

Redmond Review into the effectiveness of local audit and the transparency of local authority financial reporting

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Purpose of the Report

1. To provide the Audit Committee with a summary of the current audit framework applicable to local government and the issues existing within this framework.
2. To brief the Committee on the outcomes arising from the Redmond Review into the effectiveness of local audit and the transparency of local authority financial reporting, and the potential implications for local government.

Public Interest

3. Local public services account for a significant amount of public spending. In 2019-20, local authorities, local police and local fire bodies spent nearly £100 billion delivering their services, which many local taxpayers rely on every day. South Somerset District Council (SSDC) alone spent £142 million in 2020/21 (£100,128,500 revenue expenditure and £42,177,000 on capital expenditure).
4. Financial statements are the main way in which local public bodies account for how they use their resources. Local public bodies must prepare and publish financial statements setting out their financial performance for the year. To do this, bodies need to maintain proper accounting records and ensure they have effective systems of internal control.
5. Taxpayers, national bodies and other stakeholders reasonably expect that the auditor will normally be able to assure that the financial statements have been properly prepared, are free from material error, and that the body has proper arrangements in place to secure value for money.
6. Where the auditor is satisfied that the financial statements present a true and fair view, they issue an unqualified opinion. Where they are not satisfied, or where they have other matters to which they wish to draw attention, they give a qualified or 'non-standard' report. Where the auditor considers that a particular matter is sufficiently serious to draw to public attention more widely, including informing the relevant Secretary of State, they may choose to make a statutory recommendation requiring a public response or issue a Public Interest Report (PIR).
7. Local authorities have faced significant challenges since 2010-11 as funding has reduced and demand for key services has grown. Not only are the risks from poor governance greater in the current context as the stakes are higher,



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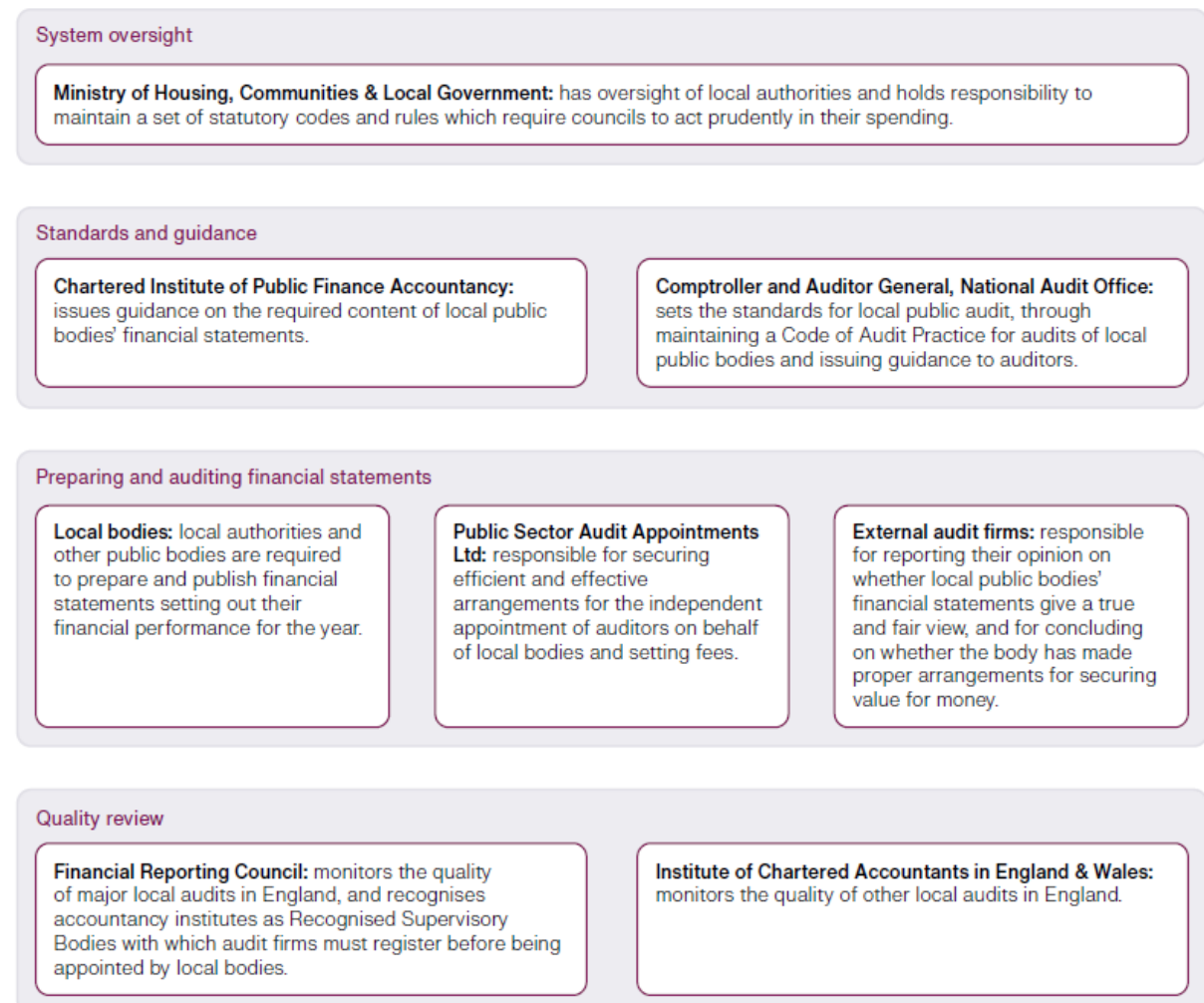
but the process of governance itself is more challenging and complex as activities become more varied, complicated and commercial in many councils, including SSDC. External audit is one of the checks and balances in the system and plays a key role. Any proposed changes to the existing arrangements for preparing financial statements and their audit are therefore important to understand in terms of governance and the stewardship of public funds.

