

Agenda item 4

		AGS/77/20
Report title: Redmond Review		
Report to: Audit, Governance and Standards Committee		
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Date of meeting: 28 September 2020		For: Noting
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Divisions affected: All Essex		

1. Purpose of report

- 1.1 The purpose of this report is to inform members of the conclusions and recommendations arising from the independent review into **Oversight of Local Audit and the Transparency of Local Authority Financial Reporting** (the 'Redmond Review').

2. Recommendations

- 2.1 That the report and the three recommendations to local authorities be noted.
- 2.2 Agree that the Committee should ask the Chairman of the Council to receive a report on the accounts as soon as possible after the Committee has considered the annual accounts.
- 2.3 Note that the Council is in the process of complying with the recommendation regarding the appointment of at least one independent member, suitably qualified, to the Audit Committee.
- 2.4 Note that the Chief Executive, the Monitoring Officer and the Chief Financial Officer currently have the facility to meet with the Key Audit Partner at least annually.

3. Background

- 3.1 The **Local Audit and Accountability Act 2014** (the 2014 Act) transferred the audit functions previously carried out by the **Audit Commission** to a range of successor bodies. The audit of the 2018/19 accounts was the first full year in which all the new arrangements were in operation.

- 3.2 In July 2019, the Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) launched an independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit. The Secretary of State appointed **Sir Tony Redmond** to conduct this review.
- 3.3 The Redmond Review was tasked with examining the existing **purpose**, **scope** and **quality** of statutory audits of local authorities in England and the supporting regulatory framework to determine whether:
- It is operating in line with policy intent;
 - The reforms introduced by the 2014 Act had improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
 - The current statutory framework for local authority financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold local authorities to account.
- 3.4 The conclusions and proposals from this review were published on **8 September 2020**. The full report is appended, but the following paragraphs provide a summary of the key findings and recommendations.

4. Redmond Review findings

Direction and regulation of local audit

- 4.1 Currently there are a range of different entities with a statutory role in overseeing and/or regulating elements of the local authority accounting and audit framework:
- **Public Sector Auditor Appointments Ltd (PSAA)** – is the appointing body for 98% of local authority audits because virtually all local authorities opted into using its services. It has responsibility for management of the contracts.
 - **Comptroller and Auditor General (C&AG) / National Audit Office (NAO)** – sets the Code of Local Audit Practice.
 - **Financial Reporting Council (FRC)** - sets standards and guidance for auditors and monitors the quality of larger local authority audits.
 - **Institute of Chartered Accountants in England and Wales (ICAEW)** – responsible for registration of local authority Key Audit Partners and audit firms and for quality monitoring of smaller local authority audits.
 - **Chartered Institute of Public Finance and Accountancy (CIPFA)** – sets the Code of Local Authority Accounting Practice and other statutory Codes and produces sector specific good practice guidance.

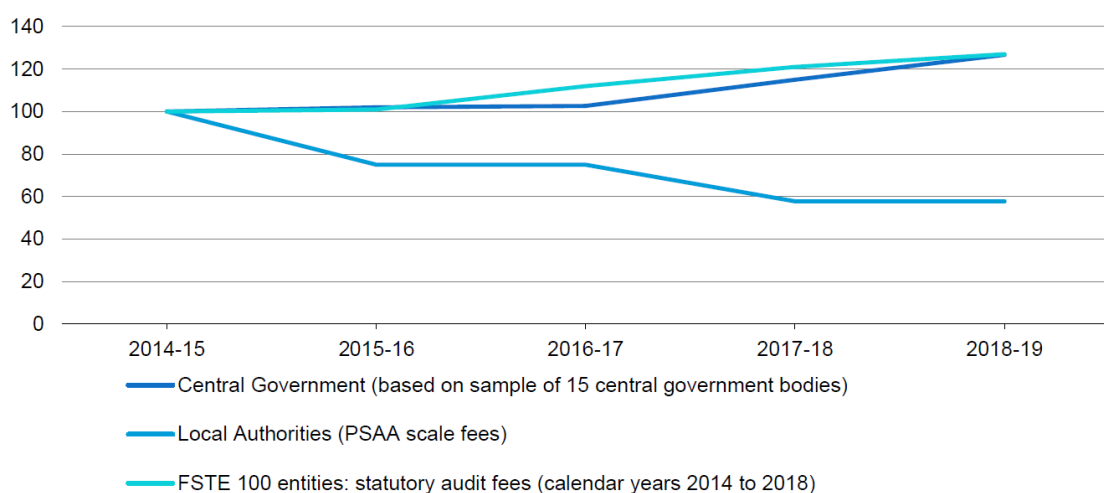
- **Ministry of Housing, Communities and Local Government (MHCLG)** – has policy responsibility for the effectiveness of the local authority audit and governance framework. It also has the power to change the system and to intervene directly in a failing local authority.

