Audit and Standards Committee

5 November 2020

Local Authority Financial Reporting and External Audit: Independent Review

Recommendations

The Audit and Standards Committee is asked comment on the recommendations of the Redmond Review in light of the implications for the County Council and the views of the Strategic Director for Resources as set out in the report.

1. Purpose of the Report

1.1. In the summer of 2019 the Secretary of State for Housing Communities and Local Government, Robert Jenrick MP, commissioned a review into the effectiveness of external audit and transparency of financial reporting in local authorities in England. Sir Tony Redmond issued his report of the review's findings on 8 September 2020.

1.2. The purpose of this report is to inform the Committee of the key findings set out in the report, the resulting recommendations, the implications for the County Council and the work of this Committee and the views of the Authority's Strategic Director for Resources (as the statutory s151 officer) on the changes proposed.

1.3. There are also implications of the review for our external auditors. **Appendix A** is a note from Grant Thornton on the same issue. The auditors will be at the meeting to add any commentary from their perspective.

2. Local Audit Arrangements

<u>Key Findings</u>

2.1. The report expressed serious concerns about the state of the local audit market, with the current market found to be very vulnerable and the resourcing of local audit in serious question.

2.2. It identified that six different entities currently have a statutory role in overseeing and/or regulating elements of the local authority accounting and audit framework. The report found that this resulted in a lack of coherence in the system, compounded by the fact that no one body has oversight of the whole.

2.3. Concerns were also identified regarding the effectiveness of local audit. In 2018/19 40% of audits were not completed by the end of July deadline. The report concluded that the cost of audit is 25% less than it should be and as a result the quality of auditors has reduced with not all auditors having sufficient experience or knowledge of local authorities and local government finance.

2.4. Finally in terms of the local audit arrangements, all of the firms active in the market indicated that they are very conscious of the reputational damage of a poor rating from the Financial Reporting Council for one of their local authority audits, and that this influenced the focus of their audit work.

Recommendations

2.5. The recommendations for changes to local audit arrangements as a result of these findings are:

- The establishment of a new 'Office of Local Audit Regulation' to manage, oversee and regulate local audit;
- The establishment of a Liaison Committee, comprising key stakeholders and chaired by the Ministry for Housing, Communities and Local Government (MHCLG), to receive reports from the new regulator on the development of local audit;
- The Office of Local Audit Regulation is given the power to impose sanctions where there are serious or persistent breaches of expected quality standards by those undertaking local authority audits;
- A revision of the fee structure to reflect the true cost of local audit; and
- The engagement of audit firms should be accompanied by a new price/quality regime to ensure that audits are performed by auditors who possessed the skills, expertise and experience necessary to fulfil the audit of local authorities.

Implications for the County Council

2.6. There are no direct implications for the County Council, except the expectation we will face a 25% increase in fees. This would increase the cost of audit by up to £40k for the County Council and the Pension Fund and would bring fee levels back to where they were a few years ago.

2.7. Our audit was completed on time and the key members of our local audit team have been the same for several years and are experienced in local government. Therefore, these issues identified by the Review are not those that have been experienced by the County Council to date.

Views of the Strategic Director for Resources

2.8. We would agree with many of the findings of the Redmond review. The current system is too fragmented and there is a consequent lack of clarity about roles and responsibilities. The market needs stabilising and there is a risk providers will exit the market. Reviewing these arrangements and giving one body overall oversight is therefore to be welcomed. However, this is supported with a note of caution. There is a risk that the new body will turn into another Audit Commission and, despite the intentions of the report, end up imposing ways of working and detailed reporting requirements on local authorities and providing commentary and oversight on policy issues that should be the responsibility of a local authority through its democratic mandate.

2.9. There is irritation in some quarters of local government about the potential increase in cost. It is difficult to judge whether this is a reaction to the tight financial position authorities find themselves in or a genuine belief that the cost of audit is currently about right and should not be increased. As stated above, we do not believe the fee increase to be unreasonable provided the additional capacity is directed to providing independent high-quality advice to those charged with governance.

3. Governance Arrangements

Key findings

3.1. The focus of the report in this area was on whether Audit Committees (or Audit and Standards in our case) sufficiently understand the issues to enable them to question and challenge in an effective way. The key findings were that there are:

- Relatively low numbers of independent Audit Committee members;
- Limitations on the capability of Audit Committee members to understand the issues;
- Little communication between the Audit Committee and inspectors;
- No real relationship between Audit Committee and Full Council;
- Little collective engagement between auditors and a local authority’s three statutory officers on either an informal or formal basis;
- Little use made of the work of Internal Audit by External Audit; and
- A lack of transparency of audit reports.

Recommendations

3.2. The recommendations for changes to governance arrangements as a result of these findings are:

- A requirement for at least 1 independent member on each Audit Committee;
- A requirement for the 3 statutory officers (the Chief Executive (head of paid service) the Strategic Director for Resources (s151 officer) and the Assistant Director for Governance and Policy (monitoring officer)), to meet External Audit at least annually;
- A requirement to train Audit Committee members;
- An annual report from the External Auditor to be presented to first Council meeting after 30 September;
- Endorsement of the new National Audit Office's proposed requirement for enhanced value for money reporting by auditors; and
- An induction/training mechanism for new s151s on final accounts.

Implications for the County Council

3.3. Our Audit and Standards Committee is chaired by an independent member and there is the potential for two other independent members of the Committee. However, in line with the report's findings, it is difficult to attract suitably skilled and experienced independent members. Two of the three statutory officers (s151 officer and Monitoring Officer) attend Audit and Standards Committee and from a finance perspective there are also quarterly informal meetings.

3.4. We do provide induction training to new Audit and Standards Committee members but if the recommendations are implemented this would need to become a more formal programme of activity. The new activity would be for the Chief Executive to meet the external auditors and the need for the Annual Audit Letter to be presented and reported to full Council rather than to this Committee, as it is at present.

3.5. It is worth noting that the new arrangements for reporting on value for money are intended to result in a less binary more narrative report. Depending on the detail of how this is implemented and the extent to which it signals a move back towards the old assessment processes will determine the amount of any additional work.

Views of the Strategic Director for Resources

3.6. There is little in this section of the report that we do not already do, seeing it as good practice irrespective of any externally set governance requirements. Therefore, the governance changes recommended are supported.

3.7. The only concern is in relation to the enhanced work on value for money and the potential capacity needed to support this activity. There is a risk this will result in our internal value for money activity becoming a compliance check rather than a source of insight to aid decision-making at a local level. However, the direction of travel of this work is being led by the National Audit Office rather than flowing from the Redmond Review itself.

4. Reporting Arrangements

Key Findings

4.1. There was agreement from all those that engaged with the review that local authority accounts are impenetrable for anyone other than experts and do not aid transparency about what local authorities do or how they use the money raised through local taxation. Specifics concerns were the focus of audit work on property and pension fund valuations which have little or no relevance to decision-making and the extent of variations in the content of the narrative statement.

4.2. Finally, there were concerns that Finance staff did not always have the necessary expertise or status in their organisation for their roles in completing the accounts process.

Recommendations

4.3. The recommendations for changes to reporting arrangements as a result of these findings are:

- A new (additional) standardised statement of services and costs that compares budget setting council tax information to outturn to be presented alongside the accounts. This will be consulted on and used in trial basis for the 2020/21 accounts. In 2021/22 the statement will be subject to audit;
- A requirement for CIPFA/LASAAC to review the statutory accounts to determine whether there is scope to simplify them by removing disclosures that do not add value, particularly in relation to property, plant and equipment and pensions valuation issues;
- An extension to the deadline for publishing audited local authority accounts to 30 September from 31 July each year; and
- A requirement for the CFO to confirm local authority staff are suitably skilled and experienced to produce the statutory accounts.

Implications for the County Council

4.4. The new standardised statement will be a significant additional piece of work at a time when the capacity of the Finance Service is already stretched. This may require additional resourcing. The statement will in part duplicate parts of the Statement of Accounts and the Council's normal outturn reporting. The content will be mandatory and will not align to our organisational structure, so will be an alternative cut of the same information.

4.5. The review of the required content of the statutory accounts is to be welcomed, but this is likely to be several years down the line. In the interim it would be helpful if some of the benefit of the extension of deadline for completing the audited accounts was allocated to local authorities.

4.6. In terms of the experience/status of staff completing the accounts within the Council, this was specifically recognised as a technical specialist role in the Finance Service redesign.

Views of the Strategic Director for Resources

4.7. We have made a considerable effort to make the narrative statement accessible for lay-readers of the Authority's accounts. Our continuous improvement in this has been acknowledged by both this Committee and full Council. The imposition of the additional new standardised statement because not all authorities have the same commitment to accessible, transparent reporting is, therefore, frustrating. Our preference would be for this to be tackled with individual authorities rather than a blanket change for all.

4.8. Internally the production of the new standardised statement is likely to create additional confusion. Elected Members will receive four reports essentially containing the same information but each in a different format with a different service breakdown – the financial monitoring reports to Cabinet, the statement of accounts itself, the narrative statement and the proposed new standardised statement. Internally, for those charged with governance, it is therefore difficult to identify any added benefit, especially given the additional resource input, without one of the other requirements being dropped.

4.9. For local communities the critical element in assessing the effectiveness of how their council tax was used is the relationship between financial and service performance. This can be done more effectively though the narrative statement rather than a further financial statement as, when done effectively it ties the planned service and financial performance together. This will be different for every authority.

4.10. The primary benefit of the new statement will be the ability to comment and make comparisons between authorities easier for those wanting to undertake external oversight or follow up on specific issues. But, even with a standardised format, this will not be simple. Local authorities are not homogenous, for example there are only eight authorities with the same mix of functions as the County Council and therefore a significant core understanding of local government would still be required to make any use of the statements meaningful.

4.11. The critical aspect of making the financial performance of local authorities more transparent and accessible is tackling the complexity of the statutory financial reporting requirements themselves. As the report acknowledges, this was beyond the remit of the Review and is still a further piece of work that is needed. We would strongly support any further endeavours to simplify the statements and would wish to see this taken forward in a collaborative way at the earliest opportunity.

4.12. The pressure to move the deadline for completion of the audit of accounts back to September is being driven by the capacity of the external audit firms to audit all public sector bodies (local government, health, colleges etc) within a three-month period. Extending the deadline to September therefore makes sense from a work planning perspective, however, it is somewhat incongruous when considered alongside proposed increases in audit fees and a stated desire to provide meaningful (and therefore timely) information to local residents.

4.13. That said, we recognise that many authorities struggle to meet the current 31 May deadline for the production of draft accounts and therefore, if a change is to be made, it would also ease the pressure on Finance teams to extend the deadline for the production of draft accounts back to the end of June.

4.14. However, extending the deadline for overall work planning purposes should not mean the length of individual audits is increased as later deadlines for audits risk overlapping with the start of the annual budget cycle. We would still want this to be done on the basis of an agreed local timetable e.g. a four-week audit remains a four-week audit, it is just the start date that moves.

4.15. There is one slight caveat to this. The delays in the audit of the 2019/20 accounts because of Covid-19 have led to more retrospective questioning of estimates and assumptions that were made at the end of March because more information is available six months further on. Any change of date should be accompanied by the recognition, where reasonable, that the accounts were produced at a point in time, based on the information and knowledge available at that time rather than the reopening of decisions based on hindsight.

5. Next Steps

5.1. Implementation of the recommendations from the Redmond Review will, in part, require regulatory or legislative change. The next stage is for the Government to respond to the review and indicate the possible timing for any changes that require legislative change. If supported by Government, there will also be a consultation on the content of the new standardised service statement that will need to close by December 2020 if it is to be implemented on a trial basis for the 2020/21 Accounts.

5.2. The Committee will be kept informed of progress on the implementation of the Redmond Review.

6. Financial Implications

6.1. There are two potential direct financial implications for the Authority as a result of implementing the recommendations of the Redmond Review. The first is the likely increase of up to £40,000 in the annual audit fee for both the County Council and Pension Fund accounts.

6.2. The second is the additional resource commitment needed to produce the new standardised statement. This is likely to consist of one-off funding for the changes needed to the financial systems to provide the data that underpins the new standardised report and then the additional permanent capacity needed to produce the additional statement and the associated working papers on an annual basis. The level of the additional costs cannot be assessed with any accuracy until the consultation paper on the new standardised statement is issued.

7. Environmental Implications

7.1. There are no environmental implications arising from this report.

8. Background Papers

"Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting" – the Redmond Review, published September 2020

Annex 4d “Illustrative Simplified Financial Statement: Unitary Authority” This is the nearest statement to the one the County Council would be required to produce if this proposal is taken forward.

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Elected Members have not been consulted in the preparation of this report.