Recommendations

8. That the Audit Committee notes this briefing on the local audit framework, the changes proposed to it arising from the Redmond Review, and the implications for local government.

The current local audit framework

Figure 1: Roles and responsibilities for the audit of local bodies



Source National Audit Office: <https://www.nao.org.uk/report/timeliness-of-local-auditor-reporting-on-local-government-in-england-2020/>



9. Local audit has changed significantly since the abolition of the Audit Commission in 2015. The Local Audit and Accountability Act (2014) sets out the local audit arrangements from 1 April 2015 that currently apply to local government, local police and local fire bodies.
10. The introduction of the local audit framework under the 2014 Act spread roles and responsibilities for local audit across multiple organisations. Figure 1 sets out briefly the roles and responsibilities of the Comptroller and Auditor General (the head of the National Audit Office (NAO)), external audit firms, Public Sector Audit Appointments (PSAA), local public bodies and professional accounting institutions.
11. The Act also resulted in the establishment of Public Sector Audit Appointments Ltd (PSAA) a subsidiary company of the Local Government Association (LGA) to procure audits for councils across the country. Relevant local bodies have the choice on whether to opt into these arrangements and some 98% (all but 10) have done so for the period from 2018 to 2023. A proposal to opt in from 2023 onwards will be considered by the Audit Committee at its November meeting before going to full Council for decision.
12. In addition, the Accounts and Audit Regulations (2015) set out the publication requirements for local authority financial statements by specifying a date by which a local authority should publish its accounts. Where an authority is unable to publish its accounts including the auditor's opinion, it must also publish a notice to that effect including reasons for the delay. The publication deadline for the 2019/20 audited statement of accounts was moved from 31st July to 30th November, due to the effect of the COVID-19 pandemic and to reduce the burden on councils and audit firms, and an extended deadline (to the 30th September) will remain the case for the next two financial years.

Problems with the current local audit framework

13. A report from the House of Commons public accounts committee (PAC) published on the 14th July 2021 says "*if local authorities are to effectively recover from the pandemic, it is critical that citizens have the necessary assurances that their finances are in order and being managed in the correct manner. Delays and quality issues undermine the value and purpose of audit, reducing the assurance to taxpayers and elected representatives*". The report concludes that "*...without urgent action from government, the audit system for local authorities in England and Wales may soon reach breaking point.*" (Source: "*Local auditor reporting on local government*")

<https://publications.parliament.uk/pa/cm5802/cmselect/cmpubacc/171/17104.htm>

14. The problems with the current local audit framework include:
 - Late delivery of audit opinions
 - The quality of audits undertaken
 - The focus on issues that are not priorities for the public sector



