

Audit Consultation (Redmond Review)

Purpose of report

For direction.

Summary

This report provides a summary of [the call for views](#) as part of the Independent Review of Local Authority Financial Reporting and External Audit in England which closes on 22 November. Members are asked to provide a steer on the proposed content of the LGA's response, the detail of which will be cleared by Resources Board. This report will also be presented at the Leadership Board on 30 October 2019.

Recommendation

That members note the report and provide comments on the proposed content of the LGA's response to the call for views.

Action

Officers to proceed in accordance with the steer from Improvement and Innovation Board and Leadership Board and draft a formal response to be cleared by Resources Board.

Contact officer: Alan Finch
Position: Principal Adviser (Finance)
Phone no: 020 7664 3085
Email: Alan.Finch@local.gov.uk

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Background

1. This report provides a summary of [the call for views](#) as part of the Independent Review of Local Authority Financial Reporting and External Audit in England which closes on 22 November. Members are asked to provide a steer on the proposed content of the LGA's response, the detail of which will be cleared by Resources Board at their meeting on 19 November. This report is being considered by both Leadership Board and by the Improvement and Innovation Board. Sir Tony Redmond is attending the October meeting of Leadership Board and the November meeting of Resources Board.
2. The [review](#) was initially announced by the then Secretary of State at the LGA's conference in July. The review will be led by Sir Tony Redmond. Sir Tony is a former Local Government Ombudsman and has also been President of CIPFA, a council Treasurer and Chief Executive and a Local Government Boundary Commissioner.
3. The review is a post implementation review of the [2014 Local Audit and Accountability Act](#), the Act that abolished the Audit Commission and replaced it with a new audit regime for local authorities, local health bodies and other public bodies. The review covers local authorities, including councils and parish councils, Police and Crime commissioners, Fire and Rescue Authorities, Independent Drainage Boards and Parks Authorities, but it will not look at Clinical Commissioning Groups or NHS trusts, though they are covered by the 2014 Act.
4. The LGA successfully lobbied for some changes to the Act. In particular the option for councils to opt-in to a form of national procurement of external audit through a sector led body rather than each council having to separately procure their own external auditor – which would have resulted in increased costs for councils as well as significantly more costs of carrying out the procurement compared to one national procurement exercise.
5. This led to the creation, by the LGA, of Public Sector Audit and Appointments Ltd (PSAA). 98 per cent of councils opted in to PSAA. PSAA subsequently procured external audit firms for these councils. The tender exercise which included increasing the weighting given to quality in the selection of firms compared to the exercise that the Audit Commission had carried out previously, resulted in the selection of 5 firms. The prices agreed with these five firms were the prices they bid at and no attempt was made by PSAA to drive down the prices further.
6. According to the terms of reference, the Review will examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework in order to determine:

- 6.1. Whether the audit and related regulatory framework for local authorities in England is operating in line with the policy intent set out in the Local Audit and Accountability Act 2014 and the [related impact assessment](#);
 - 6.2. Whether the reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
 - 6.3. Whether 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; and
 - 6.4. To make recommendations on how far the process, products and framework may need to improve and evolve to meet the needs of local residents and local taxpayers, and the wider public interest.
7. In launching the review at the LGA conference, the then secretary of state raised concerns about the consequences if audits aren't carried out properly and fail to detect significant problems. This included the impact on "faith in local democracy" as well as confidence in financial reporting. He also emphasised that the aim of the review should be to ensure the audit framework helps members, Section 151 officers and chief executives make informed and responsible decisions about improvements, and that the review should also look at how greater input from citizens can be achieved.
8. The Redmond review is one of a number of formal developments affecting the audit profession and potentially impacting on local authority audit:
- 8.1. The Kingman Review published in December 2018 was a review of the audit regulator, the Financial Reporting Council (FRC), which has led to the abolition of the FRC and its replacement from early next year with the Audit, Reporting and Governance Authority (ARGA). The quality of audit in the private sector has been criticised following a number of high profile corporate failures. Both the old and the new body have a role in regulating the quality of firms registered to undertake local authorities' audits.
 - 8.2. The National Audit Office (NAO) is currently reviewing [the Code of Audit Practice](#), which is the code of practice (underpinned by guidance) that local authority auditors must follow. Following a general consultation earlier this year, [a second consultation](#), on the actual draft revised code, is currently underway and closes on 22 November.
 - 8.3. CIPFA has been undertaking [an ongoing project](#) to simplify the [Code of Practice on Local Authority Accounting in the United Kingdom](#), which is the code that covers the form and content of local authority accounts.

