities do. Consideration was given to simplifying the accounting framework for local government accounts, however this was not considered appropriate in the context of local authorities becoming more commercial in their operations.

4.2 The Review Recommendations are set out in full at Appendix 1. The Review contains 23 recommendations, of which 4 apply only to smaller authorities with does not include the City Council.

#### 4.3 External Audit Regulation

The central recommendation of the Review is for the creation of a new body, the Office of Local Audit and Regulation (OLAR), to manage, oversee and regulate local audit with the following key responsibilities:

- procurement of local audit contracts;
- producing annual reports summarising the state of local audit;
- management of local audit contracts;
- monitoring and review of local audit performance;
- determining the code of local audit practice; and
- regulating the local audit sector.

4.4 The review also focusses on the sustainability of the external audit market, the skills within the audit team and the level of audit fees. It concludes that the local audit market is very fragile and that the current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. With 40% of audits failing to meet the required deadline for report in 2018/19, there is a serious weakness in the ability of auditors to comply with their contractual obligations. The report therefore recommends that an increase in fees is considered and the 30 September deadline for audit completion reinstated, rather than 31 July.

4.5 Public Sector Audit Appointments (PSAA) was incorporated by the Local Government Association in 2014 and has been specified by MHCLG as an 'appointing person' under provisions of the Local Audit and Accountability Act 2014. PSAA appoints external auditors to local authorities and is responsible for the statutory function of setting audit fees, including the current practice of agreeing fee variations for additional audit work. It is recommended that the responsibilities of this body be discharged by the OLAR which will set a fee structure that will 'ensure that adequate resources are deployed to meet the full extent of local audit requirements' and that the quality of the audit will 'be consistent with the highest standard of audit within the revised fee structure.'

4.6 A number of other recommendations are made in this category, including that, where appropriate, external audit should use the work of Internal Audit to support their conclusion. The report recognizes that internal auditors are much closer to the

business than external audit, providing a 'rich source of knowledge' and work which focuses on governance and service delivery matters.

- 4.7 It is also recommended that the external auditors should report to Full Council annually in September in addition to the current practice of reporting to Audit Committees. They should report to all members on risks identified and conclusions reached in a transparent and understandable format to reduce the risk that a majority of elected members may not be sighted on serious governance or financial resilience issues.
- 4.8 Other recommendations included:
- Formalising the facility for the Chief Exec, Monitoring Officer and Chief Finance Officer to meet with the Key Audit Partner at least annually, and;
  - Appointing at least one suitably qualified independent member to the Audit Committee
- 4.9 In their response the Government agreed that the external auditor be required to present an annual audit report to a Full Council meeting, irrespective of whether the accounts have been certified. The Government response noted that many local authorities feel existing reporting arrangements to audit committees are sufficient, however they felt that presentation to Full Council is an important opportunity for potential risks or concerns to be escalated in a timely way and that this should be best practice.
- 4.10 The Government have agreed to work with key stakeholders such as CIPFA, the NAO and the LGA to ensure that, where appropriate, new guidance is issued which addresses the recommendations relating to meetings between chief officers and the external auditor and the appointment of an independent member(s) to audit committees. They also agreed work with CIPFA, the National Audit Office and the LGA on strengthening engagement between external and internal audit.
- 4.11 The Government have accepted the recommendation to review the current fee structures in local audit, to provide greater flexibility to meet audit firms' costs. An additional £15m will be allocated to local authorities to help fund additional costs arising from the change in audit fees next year.
- 4.12 The Government has also recognised that next year will be particularly challenging as audit firms seek to catch-up after the significant Covid-19 related delays this year and trying to return to a 31<sup>st</sup> July deadline to audit the 2020/21 accounting period would be unrealistic. Hence, they have agreed in the moving of the audit deadline to 30<sup>th</sup> September for local authorities for the next two years and to keep this under review, but without committing to a permanent change.
- 4.13 However, the Government have not agreed with the recommendation to create the new OLAR, stating that it is not currently persuaded that a new arms-length body is required. It added that unless there is an exceptional reason for a new body, the Government will look to explore new options. The response said: "The creation of a strong system leader for local audit, especially in the form of a new body, would entail significant structural reform".
- 4.14 Financial Resilience of Local Authorities

Under the current regulations there is no specific responsibility for auditors to provide an opinion on whether a local authority is financially sustainable. The review recommends that MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained and that key concerns relating to service and financial viability be shared between Local Auditor and Inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's Annual Report.

4.15 The Review considers a number of possible frameworks for assessment including CIPFA's Pillars of Financial Resilience and the Financial Management Code of Practice (FM Code). Although not prescribed in the formal recommendation, the review notes that MHCLG could give the FM Code statutory status and require local authorities to report on compliance with the Code in their Annual Governance Statement with auditors expected to report on material breaches.

4.16 The Government responded that they will also work with the Department for Health and Social Care, the Department for Education, the Home Office and the NAO to support the sharing of key information between inspectorates and external auditors,

#### 4.17 Transparency of Financial Reporting

The review recommends the development of a new 'Summarised Accounts' or 'Simplified Statements' that are prepared on the budget setting basis and reconcilable to the Council Tax Requirement. These accounts would:

- include a standardised statement of service information and costs, perhaps based on the statutory Service Reporting Code of Practice (SERCoP)
- be reconcilable to the Statutory Accounts
- be subject to audit.

4.18 The objective of creating these additional statements is to increase transparency and, as a short stand-alone document, would be accessible to taxpayers and service users. There may also be an opportunity to remove some of the existing statements and disclosures within the statement of accounts that reconcile the outturn position, funding position and IFRS accounting basis, although it is noted that the work to complete the reconciliation would still need to be undertaken.

4.19 The Government has agreed with the need for a new standardised statement summarising council accounts and said it would work closely with CIPFA to consult on the content of this.

## **5. Implications arising from the Review**

5.1 The Review's recommendations and the Government's response to them are set out in detail in Appendix A. However, it should be noted that the Council is not considered a smaller authority for audit and accounts purposes, so recommendations in this area do not apply to this Council (recommendations 14, 15, 16 and 23).

5.2 The recommendations are likely to directly impact the Council in the following ways:

- Increased external audit fees; (an additional £15m will be allocated to local authorities to help fund additional costs arising from the change in audit fees in 2021/22).
- An annual report being submitted to Full Council by the external auditor;
- The production of additional statutory financial information (although this may be offset by a removal of other disclosures following a review by the Local Authority Code Board); and,
- An extension to audit deadlines (2-year extension currently in place)
- Introduction of a governing body to manage, oversee and regulate
- A review of governance arrangements and accounting codes;
- Ensuring local auditors are provided with the requisite skills and training and statute be amended to ensure audit firms with these skills are not excluded from bidding from local authority work; and,
- That External Audit recognises that Internal Audit work in appropriate circumstances.

## **6. Strategic Priorities**

- 6.1 There are no direct implications for the Council's strategic priorities. The external audit of, and production of, the Council's financial statements is a statutory requirement and as such contributes towards the fitness for purpose of the Council's governance arrangements.

## **7. Organisational Impacts**

- 7.1 Finance (including whole life costs where applicable)

Whilst it is not clear how these recommendations may impact on audit fees, the Government have announced additional funding of £15m in 2021/22 to help fund additional costs arising from the change in audit fees.

The additional work recommended on financial reporting is not anticipated to require additional resourcing as it is expected this could be managed within existing resources.

- 7.2 Legal Implications including Procurement Rules

The statutory framework within which local authority audits are conducted is set out in the Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015.

At this stage, the report only sets out recommendations to the Government and has no legal standing. Some of the recommendations will require amendments to primary legislation if adopted.

The council will need to ensure it complies with any changes to the codes of practice and legislation as these arise.

### 7.3 Equality, Diversity and Human Rights

The Public Sector Equality Duty means that the Council must consider all individuals when carrying out their day-to-day work, in shaping policy, delivering services and in relation to their own employees.

It requires that public bodies have due regard to the need to:

- Eliminate discrimination
- Advance equality of opportunity
- Foster good relations between different people when carrying out their activities

## 8. Risk Implications

8.1 There are no direct risk implications arising as a result of this report.

## 9. Recommendation

9.1 The Audit Committee note the update on the Redmond Review and potential implications for the Council.

**Is this a key decision?** No

**Do the exempt information categories apply?** No

**Does Rule 15 of the Scrutiny Procedure Rules (call-in and urgency) apply?** No

**How many appendices does the report contain?** One

**List of Background Papers:** None

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## Summary of MHCLG's response to the recommendations made by the Redmond Review

### Action to support immediate market stability (recommendations 5, 6, 8, 10, 11)

Recommendation	MHCLG Response
5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.	<b>Agree</b> ; we will work with key stakeholders to deliver this recommendation
6. The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.	<b>Agree</b> ; we will look to revise regulations to enable PSAA to set fees that better reflect the cost to audit firms of undertaking additional work
8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.	<b>Part agree</b> ; we will work with the FRC and ICAEW to deliver this recommendation, including whether changes to statute are required
10. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.	<b>Part agree</b> ; we will look to extend the deadline to 30 September for publishing audited local authority accounts for two years, and then review
11. The revised deadline for publication of audited local authority accounts be considered in consultation with NHSI(E) and DHSC, given that audit firms use the same auditors on both Local Government and Health final accounts work.	<b>Agree</b>

### Consideration of system leadership options (recommendations 1, 2, 3, 7, 13, 17)

Recommendation	MHCLG response
1. A new body, the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit with the following key responsibilities:  -procurement of local audit contracts - producing annual reports summarising the state of local audit - management of local audit contracts - monitoring and review of local audit performance	<b>We are considering these recommendations further</b> and will make a full response by spring 2021.



Recommendation	MHCLG response
<ul style="list-style-type: none"> <li>- determining the code of local audit practice</li> <li>- regulating the local audit sector</li> </ul>	
<p>2. The current roles and responsibilities relating to local audit discharged by the:</p> <ul style="list-style-type: none"> <li>- Public Sector Audit Appointments (PSAA)</li> <li>- Institute of Chartered Accountants in England and Wales (ICAEW)</li> <li>- FRC/ARGA</li> <li>- The Comptroller and Auditor General (C&amp;AG) to be transferred to the OLAR</li> </ul>	<p><b>We are considering these recommendations further</b> and will make a full response by spring 2021.</p>
<p>3. A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.</p>	<p><b>We are considering these recommendations further</b> and will make a full response by spring 2021.</p>
<p>7. That quality be consistent with the highest standards of audit within the revised fee structure. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.</p>	<p><b>We are considering these recommendations further</b> and will make a full response by spring 2021.</p>
<p>13. The changes implemented in the 2020 Audit Code of Practice are endorsed; OLAR to undertake a post implementation review to assess whether these changes have led to more effective external audit consideration of financial resilience and value for money matters.</p>	<p><b>We are considering these recommendations further</b> and will make a full response by spring 2021.</p>
<p>17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.</p>	<p><b>We are considering these recommendations further</b> and will make a full response by spring 2021.</p>

### **Enhancing the functioning of local audit, and the governance for responding to its findings (recommendations 4, 9, 12, 18)**

Recommendation	MHCLG response
<p>4. The governance arrangements within local authorities be reviewed by local councils with the purpose of:</p> <ul style="list-style-type: none"> <li>- an annual report being submitted to Full Council by</li> </ul>	<p><b>Agree;</b> we will work with the LGA, NAO and CIPFA to deliver this recommendation</p>

**Recommendation****MHCLG response**

the external auditor

- consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee
- formalising the facility for the CEO, Monitoring Officer
- Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice. **Agree;** we will work with the NAO and CIPFA to deliver this recommendation

12. The external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year, irrespective of whether the accounts have been certified; OLAR to decide the framework for this report. **Agree;** we will work with the LGA, NAO and CIPFA and other key stakeholders to deliver this recommendation, including whether changes to statute are required

18. Key concerns relating to service and financial viability be shared between local auditors and inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's annual report. **Agree;** we will work with other departments and the NAO to deliver this recommendation

### **Improving transparency of local authorities' accounts to the public (recommendations 19, 20, 21, 22)**

**Recommendation****MHCLG response**

19. A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts. **Agree;** we will look to CIPFA to develop a product through consultation with local government. We will work with CIPFA to deliver this recommendation

20. The standardised statement should be subject to external audit. **Agree;** we will work with CIPFA, the LGA and the NAO to deliver this recommendation

21. The optimum means of communicating such information to council taxpayers/service users be considered by each local authority to ensure access for all sections of the communities. **Agree;** we will work with the LGA and CIPFA to deliver this recommendation

**Recommendation****MHCLG response**

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22. CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary.

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