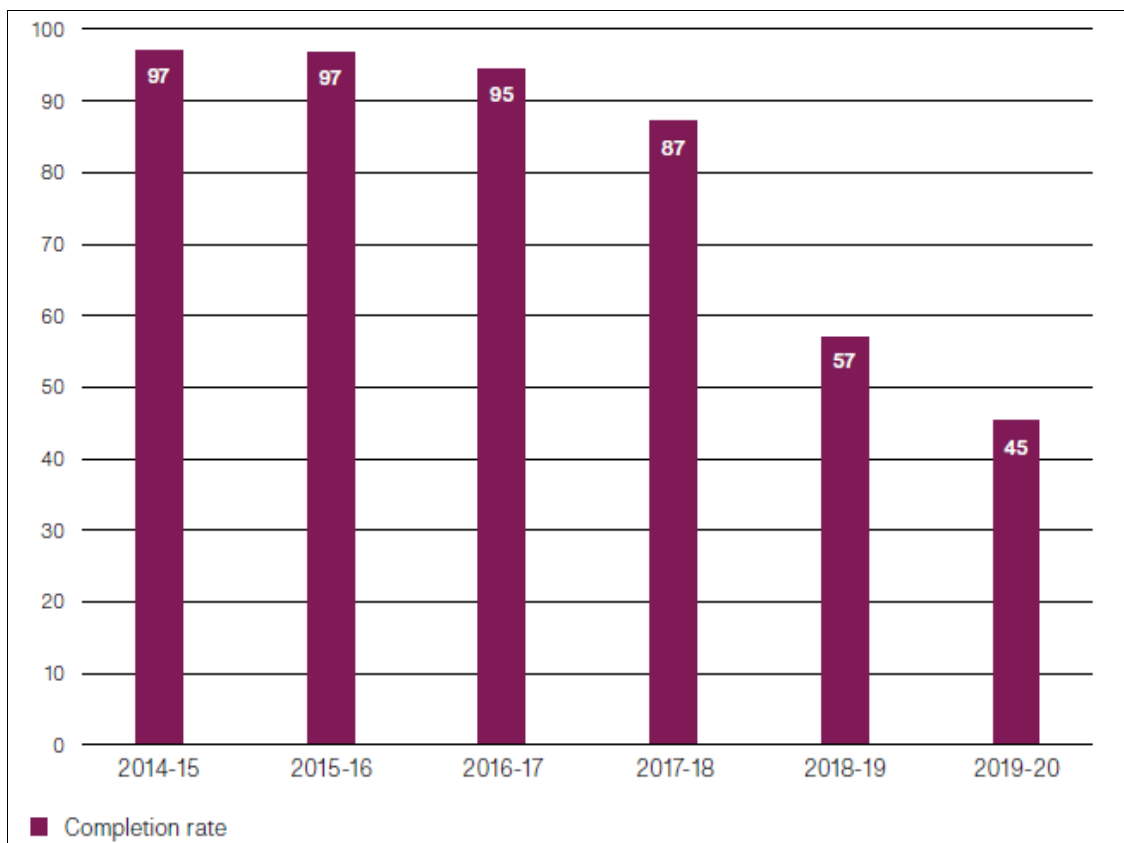
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- The complexity of the Statement of Accounts
- The small number of firms able to service the needs of local public sector audits

Late delivery of audit opinions

15. Less than half of local bodies' 2019-20 audits were completed by the extended deadline of 30 November 2020. Figures compiled by Public Sector Audit Appointments Ltd (PSAA) show that 267 audit opinions (55%) were not issued by 30 November 2020. This was despite the then Ministry of Housing, Communities & Local Government (the Department) easing the deadline for the completion of the 2019-20 audits. It continued a downward trend (Figure 2) which has accelerated since 2017-18.
16. SSDC did not publish the 2019/20 audited Statements on time (it was delayed by one month) and it will not be able to do so for 2020/21.

Figure 2: Proportion of opinions issued by the accounts publication deadline



Source: National Audit Office analysis of Public Sector Audit Appointments Ltd published data

17. The impact of late delivery of audit opinions include the following:
 - This can delay timely management action to address any financial or performance issues identified by the auditors.