- 8.4. In addition the MHCLG has recently begun a process of reviewing the accountability framework for local government with key stakeholders from the sector. The LGA's Chief Executive Mark Lloyd sits on this group.

Areas covered in the Redmond review's call for views

9. The call for views asks a total of 43 questions grouped under the following eight headings. All 43 questions are shown at **Appendix A** to this report.

- 9.1. Definitions of audit and users of the accounts;
- 9.2. The expectation gap;
- 9.3. Audit and wider assurance;
- 9.4. Governance framework for the audit system;
- 9.5. Audit product and quality;
- 9.6. Auditor reporting;
- 9.7. Framework for responding to audit findings;
- 9.8. Financial reporting framework; and
- 9.9. Other issues.

10. The first two headings above are described as being "strategic" while the rest are described as "technical". "Strategic" focusses on what users of the accounts can expect and "technical" refers to the statutory and professional frameworks underpinning the overall audit and financial reporting framework.

11. The call for views from the review also draws attention to the growing debate taking place about whether the coverage of the current audit is fit for purpose and whether there is an 'expectations gap' between what stakeholders expect audit to achieve and what it can realistically deliver. It will be important to distinguish in our response between issues that improve current arrangements and those that might add an extra burden onto local authorities.

Issues that members may wish to take into account in directing a response

12. The following paragraphs include possible issues that could be included when framing a detailed response to the 43 questions in the call for views. Members are asked to give a steer on the key issues that they would like to see addressed in the response:

- 12.1. Councils operate within a different governance framework from companies and are not entirely like other public sector bodies either. A "one size fits all" approach to audit is not appropriate.
- 12.2. The audit approach must be proportional. Audit should not be about duplicating controls that already exist. Auditors should take a risk-based approach to the level of work required.

- 12.3. Councils have been largely successful in the last ten years in responding to the challenges of austerity and to date only one council has failed to maintain a position of financial sustainability.
- 12.4. Widening the scope of audit may be a burden to the sector rather than a help.
- 12.5. Improvements could be made to financial and audit reporting – both in clarity and the timetable.
- 12.6. The current system, a comprehensive audit of accounts and a value for money judgement, has been in place since 1983. Between 2000 and 2009 it was supplemented by a use of resources assessment score as part of the Comprehensive Performance Assessment / Comprehensive Area Assessment. It was widely held by councils at the time that it added limited value for the effort involved and a return to this regime would not be welcomed. In 2006, it was estimated by the NAO that the total cost of monitoring and inspecting councils was in excess of £2bn.
- 12.7. Sector Led Improvement (SLI) has become more sophisticated and has expanded to fill some of the space previously taken up by the comprehensive performance / area assessment. SLI is less bureaucratic and has successfully supported the sector generally and individual councils to meet a historically difficult challenge. The improvement grant to support sector led improvement currently totals just under £20m.
- 12.8. The Local Audit & Accountability Act 2014 came fully into effect on 1st April 2019 when the new audit contracts came into effect. 2018/19 is therefore the first full year of the new audit contracts.
- 12.9. There have been issues with the delivery of a number of the 2018/19 audit. There are several reasons for this including:
- 12.9.1. Inability of some audit firms to deploy sufficient resources to complete audits on time;
 - 12.9.2. The change of the deadline. The new 31 July deadline (which first applied to audits for 2017/18) is not sustainable. The LGA has previously called for the deadline to return to the end of September and it is suggested that this call is included in the response to the call for views;
 - 12.9.3. Additional requirements added in to the audit process following criticism of auditors generally in the Kingman Review and by the Financial Reporting Council (FRC);
 - 12.9.4. Concerns about the sustainability of the audit market going forward, and how to improve it;

12.9.5. The NAO's review of the Local Code of Audit Practice is picking up issues about timeliness of audit reporting and meaningfulness of audit opinions, particularly relating to the value for money opinion. This includes a move away from standard "boiler plate" opinions to enable a more meaningful commentary from the auditor. Supportive views on both of these were included in the LGA's response to the NAO's first consultation and it is suggested that similar views are included in this response.