4.2 None of these entities has a statutory responsibility to make sure that the framework operates in a coherent manner. The Redmond Review concluded that this lack of coordination and leadership is a significant weakness in the current framework.

Procurement of local audit

- 4.3 Both the audit firms and their key audit partners need to be approved by the ICAEW to undertake local authority audits. A prerequisite to entry is recent experience of undertaking local authority audits.
- 4.4 When the PSAA ran a procurement in 2017, to appoint local authority auditors for the period 2018/19 to 2022/23, there were **9** firms registered with the ICAEW to undertake these audits, with a total of **96** key audit partners able to issue an audit opinion. Of the **9** firms registered to undertake these audits, only **5** were awarded contracts by the PSAA, with **67** key audit partners able to issue audit opinions (a **13%** reduction from the number of key audit partners under the previous contracts).
- 4.5 Audit fees in the local authority sector have dropped significantly since the Audit Commission was abolished, while audit fees in other sectors have risen.

Sector by sector comparison of change in audit fees over time



- 4.6 The scale fee paid by individual local authorities under the contracts let by the PSAA in 2017 were set with reference to the fees allocated to individual authorities when the Audit Commission let the 2012 and 2014 audit contracts. The PSAA did not seek to assess the amount it would cost to audit each local authority based on their level of audit risk in the past ten years.

- 4.7 As the scale fees have fallen, there has been an increasing prevalence of auditors requesting fee variations over the same period. The PSAA asked all firms active in the market to estimate the additional scale fee required to ensure that current quality standards are satisfied. Four audit firms suggested that increases of between **15%** to **25%** are required, and the fifth firm suggesting an increase of **100%** is needed.

Audit performance

- 4.8 Auditors of local authorities provide two audit opinions:

- A **financial audit opinion** which aims to confirm that the financial statements are free from material error and are properly prepared in accordance with the relevant accounting and legislative framework.
- An opinion on the effectiveness of the systems in place to meet the best value duty (referred to as the **value for money** conclusion).

The Review concluded that coverage of these audits is far narrower than many stakeholders expect.

- 4.9 The Review considered the extent to which auditors of local authorities:

- Meet **contract specifications** in respect of the financial audit opinion and value for money conclusion.
- Demonstrate **sufficient understanding** of the local authority environment through identification and testing of key financial audit and value for money risks.
- Deliver audits in a **cost-effective** way.
- Make **balanced** and **considered recommendations**.
- Issue reports and recommendations in a **timely manner**.

- 4.10 Although the Review concluded that external auditors were meeting the contract specification by delivering audits that, for the most part, meet relevant quality standards, an increasing number of audits are not being completed by the statutory deadline for publishing audited accounts. In 2018/19, only **57%** of opinions were issued by the statutory publication deadline, compared to **95%** in 2016/17. For the first time in 2019/20, having insufficient qualified individuals to deliver the audits at the appropriate time is being given as the reason for some of the delays.