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- Audited accounts provide confidence, assurance and transparency for the budget setting process. There have been recent cases where an audit had revealed information that affected the value of a local authority's reserves and which had knock-on effects on future budget.
 - As local authorities commence their annual budget planning during the autumn of the preceding year, the late delivery can, particularly in a small finance team, take time away from medium term financial planning in order to respond promptly and efficiently to queries raised during the audit process.
 - The late delivery of local audit opinions delay the audits for some government departments, impacting on the assurance Parliament receives over how taxpayers' money is used. For example, the 2019–20 audits of the Care Quality Commission and of the Department for Environment, Food & Rural Affairs, were delayed due to issues with the audit of the Local Government Pension Scheme. In addition, the 2019-2020 Whole of Government Accounts (WGA) was delayed by more than 15 months.
 - Many of the audit firms employed on local audit work have several clients, with varying reporting deadlines. Audits of local NHS bodies usually happen before audits of local authorities, which happen before audits of the higher education sector. Delays in the audits of local authorities therefore affect the delivery of other audits and disrupt the audit firms' usual cycle of audit planning and delivery.
18. The National Audit Office in its publication "*Timeliness of Local Auditor Reporting on Local Government*" (2020), and after seeking the views of audit firms and stakeholder bodies, give the following underlying reasons for late delivery of audit opinions:
- Insufficient staff with the right qualifications, skills and experience in both local finance teams and firms serving the public audit sector and a net loss of staff from both.
 - Serious shortfalls in the number of specialists which audit firms rely on to carry out audits of local authorities. To maintain accreditation, audit firms' key audit partners must have at least three years' oversight experience of auditing local authorities. Most key audit partners are over 50 years old and audit firms are likely to find it difficult to replace experienced staff when they retire. (Source: PAC "*Local auditor reporting on local government*" (2021)).
 - The requirements of International Financial Reporting Standards (IFRS), along with the increased expectations from the Financial Reporting Council (FRC) following the high-profile corporate failures such as Carillion, have combined to produce a significant increase in audit work, such as on asset and pensions valuations.
 - Competing workload pressures, both within the finance function and elsewhere in local authorities, diverts staff resources from completing



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working papers and preparing accounts within the time available for submission to the external auditor.

- Complex technical issues have been a significant factor in delaying sign-off. This includes auditing local bodies' investments in commercial property and in 3rd party enterprises and subsidiaries requiring group accounts.
- Audit firms have told the Public Accounts Committee that they safeguard quality before deadlines and that they would not provide an opinion on an audit of a local authority to an "arbitrary deadline" or without sufficient evidence, at the appropriate quality, to support it.
- The COVID-19 pandemic has exacerbated problems which already existed within the local audit landscape. Staff sickness and staff isolating have reduced staffing levels. Working from home arrangements have also affected some access to records and some communications between finance staff and audit staff. This has been exacerbated by additional workload related to COVID-19, such as distributing COVID-19-related grants to local businesses and familiarisation with the guidance announced by government.

The quality of audits undertaken

19. The Financial Reporting Council (FRC) is the independent body responsible for monitoring the quality of major local audits in England. The Institute of Chartered Accountants in England and Wales (ICAEW) monitors the quality of the remaining local audits.
20. The FRC inspected 15 financial statement audits in 2019-20 across seven local audit firms. In its report "*Major local audits – audit quality inspection*" (October 2020) it described the overall results as concerning, with only 40% of audits judged good or requiring no more than limited improvement, down from 64% in 2018-19. The FRC said that urgent action was required from some of the firms, to take appropriate action to respond to the findings and ensure improvements were made in audit quality, given the deterioration in quality in the year.
21. Areas where improvements in audit quality were needed included:
 - The valuation of property (including investment property)
 - Sufficiency of audit procedures to confirm that all expenditure transactions occurred and were recorded appropriately
 - The auditor's response to fraud risks
 - Consideration of the risk that money owed to the authority might not be collectable in full (impairment of receivables)
 - Valuation of assets supporting pension funds
 - The effectiveness of the Engagement Quality Control review (an arrangement whereby a second audit engagement lead is used to ensure that key audit judgements are reviewed and challenged effectively).