13. The Redmond Review also covers the reporting of accounts by councils. Despite many and varied initiatives over the years with the aim of simplification, council accounts remain almost unintelligible to most readers. There is always likely to be a trade-off between accuracy and completeness of reporting and its general understandability to non-experts. Additional complexity is added by the need to comply with a range of international accounting standards, many of which do not recognise the circumstances of local councils. Realistically, most taxpayers are unlikely to get assurance directly from the accounts that public money is being appropriately recorded and used for legitimate purposes. Instead they will need to rely on those responsible for governance and auditors to provide suitable assurance based on their commentary of those accounts. This places increased importance on the audit regime, but also means that audit reporting must be meaningful, intelligible and timely.

Next steps

14. Members are asked for views on the general lines outlined above and any other issues they would like included in the LGA submission to the Redmond Review. It is proposed that officers use these lines to help frame detailed responses to the 43 questions in the call for views. The full response will be submitted to Resources Board's meeting in November for approval.

Recommendations

15. Members are asked to note the report and provide comments on the proposed content of the LGA's response to the call for views.

16. Officers to proceed in accordance with the steer from Leadership Board and Improvement and Innovation Board and draft a formal detailed response to be cleared by Resources Board.

Implications for Wales

17. The review applies to arrangements in England only.

Financial Implications

18. This is part of the LGA's core programme of work and as such has been budgeted for in 2019/20 core work programme budgets.

Appendix A – Full list of questions asked in the call for views

Definitions of audit and users of the accounts

Q1. Who, in your opinion, are the primary users of/main audience for local authority accounts?

Q2. Who are the other users of local authority accounts? Are any of these other users of accounts particularly important?

Q3. What level of financial literacy/familiarity with accounts and audit is it reasonable to expect the primary users of accounts to have and what implications does this have for the information presented in accounts and/or the information that should be subject to external audit?

Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it?

The expectation gap

Q6. In your opinion, what should an external audit of a set of local authority financial statements cover?

Q7. In your opinion, what should the scope of the external auditor's value for money opinion be?

Q8. What is your view on the scope of an external audit engagement as described in Chapters 1 and 2 of this Call for Views? If it is different from your expectations, does this have implications for the reliance you place on external audit work?

Q9. Should the external audit engagement be extended? If so, which additional areas/matters are most important for external auditors to look at? What would be the cost implications of extending the engagement to the areas/matters you consider to be most important be?

Audit and wider assurance

Q10. Should the scope of the vfm opinion be expanded to explicitly require assessment of the systems in place to support the preparation of some or all of the reports that statute requires to be presented to full Council? If you do, which reports should be within scope of the external audit vfm engagement? If not, should these be assessed through another form of external engagement? If you believe that the vfm opinion should be extended to cover these reports will there be implications for the timing of audit work or auditor reporting?

Q11. Should external auditors be required to engage with Inspectorates looking at aspects of a local authority's service delivery? If you believe that this engagement should happen, how frequent should such engagement be and what would be the end purpose of doing so?

Governance framework for the audit system

Q12. Does the current procurement process for local authority audit drive the right balance between cost reduction, quality of work, volume of external audit hours and mix of staff undertaking audit engagements?

Q13. How should regulators ensure that audit firms and responsible individuals have the skills, experience and knowledge to deliver high quality financial and vfm audits, whilst ensuring the barriers to entry do not get too high?

Q14. What metrics should regulators use when assessing whether financial and vfm audits are delivered to an appropriate level of quality?

Q15. Do you agree with the Independent Review of the Financial Reporting Council's findings and recommendations; and why do you agree/not agree? If you agree with the recommendations do you think the 'single regulatory body' should be the "successor body to the FRC" or a sector specific entity? If you do not agree with the recommendations are there any other changes you would make to the regulatory framework for local authority audit?

Audit product and quality

Q16. Do external audit firms have enough understanding of the local authority regulatory framework to focus audit work on the right areas? How do they/should they demonstrate this? Who should regulate this work?

Q17. Do auditing standards have a positive impact on the quality of local authority financial audits?

Q18. Do audit firms allocate sufficient resources to deliver high quality and timely audits? How is consistency and quality maintained in external audit work? To what extent is there consistency in audit teams year on year? What more can be done to ensure consistency between firms?

Q19. To what extent are senior audit staff, particularly the responsible individual signing the audit certificate, visibly involved in audit work? Who do senior audit staff meet with?

Q20. Should external auditors consider financial resilience as a key factor when designing their vfm work programme? If so, what factors do they/should they consider as indicative of a lack of financial resilience?

Q21. Does the Code of Audit Practice provide enough guidance on how much work needs to be done to support the vfm opinion? If not, what should it cover?

Q22. Do auditing standards provide appropriate guidance on quality standards for vfm audits? If not, is guidance needed and should it be included in the Code of Audit Practice or elsewhere?

Q23. What is the current relationship between external and internal audit? How should that relationship be developed to add most value to local authorities and local residents?

Q24. What should happen when a regulator finds that a local authority audit has not met quality standards? Where should the balance between ensuring effective enforcement action against auditors and maintaining participants in the audit market lie?

Auditor reporting

Q25. Do you think that the format of the vfm audit opinion provides useful information? If not what would you like it to cover?

Q26. Do you think the vfm opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate?

Q27. Do you think that the vfm opinion is presented at the right point in a local authority's annual financial management and budgeting cycle? If not when do you think it would be most useful?

Q28. Where auditors have identified significant issues, audit certificates and reports have often been delayed? Why do you think this is and can changes be made to the framework to encourage earlier reporting of significant issues?

Q29. In your view, what sorts of issues should Public Interest Reports be used to highlight?

Q30. Statistics demonstrate that very few Public Interest Reports and Statutory Recommendations have been issued. Why do you think this is? Does it indicate an issue with the framework or common behaviours? If you think this is an issue, what can be done to incentivise more frequent and timely reporting of significant issues?

Q31. Does a publication summarising the results of local authority audits add value? If so who should publish it and what information would they need to have access to to perform this function effectively?

Framework for responding to audit findings

Q32. To whom should external auditors present audit reports and findings; is it the audit committee, to full council or equivalent or another committee? If findings are not presented to full council or equivalent what information (if any) should full council or equivalent receive?

Q33. In your authority, what is the membership of the audit committee (number of members, how many are independent etc) and which officers typically attend?

Q34. How should local authorities track implementation of recommendations made by internal audit, external audit and relevant statutory inspectorates? What should the external auditors do if recommendations are not being implemented?

Q35. Should there be a role for an external body in tracking action taken in response to modified audit opinions and/or statutory recommendations and public interest reports? If so should that responsibility sit with MHCLG, the sector specific oversight body recommended by the Independent Review of the Financial Reporting Council or another body?

Financial reporting framework

Q36. Do local authority accounts allow the user to understand an authority's financial performance and its financial resilience? If not, how could they be revised to be more understandable? What information could be presented to enable users of the accounts to understand whether the financial position of a specific LA is getting better or worse?

Q37. The UK Government is committed to maintaining IFRS based accounting for the UK public sector. Given this, how would you recommend resolving the mismatch between the accruals and funding basis to improve the understandability of local authority accounts?

Q38. Do you think that summary financial information should be reported in the annual report section of the accounts? If so, on what basis and should this information be covered by the financial audit opinion?

Q39. If you think that summary financial information should be reported in the annual report section of the accounts, should it be presented with performance information? If so, what performance information would be of most interest to stakeholders?

Other issues

Q40. For larger authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner? If not, how should the regime be modified?

Q41. Is more guidance needed to help auditors assess the impact of significant changes to common business models? If so is this guidance needed to support the financial audit, the vfm audit or both?

Q42. Is the financial reporting and audit framework for larger category 2 authorities appropriate? If not, what additional information should be subject to audit/assurance and what would be the cost implications of this?

Q43. For smaller authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner and is the cost of processing and responding to objections proportionate? If not, how should the regime be modified?