- 4.11 There is some evidence that the reduction in audit fees referred to above, combined with the accelerated timetable for publication of audited accounts introduced in 2017/18, has led to a decline in the number of auditors with appropriate skills, knowledge and expertise. Indeed, many local authorities reported concerns about:

- Auditors not having a full understanding of how local authorities are funded and how this impacts the accounts;
- A lack of continuity in members of the audit team; and

- A lack of understanding of local authority specific financial statements.
- 4.12 Underpinning concerns about audit performance is auditor focus. There is a perception amongst many local authorities that an increasing amount of time is spent auditing fixed asset and pension valuations. What is less clear is the extent to which this has led to a reduction in audit work in other areas, but given the reduction in audit fees, it is likely to have had some impact.
- 4.13 The Review found it harder to assess audit performance in relation to VFM engagements as auditors have more discretion about the amount of work they need to undertake before forming their VFM opinion. However, the squeeze in audit fees and the reduction in the number of auditors with appropriate skills, knowledge and expertise, is a matter of significant concern.
- 4.14 Auditors can issue recommendations to management through their end of audit communications. However, the Review found that number of recommendations issued has declined year on year. Most of the recommendation that were issued related to technical accounting issues rather than financial control or value for money matters, contributing to the perception that the process is not adding as much value as previously.

Governance arrangements in place for responding to audit recommendations

- 4.15 The Review commented that effectiveness of audit must, in part, be determined by the arrangements in place within local authorities for considering and acting upon external audit reports. All local authorities are required to set up Audit Committees or the equivalent, with responsibility for considering the annual accounts and receiving internal and external audit plans and reports and for providing independent challenge in respect of accountability and risk management arrangements.
- 4.16 The Review concluded that:
- That it is rare for Audit Committees to put a substantive item onto the Full Council's agenda.
 - 56% of audit committees have no independent members.
 - Frequency of attendance at Audit Committees by statutory officers (Chief Executive, Monitoring Officer and Chief Financial Officer) is mixed.
 - The scope of most audit committees covers the majority of the items in the CIPFA position statement and supporting guidance on Audit Committees, but not all. There were two areas which either had minimal or no specific coverage: partnership governance and value for money and best value.
- 4.17 With regard to the external auditor's work, the Review concluded that:
- The content of the standard suite of external audit reports is mandated by auditing standards, making them highly technical.

- External auditors should report to Full Council on risks identified and conclusions reached in a transparent and understandable format.

Audit work on the financial resilience of local authorities

4.18 External auditors do not currently have a specific responsibility to provide an opinion on whether a local authority is financially sustainable, although are required to:

- consider whether a local authority is a going concern; and
- assess the adequacy of its arrangements to secure value for money in its use of resources.

4.19 CIPFA has attempted to define financial resilience in its:

- Financial Management Code (FM Code)
- Pillars of Financial Resilience

However, these do not have statutory backing. Neither do they explicitly cover the impact of commercialisation on an authority's financial resilience.

4.20 The Review concluded that scope of the external audit should include a substantive test of a local authority's financial resilience and sustainability.

4.21 The new NAO Code of Audit Practice will require auditors to provide a narrative statement on Councils' value for money arrangements rather than a binary opinion. This should provide more useful information to stakeholders.

4.22 Auditors should use the indicators of financial stress in the CIPFA 'Pillars of Financial Resilience' and critically evaluate the Chief Financial Officer's Section 25 reports on the robustness of the Council's budget estimates and the adequacy of its reserves, other statutory reports and management estimates to inform their view of an authority's financial resilience.

Financial reporting in local government

4.23 Local authorities are required to have regard to the statutory Code of Local Authority Accounting Practice issued by CIPFA. This Code is based on private sector accounting standards, adapted for the specific circumstances of local authorities and overridden by specific statutory provisions.

4.24 Local authority accounts are lengthy and complex. This is primarily because there is a difference between the budget analysis of information for council tax purposes and the statutory basis of year end accounts.

4.25 An issue related to the complexity of local authority accounts is the capacity of external auditors to validate technical accounting treatments without a familiarity with local authority finance and accounting. Auditors have also

argued that local authorities do not always have accounting staff with relevant technical expertise either.

- 4.26 The Redmond Review identifies three broad options for enhancing the transparency and usefulness of local authority financial statements:
- Review of International Financial Reporting Standards (IFRS) as a basis for preparing the Accounts.
 - Expand and standardise the current narrative statement.
 - Introduce a new summary statement presented alongside the IFRS based accounts, prepared on a budget setting basis.

A new summary statement is favoured, but this would need to reconcile to the statutory accounts and be subject to external audit to have credibility.

Conclusions of the Redmond Review

- 4.27 The current local audit arrangements fail to deliver the policy objectives underpinning the 2014 Act.
- 4.28 The local audit market is vulnerable, and evidence suggests that audit fees are at least 25% lower than is required to fulfil the local audit requirements effectively.
- 4.29 A weakness of the current arrangements is that there is no coordination and regulation of local audit activity. This role is best discharged by a single overarching body.
- 4.30 There is a potential weakness in the way in which audit outcomes are considered and presented to both the local authority and to the public.
- 4.31 There is a compelling argument to extend the scope of audits to include a substantive test of financial resilience and sustainability.
- 4.32 In scrutinising financial sustainability, the auditor should assess the risks identified in the Chief Financial Officer's annual report on the budget and review of compliance with the CIPFA Financial Management Code.
- 4.33 The technical complexity of the Accounts means that service users and council taxpayers are unable to understand them. Transparency and consistency could be improved through production of a simplified statement of service information and costs that compares budgeted with actual financial performance.

5. Redmond Review recommendations

Direction and regulation of local audit

- 5.1 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
 - Determining the Code of Local Audit Practice
 - Regulating the local audit sector.
- 5.2 A liaison committee should be established, comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.

Procurement of local audit

- 5.3 The current fee structure for local audit to be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.
- 5.4 Statute to be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

Audit performance

- 5.5 All auditors engaged in local audit to be provided with the requisite skills and training to audit a local authority, irrespective of seniority.
- 5.6 Quality is to be consistent with the highest standards of audit within the revised fee structure.
- 5.7 In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.
- 5.8 External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.
- 5.9 Deadline for publishing audited accounts to be revisited with a view to extending it from 31 July to 30 September (subject to consultation with Health bodies).

Governance arrangements in place for responding to audit recommendations

- 5.10 An annual report should be submitted to full Council by the external auditor after 30th September each year, irrespective of whether the accounts have been certified (OLAR to decide the framework for this report).
- 5.11 Consideration should be given to the appointment of at least one independent member, suitably qualified, to the Audit Committee.
- 5.12 The facility for the Chief Executive Officer, Monitoring Officer and Chief Financial Officer to meet with the Key Audit Partner at least annually should be formalised.

Audit work on the financial resilience of local authorities

- 5.13 MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.
- 5.14 Key concerns relating to service and financial viability should be shared between Local Auditors and Inspectorates including Ofsted and the CQC prior to completion of the external auditor's Annual Report.
- 5.15 The changes implemented on 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.

Financial reporting in local government

- 5.16 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. The standardised statement should be subject to external audit.
- 5.17 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.
- 5.18 CIPFA / LASAAC are 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.

6. Financial Implications

- 6.1 The fee payable by the Council for external audit services carried out by our appointed auditor for the 2019/20 financial year is estimated at **£138,000**. It is possible that this fee will be significantly higher in subsequent years, because

of changes arising from the Redmond Review. An increase of at least **25%** is suggested; an increase of this magnitude would add an additional **£35,000** to the annual audit fee currently payable by the Council.

- 6.2 Officer time required to support the external audit process may increase as a consequence of a change in depth, scope and extension of the timetable for the external audit.
- 6.3 There may be a cost associated with appointing an independent Audit Committee member and of additional training for Audit Committee members.

7. Legal Implications

- 7.1 The recommendations in the review may lead to a change in the law as it applies to this Committee. Although we cannot know what any changes in the law may be, it is open for the Council to take steps to implement the three recommendations to local authorities (see paragraphs 5.10-5.12 of the report) and the recommendations in this report ask the Committee to implement them

8. Appendices and background papers

- 8.1 Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting.