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Outcome of Independent Review of Local Authority Financial Reporting and External Audit in England (the “Redmond Review”): Emerging views and LGA response

Purpose of report

For decision.

Summary

The report of the Independent Review of Local Authority Financial Reporting and External Audit in England was published on 8 September 2020. The report was discussed briefly at the IDeA Board the following day and in more detail at Resources Board the following week. Members were keen that the LGA should formulate a response to the review’s recommendations to be sent to MHCLG (MHCLG has not yet responded to the report). This paper proposes a policy response from the LGA, based on the discussions to date. Tony Redmond attended an LGA hosted webinar on 7 October and is due to attend the LGA Leadership Board on 21 October.

Recommendations

That Members of the Executive Advisory Board approve the lines for the response to the Redmond review as outlined in paragraphs 10 to 14 of the report and these are used to draft a response to the Government.

Action

Officers to proceed as per the agreed recommendation.

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Outcome of Independent Review of Local Authority Financial Reporting and External Audit in England (the “Redmond Review”): Emerging views and LGA response

Background

1. The [Independent Review of Local Authority Financial Reporting and External Audit in England](#) was initially announced by the then Secretary of State at the LGA’s conference in July 2019. The review has been 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. The call for evidence from the review received over 150 responses and Sir Tony and the review team carried out over 100 interviews and made presentations to many organisations, including Boards of the LGA. Resources Board approved the LGA’s [response](#) to the review’s [call for evidence](#) at its meeting in November 2019. The [report of the review](#) was published on 8 September.
2. Resources Board received a report on the review and its recommendations at its meeting on 15 September. The meeting was attended by Cllr Peter Fleming (Chair IDeA Board) and Steve Freer (Chair PSAA) who both addressed the meeting. This followed a shorter discussion at IDeA Board on 9 September.
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 the NHS is out of scope. Therefore, the review did not look directly at the audit and reporting of Clinical Commissioning Groups or NHS trusts, though they are covered by the 2014 Act, and the audit of such bodies is often undertaken by the same firms that audit local government.
4. This 2014 Act led to the creation, by the LGA, of Public Sector Audit Appointments Ltd (PSAA). Ninety-eight per cent of councils opted into the procurement by PSAA. PSAA subsequently procured external audit firms for these councils.

Recommendations in the Redmond Report

5. The full recommendations from the review are appended to this report.
6. The main recommendations are:

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- a. To set up a new body, the Office of Local Audit and Regulation (OLAR), to manage, oversee and regulate local audit. This body would take over all of the functions currently exercised by PSAA, as well as some functions currently carried out by other bodies such as the National Audit Office, the Financial Reporting Council (FRC) and the Institute of Chartered Accountants in England and Wales (ICAEW). The cost of this body is estimated to be £5 million per annum. Such a body would not be seen as having similar features to the Audit Commission, but it would have the power to hold auditors to account for their performance;
 - b. The Regulator (the new OLAR) would be supported by a Liaison Committee comprising key stakeholders and chaired by the Ministry of Housing, Communities and Local Government (MHCLG);
 - c. Ensure auditors have adequate skills and training and are properly resourced;
 - d. Review the audit fee structure (Redmond suggested that fees are too low);
 - e. Formalise links between external auditors and Inspectorates such as Ofsted, Care Quality Commission and HM Inspectorate of the Constabulary and Fire and Rescue Services (HMICFR);
 - f. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year and consider this in the light of deadlines for the audit of local NHS bodies outside the scope of the review but audited by the same auditors.
7. The report also included some recommendations on financial reporting, including a new standardised statement of service information and costs be prepared by each authority and be compared with the budget that was agreed to set the council tax/precept/levy and presented alongside the statutory accounts, and subject to audit.
8. The LGA's fully owned subsidiary, Public Sector Audit Appointments Ltd (PSAA) is affected by the proposals. It is one of the bodies that would be subsumed into the proposed Office for Local Audit Regulation (OLAR).
9. MHCLG has not yet responded to the recommendations. In its report on commercial property and investments, the Public Accounts Committee (PAC) requested that the department write to the PAC with its response to the Redmond report within three months of publication. MHCLG's response to the PAC's report on council investments says it will respond on Redmond by December.

LGA response to the Redmond Report

10. At the Resources Board meeting on 15 September, members questioned whether the recommendations in the Redmond report would solve the problems around the robustness of the local audit market. Members were opposed to the formation of a

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new regulatory body. Resources Board members recommended that the LGA respond to the Redmond report and were keen that the response should include a proposed way forward. The following points, which have been checked with Resources Lead Members, could be included in a response to the review report:

- a. The main issue remains the supply side of the audit market, with too few firms engaged in the market and too few suitably qualified auditors employed by firms. These problems have been shown by the delays in finalising audited accounts (which have been due to a shortage of suitably qualified senior staff). In addition, many councils have reported that the lack of skills and knowledge of staff undertaking audits impact on the time of council staff supporting the audit process. This is a complex and difficult problem which we do not believe will be resolved by measures in the Redmond report and it will require a lot more work across a whole range of bodies / stakeholders to resolve, not least the audit firms and the audit profession itself. It is not within the power of the proposed new body to resolve this.
- b. Welcome the recommendation for the creation of the MHCLG led stakeholder group - the LGA called for this in the call for evidence.
- c. The exclusion of the audit of health (which was not included in Redmond's terms of reference) would continue fragmentation. Adding NHS audit within procurement arrangements and adding other public bodies as well would help build market capacity. Local NHS audit is currently undertaken by the same audit teams as local authority audit, so a solution for one affects the other and we welcome Sir Tony's call for coordination between MHCLG and DHSC.
- d. As expressed in the LGA's response to the call for evidence to the Redmond review - the 2014 Act only came fully into effect in 2019 (when the current round of audit contracts started), it is too early to be contemplating major change.
- e. Proposed changes to the audit and accounts deadlines, in line with the temporary changes made this year, are welcome. The LGA called for this in its submission.
- f. Express concerns about bringing together auditor procurement and audit regulation in one body – this doesn't happen with other regulating bodies. There could be a conflict of interest, for example, if auditors defend poor performance by criticising the contract. Procurement and contract management remain crucial, but this is separate from regulation and should be carried out by a separate body. If changes to regulation result in applications from audit firms to vary contracts, then the responsibility for the change occurring needs to be clear and, if necessary, funded through the new burdens process.
- g. Councils are given the opportunity to opt in to the PSAA procurement arrangements (and 98% of them have done so). This ensures procurement is under local control. If procurement were moved to a centralised regulatory

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- body, it could centralise the function under Government control with no sense that councils can opt in or out and retain local control.
- h. PSAA has undertaken a wider role than just audit procurement. It has carried out improvement related activity to support councils and audit committee members in developing skills in managing local relationships with auditors, for example through initiatives such as the Local Audit Quality Forum. This work would be hard to reconcile with a regulator's remit and would likely be lost if PSAA were subsumed within a regulatory body.
 - i. The suggestion that fees should be increased because the audit firms' margins have reduced is not the answer, and in any event could raise legal challenges by firms that weren't awarded contracts at the time of the original procurement exercise.
 - j. The main factor driving financial resilience is government underfunding, not lack of control over councils. The response to resilience should not be about auditors anticipating local democratic decision-making (for example by extrapolating from past decisions about use of reserves) or heaping controls on top of controls (for example the report floats the idea that auditors should sign off the CFO's sign off of the budget).
 - k. We welcome the simplification of accounts because of the importance of local accountability though there are some concerns about extra work for councils and auditors.
 - l. Audit Committees need to remain member led although the concept of independent members on audit committees was welcomed and considered good practice.
11. As mentioned above, Resources Board members asked that the response should include a proposed way forward. The fundamental problem to be solved with such a way forward is that with the audit market and the impact it is having on councils. Redmond has made other recommendations that are wider than this (and some of those can be supported, at least in part) but the practical way forward should concentrate on this fundamental problem.
12. A way forward that would be consistent with the points made above would be as follows
- a. Oppose the creation of a new body, the office of local audit regulation, which would have incorporated the procurement functions of PSAA.
 - b. Instead, the current procurement arrangements with PSAA should be given more time to bed in before any (externally imposed) changes are considered. 2019 is effectively the first year that the new arrangements have operated in full.

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- c. As recommended by Redmond, a Liaison Committee be established comprising key stakeholders and chaired by MHCLG. This should be as outlined in the LGA's original submission.
 - d. Reduce fragmentation by exploring options to incorporate the audit of local NHS (which was not included in Redmond's terms of reference) within current local procurement arrangements and adding other public bodies as well. This would help build market capacity. Local NHS audit is currently undertaken by the same audit teams as local authority audit, so a solution for one affects the other.
 - e. Promote Redmond's call for coordination between MHCLG and DHSC
 - f. Push the accounts deadline back to 30 September, as recommended by Redmond.
 - g. Any increase in audit fees should be funded through the new burdens process.
13. Further points have also been made about the role of PSAA in managing performance against audit contracts. This needs to be done in a way that is consistent with maintaining audit quality, standards and independence. In the [LGA response to the annual consultation on audit fees](#) earlier this year, we highlighted issues that were going to have an impact on future audit fees and we called on PSAA to take a stronger role in managing the fee variation process, as well as being clearer to audited bodies on its role in managing the performance against existing contracts. There is scope for PSAA to strengthen its current role.
14. On 7 October PSAA sent a letter to all audit committee chairs and section 151 officers outlining [its response](#) to the review. In this response it notified that it has been reviewing the fee variation process and aims to publish proposals for consultation soon. Hopefully this will be an opportunity to improve the current arrangements without the need for merging procurement and regulation in a new body.

Next steps

15. It is proposed that a response to the review report, to go to the Secretary of State, is drafted based on the points outlined in paragraphs 10 to 14 above, approval of the final draft to be delegated to lead members of Resources Board.

Implications for Wales

16. The review applies to arrangements in England only.

Financial Implications

17. This is part of the LGA's core programme of work and as such has been budgeted for in 2020/21 core work programme budgets.



Executive Advisory Board

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Appendix - Recommendations made in report of Redmond Review

The full recommendations of this Review are as follows:

External Audit Regulation

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; and
 - regulating the local audit sector.
2. The current roles and responsibilities relating to local audit discharged by the:
 - Public Sector Audit Appointments (PSAA);
 - Institute of Chartered Accountants in England and Wales (ICAEW);
 - FRC/ARGA; and
 - The Comptroller and Auditor General (C&AG)to be transferred to the OLAR.
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.
4. The governance arrangements within local authorities be reviewed by local councils with the purpose of:
 - an annual report being submitted to Full Council by the external auditor;
 - consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and
 - formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.
5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.
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.
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.
8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

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9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.
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.
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.
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.
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.

Smaller Authorities Audit Regulation (SAAA)

14. SAAA considers whether the current level of external audit work commissioned for Parish Councils, Parish Meetings and Internal Drainage Boards (IDBs) and Other Smaller Authorities is proportionate to the nature and size of such organisations.
15. SAAA and OLAR examine the current arrangements for increasing audit activities and fees if a body's turnover exceeds £6.5m.
16. SAAA reviews the current arrangements, with auditors, for managing the resource implications for persistent and vexatious complaints against Parish Councils.

Financial Resilience of local authorities

17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.
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.

Transparency of Financial Reporting

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.
20. The standardised statement should be subject to external audit.

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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.
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.
23. Joint Panel on Accountability and Governance (JPAG) be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered:
 - Whether “Section 2 – the Accounting Statements” should be moved to the first page of the AGAR so that it is more prominent to readers;
 - Whether budgetary information along with the variance between outturn and budget should be included in the Accounting Statements; and
 - Whether the explanation of variances provided by the authority to the auditor should be disclosed in the AGAR as part of the Accounting Statements.