

31 March 2021**Agenda Item: 10****REPORT OF SERVICE DIRECTOR FOR FINANCE, INFRASTRUCTURE &
IMPROVEMENT****LOCAL AUTHORITY FINANCIAL REPORTING AND EXTERNAL AUDIT:
GOVERNMENT RESPONSE TO THE INDEPENDENT REVIEW****Purpose of the Report**

1. To provide members with an update on following the publication of the Government response to the recommendations arising from the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting.

Background

2. The responsibilities for the framework within which local authority audits are conducted is the Local Audit and Accountability Act 2014. When the Government abolished the Audit Commission and its centralised performance and inspection regimes it put in place a new localised audit regime, refocussing local accountability on improved transparency. Now the Act has been fully implemented, the Government had a commitment to review its effectiveness by undertaking a post implementation review of the audit framework and financial reporting elements of the Act.
3. In June 2019, the Government commissioned Sir Tony Redmond to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. The findings from Sir Redmond's report were published on 8 September 2020. The Review did not look at the broader issues of local authority finances and sustainability.
4. The guiding principles of the review were accountability and transparency. How are local authorities accountable to service users and taxpayers and how are auditors accountable for the quality of their work; and how easy is it for those same individuals to understand how their local authority has performed and what assurance they can take from external audit work.
5. The Committee received a report in October 2020 which set out the recommendations arising from the review. The Government published its response to the recommendation arising from the report on 17 December 2020 and this report updates Members on that response.

Summary of Key Findings from the Review

6. The Redmond Review highlighted 3 key problems:
- a. **Current local audit arrangements do not meet the policy objectives underpinning the Local Audit and Accountability Act 2014.** In particular, the Review identified weaknesses in the functioning and value of local audit, the timeliness of its findings and how these are considered and managed by local authorities;
 - b. **Market fragility.** Sir Tony Redmond highlighted how local audit is an unattractive market for audit firms and individual auditors to operate within. He indicated that “without prompt action... there is a significant risk that the firms currently holding local audit contracts will withdraw from the market”.
 - c. **Absence of system leadership.** The introduction of the localised audit framework in the 2014 Act spread roles and responsibilities for local audit across multiple organisations. Sir Tony Redmond argues this has contributed to a lack of coherency and makes resolving the weaknesses in the system challenging
7. In addition, the Redmond Review highlighted that the statutory accounts prepared by local authorities are widely agreed to be ‘impenetrable to the public’, limiting how effectively taxpayers can judge the performance of their authority.
8. Further evidence emerged after the Review when in October 2020, the Financial Reporting Council (FRC) issued its first inspection findings into the quality of major local audits. The FRC reviewed 15 audits across the seven largest audit firms, covering both the financial statement opinion and value for money conclusion, and found that 60% required improvement.

Summary of the Government Response to the Review

9. The Redmond Review made 23 recommendations relating to the quality, timeliness and sustainability of local audit, and the transparency of local authority accounts. The response from the Ministry of Housing, Communities and Local Government (MHCLG) grouped its response into 5 themes:

a) **Action to support immediate market stability**

The department recognises the Redmond Review’s findings regarding the fragility of the local audit market and agrees that urgent action is required. The department accepts that the actions to support immediate market stability will not by themselves solve these problems, but they will help to alleviate some of the immediate funding and timing pressures facing audit firms and local authorities.

Subject to consultation, the department will review and reform regulations to provide the appointing person with greater flexibility to ensure the costs to audit firms of additional work are met. This could include enabling the appointing person to allow a fee scale to be set or changed in-year (subject to consultation with the auditor and the audited body), and/or enabling the appointing person (subject to appropriate consultation) to set additional fees across groupings of audited bodies in-year where there is clear evidence of additional work that affects those groupings.

In addition, the department will provide the sector with £15 million of additional funding in the 2021/22 financial year to support affected local bodies to meet the anticipated increase in auditor fees and to meet new burdens on councils as a result of new reporting requirements. The department will continue to monitor the financial impact of auditor fees on local government in future years.

The Review highlighted the high entry criteria for Key Audit Partners (KAPs), exacerbating staffing supply issues and making it difficult for new firms to enter the market. Consequently, the department will seek to work with the FRC and Institute of Chartered Accountants in England and Wales (ICAEW) to review entry requirements for KAPs within the scope of the existing regulatory framework, noting that again an appropriate balance needs to be struck between ensuring quality and market sustainability. Depending on the results of this work, the department will consider whether legislative change may be required.

The department will consult in the new year on how best to amend the existing regulations, with a view to having revised regulations in place before the 2021 summer recess which will set out the requirement to produce audited accounts to the 30 September from 31 July each year.

b) Consideration of system leadership options

The Review's central proposal, through a number of recommendations, was the establishment of a new independent regulator for local audit – the Office of Local Audit and Regulation (OLAR)

The department anticipates that the measures outlined elsewhere in their response will help to tackle the immediate risks in the local audit system. Early action to reform fee regulations, extend the audited account publication deadline, improve auditor training and review the KAP entry criteria are all possible within the existing local audit framework. So too is improving the transparency of local authorities' accounts and how audit outcomes are considered by local authorities.

However, the creation of a new overarching body would mark a significant departure from the 2014 Act. The Department remains committed to a locally-led audit regime which enables genuine local accountability by residents and taxpayers. Consequently, the department does not wish to re-create the costly, bureaucratic and over-centralised Audit Commission. It is government's long-standing intention not to create new arms-length bodies. Unless there is an exceptional reason for a new body, government should look to explore other options for delivering new services or functions and are not currently persuaded that a new arms-length body is required.

The Department will also consider what reporting they would expect to receive and how that could inform and strengthen the department's framework for seeking assurance that financial sustainability in each local authority in England is maintained. They particularly note the potential value in the regular production of analysis highlighting trends in local audit findings across England.

Noting the significance of this work to the future operation of the local audit framework, the department plans to engage widely across both the local audit sector and Government on

these questions. The department intends to make a full response on the above recommendations by spring 2021.

c) Enhancing the functioning of local audit, and the governance for responding to its findings

The department agrees with Sir Tony Redmond's judgment that the effectiveness of audit is, in part, reliant on the arrangements in place to ensure that concerns are effectively considered and acted upon by local authorities. The department is grateful to Sir Tony Redmond for identifying a number of practical ways in which the profile and operation of audit can be raised within local public bodies, noting that, in some instances, existing governance arrangements fail to appropriately escalate concerns identified by external audits.

The department strongly agrees with the Review's recommendation that the external auditor be required to present an annual audit report to a Full Council meeting, irrespective of whether the accounts have been certified. Although it is noted that many local authorities feel existing reporting arrangements to audit committees are sufficient, the department believes that presentation to Full Council is an important opportunity for potential risks or concerns to be escalated in a timely way and that this should be best practice. The department will explore options with relevant stakeholders including the Local Government Association (LGA) and the National Audit Office (NAO) as to how this can best be achieved, and whether the 30 September milestone is most appropriate. If a legislative opportunity arises, the department will consider enshrining this in statute.

d) Improving transparency of local authorities' accounts to the public

The department agrees with the recommendations that all local authorities be required to prepare an audited standardised statement of service information and costs. These should be short and accessible, for example one or two pages. Standardised statements should be communicated to all taxpayers and service users, and the department will explore how this can be done, for example, alongside or with council tax bills from 2022.

The ambition is for the standardised statements to be introduced as soon as possible. The department will work closely with the Chartered Institute for Public Finance and Accountancy (CIPFA) as they lead on the development and consultation with local government to produce a product, with a view to rolling statements out in 2021/22. As part of this work the department is considering whether there is a need to change regulations to mandate the inclusion of the statement alongside the accounts. The department will also engage with the NAO on the required changes to the Code of Audit Practice.

Finally, the department agrees that this is an opportunity for CIPFA/LASAAC (Local Authority (Scotland) Accounts Advisory Committee) consider whether there is scope to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary. The earliest that simplification could be reasonably incorporated into the main accounts is through the 2022/23 Accounting Code, and the department will work with CIPFA LASAAC to determine what can feasibly be achieved in that time scale. Depending on the ambition, significant changes to the accounts may require a phased approach. The department will consider further with CIPFA LASAAC.

e) Action to further consider the functioning of local audit for smaller bodies

The department welcomes the finding that no serious concerns were identified with the functioning of local audit for smaller bodies.

The department notes the recommendations to review the proportionality of external audit for smaller bodies, current arrangements for managing persistent complaints against parish councils and the transparency of the Annual Governance and Accountability Return (AGAR). The Department would welcome action by Smaller Authorities' Audit Appointment (SAAA) and Joint National Association of Local Councils (JPAG) on these recommendations.

In its consideration of options as to how best to establish strong systems leadership for local audit, the department will consider the implications for the functioning of local audit for smaller bodies, not least because smaller bodies are regulated by the same Code of Audit Practice. This will include consideration as to how any new systems leader for local audit should work with SAAA to examine assurance levels and fees if a body's turnover exceeds £6.5 million.

Other Options Considered

10. The report presents members with an update on the Government responses to the recommendations from the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting. No other options were considered.

Reason/s for Recommendation/s

11. To present members with the opportunity to consider the content of the Government responses to the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting.
12. A number of the responses point to further consultations that will appear either directly with local government or other relevant government bodies over the coming year.

Statutory and Policy Implications

13. This report has been compiled after consideration of implications in respect of crime and disorder, data protection and information governance finance, human resources, human rights, the NHS Constitution (public health services), the public sector equality duty, safeguarding of children and adults at risk, service users, smarter working, sustainability and the environment and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

- 1) Members consider whether there are any actions they require in relation to the Government responses to the recommendations arising from the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting.

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For any enquiries about this report please contact:

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Constitutional Comments (KK 18/03/2021)

14. The proposal in this report is within the remit of the Governance and Ethics Committee.

Financial Comments (NS 26/02/2021)

15. There are no specific financial implications arising from this report.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- None

Electoral Division(s) and Member(s) Affected

- All