The focus on issues that are not priorities for the public sector

22. In their 2019 report, the National Audit Office surveyed local authority finance directors (section 151 officers) for their views on external audit. (Source: Comptroller and Auditor General: *Local Authority Governance*, Session 2017–2019, National Audit Office, January 2019).
23. More than half of the section 151 officers from single tier and county councils responding to the survey indicated that they wanted changes to external audit. These included:
 - A greater focus on the value-for-money element of the audit (26%), and
 - Less of a focus on the valuation of capital assets within auditors' work on their financial statements (14%).
24. The Public Accounts Committee (July 2021) gave its view that “...*some areas of the audit to which the auditors give much attention are not proportionate to the risk to the overall financial stability and resilience of local authorities*”. It notes that the additional work that audit firms are now required to do arise from the requirements of the Financial Reporting Council and that many believed this work “...*was not a high priority in the governance of local authorities*”.
25. An example of this is asset valuations. For the private sector, the overstatement of the value of assets is a serious issue with such false accounting being used to obtain additional financing or inflate the share price. However, the movement in the value of an asset, be it up or down, does not impact on a council's financial position as there is a statutory override in place which means that the changes in value do not go into the revenue budget and have no impact on council tax.
26. Yet the valuation of assets is a key part of the audit and adds to its cost as asset valuations, particularly for commercial investment properties, which require significant input from the audit firms' specialist real-estate valuation teams.
27. The valuations are one of the big risks reported in the audit report which can mean that the gaze of those charged with governance is drawn to the changes in value rather than perhaps asking more pertinent questions? For example, and assuming these are investment properties: is the income being reported accurately? Is it sustainable? Do we understand the timing and impact of rent reviews? These are the factors that will impact on the long-term financial health of the authority, not annual fluctuations in value.
28. The audit focus on these areas means less attention is paid to perhaps more meaningful areas, such as financial resilience, outturn against budget, and performance outcomes.

The complexity of the Statement of Accounts

29. Local authorities' audited accounts are hard reading and are impenetrable to many stakeholders. The adoption of Internal Financial Reporting Standards



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back in 2011 has meant, over the years, that there has been a growth in the length of statutory accounts and the required accompanying notes. Many councils have increasingly complex financial arrangements, for example in their borrowings, investments and financial instruments, often requiring complex group accounts to be prepared.

30. The Public Accounts Committee (July 2021) has concluded that “*unless local authority accounts are useful, relevant and understandable they will not aid accountability*”.

The small number of firms able to service the needs of local public sector audits

31. Only eight audit firms have the specialist knowledge and accreditation needed to audit local authorities. Currently, the market is dominated by just two firms, (EY and Grant Thornton) which carry out around 70% of local authority audits.
32. The market therefore is not competitive and there is a significant risk of market collapse due to an over reliance on a small number of audit firms: for example KPMG stopped providing local government audits in 2017. Audit firms that have left the market no longer have the necessary specialist teams in place, if they ever considered re-entering the market.
33. New audit firms face considerable barriers in the time and costs involved in gaining entry to the market, such as developing a sufficient sized team of staff with the specialist skills, led by key audit partners, as part of gaining accreditation.
34. The Public Accounts Committee (July 2021) also notes that councils have become increasingly unattractive as clients and that audit fees in real terms have dropped significantly in recent years and now no longer reflect the work involved. This work has increased significantly, as noted elsewhere in the report: for example on pension and property valuations and the increasing regulatory requirements from the Financial Reporting Council.

Recommendations of the Redmond Review and the government’s response

35. On 10 July 2019 the then Secretary of State for Housing, Communities and Local Government, James Brokenshire, announced a review into local audit. This was chaired by Sir Tony Redmond, a former Local Government Ombudsman and former president of the Chartered Institute of Public Finance and Accountancy (CIPFA).
36. The review was originally due to report in spring 2020, but finally reported in September 2020. The review made 23 recommendations, the key proposal being the creation of a new body, the Office of Local Audit and Regulation (OLAR) which would take over the local audit functions currently held by PSAA, ICAEW, the Financial Reporting Council, and the National Audit Office.



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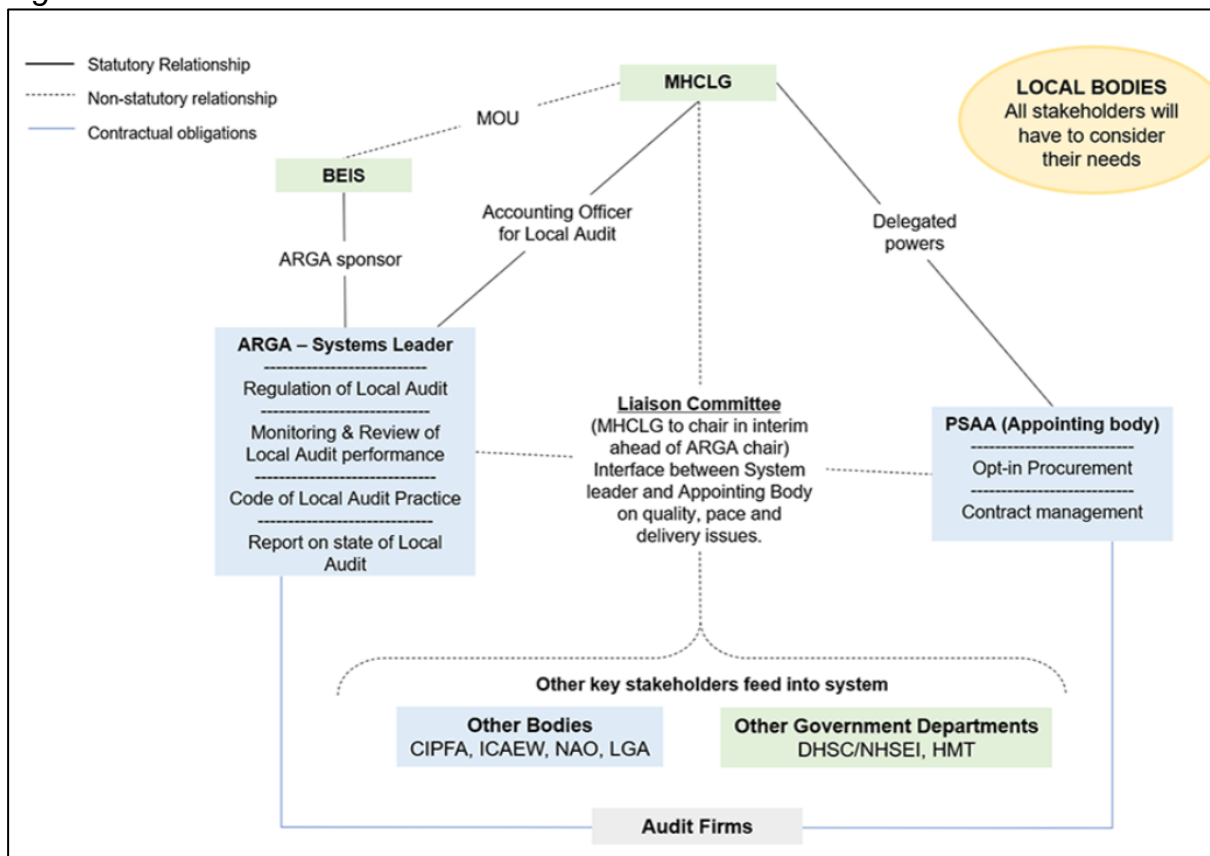
37. The report said: “...none of the six entities with responsibility for the different elements of the framework has a statutory responsibility, either to act as a system leader or to make sure that the framework operates in a joined-up and coherent manner...As a result, the lack of co-ordination and the lack of a system leader is widely recognised as a weakness in the framework by most of the stakeholder groups”.
38. The Government published an interim response in December 2020. It rejected the central recommendation of a new body. Nevertheless, it also said: “the department will commit to explore the full range of options as to how best to deliver Sir Tony’s finding that a ‘system leader’ is required. This will include close consideration of whether existing bodies could take on this function”.
39. The Government’s interim response also agreed to:
 - Accept the recommendation to review the current fee structures in local audit, to provide greater flexibility to meet audit firms' costs. PSAAs consulted on adjusting this system in November 2020, and the Government consultation closed on 1 June 2021. £15m of additional funding was allocated to local authorities in 2021-22.
 - The Government has also recognised that this year will be particularly challenging as audit firms seek to catch-up after the significant Covid-19 delays last year and that trying to return to a 31st July deadline to audit the 2020/21 accounting period would be unrealistic. Hence, they have agreed moving the audit deadline to 30th September for local authorities for the next two years and to keep this under review, but without committing to a permanent change.
40. Introduce a requirement for local authorities to publish a simplified and standardised financial statement of service information to be produced to allow comparison with the annual budget and council tax and to enhance the transparency of financial information. This new statement will be prepared in addition to the statutory accounts and will be subject to audit.
41. A full Government response to the Redmond Review was published in May 2021. The Government stated in this document that it would create a new organisation, to replace the Financial Reporting Council to be the “system leader” for local audit. This organisation will be known as the Audit, Governance and Reporting Authority (ARGA) and its creation will require primary legislation.
42. A subsequent Government technical consultation on implementation, was published on 28 July 2021 and ran up to 22 September. Government’s response to the consultation responses are currently awaited.
43. The consultation included proposals for ARGA to take on the responsibility for the Code of Audit Practice and auditor guidance notes, currently produced by the National Audit Office.



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44. The Code of Audit Practice has the status of secondary legislation and the Local Audit and Accountability Act 2014 requires it to be updated at least every five years, with the latest version of the Code published in April 2020. The updated code (currently being applied to the external audit of the 2020/21 accounts) includes enhanced value of money audit requirements including consideration of financial sustainability and governance arrangements.
45. The government's view is that the scope of local audit should reach further than for company audits, in recognition that unlike shareholders, taxpayers cannot divest from their local bodies. The Government is therefore proposing that ARGA, once it is established, undertake a post-implementation review to assess whether the new Code of Audit Practice has led to a more effective external audit consideration of financial resilience and value for money matters.

Figure 3: New Local Audit Framework



Source: MHCLG *Local Audit Framework: Technical Consultation* July 2021

46. It is also proposed that ARGA will establish a dedicated local audit unit, in order that it acquires the detailed expertise on the local audit sector, and this will be established in shadow form from April 2022. ARGA will be required to include a separate section on local audit in its statutory annual report to Parliament. The consultation asked for views on whether that should also include details of the results of audit, which was a statutory duty on PSAA up to 2017-18. Government are minded that ARGA's specific local audit responsibilities should be funded directly by MHCLG (now Department for Levelling Up, Housing & Communities).



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47. A Liaison Committee is recommended to be established and whilst the exact membership of this will be subject to further consideration, Government envisage representation from organisations including CIPFA, PSAA, LGA, NAO, ICAEW, the Department for levelling Up, Housing & Communities,, the Department of Health and Social Care (DHSC), NHS England, BEIS and HM Treasury (HMT). The Liaison Committee will be the key forum for ensuring coordination across different parties, but also for acting on risks and issues as they emerge and considering responses to developments in local audit.
48. In addition to the above the consultation also sought views on local governance arrangements regarding external audit and consideration on whether these should be delivered through the production of an updated version of CIPFA's existing guidance, "*Audit Committees: Practical Guidance for Local Authorities and Police (2018 Edition)*", or through legislation:
- An annual report being submitted to Full Council by the external auditor.
 - The appointment of at least one independent member, suitably qualified, to the Audit Committee.
 - Formalising the need for the CEO, Chief Finance Officer and Monitoring Officer to meet with the key Audit Partner at least annually.
 - External audit to submit an annual report to the first full council meeting after 30th September each year, irrespective of whether the financial accounts have been certified.
 - A change to the Audit Code of Practice to allow External Audit to liaise with the internal audit function and to use them more effectively.

Background Papers

The Local Audit and Accountability Act (2014)

<https://www.legislation.gov.uk/ukpga/2014/2/schedule/12/paragraph/95>

The Accounts and Audit Regulations (2015)

<https://www.legislation.gov.uk/uksi/2015/234/regulation/12/made?view=plain>

House of Commons Public Accounts Committee (PAC) "*Local auditor reporting on local government*" (2021)

<https://publications.parliament.uk/pa/cm5802/cmselect/cmpublicacc/171/17104.htm>

National Audit Office "*Timeliness of Local Auditor Reporting on Local Government*" (2020)

<https://www.nao.org.uk/report/timeliness-of-local-auditor-reporting-on-local-government-in-england-2020/>

Financial Reporting Council "*Major local audits – audit quality inspection*" (2020)

<https://www.frc.org.uk/news/october-2020/frc-publishes-major-local-audit-inspection-results>



National Audit Office, Comptroller and Auditor General: “*Local Authority Governance*” (2019).

<https://www.nao.org.uk/wp-content/uploads/2019/01/Local-authority-governance.pdf>

Ministry of Housing, Communities & Local Government “*Review of local authority financial reporting and external audit*” (2019)

<https://www.gov.uk/government/news/audit-quality-of-councils-will-face-examination-in-new-independent-review>

Ministry of Housing, Communities & Local Government “*Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting*” (2020)

<https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>

Ministry of Housing, Communities & Local Government “*Local authority financial reporting and external audit: government response to the Redmond review*” (2020)

<https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-government-response-to-the-redmond-review>

Ministry of Housing, Communities & Local Government “*Local authority financial reporting and external audit: Spring update*” (2021)

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Department for Levelling Up, Housing & Communities “*Local audit framework: technical consultation*” (2021)

<https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation>