

# Report to the Audit & Governance Committee



**Report reference:** AGC-011-2020/21  
**Date of meeting:** 28 September 2020

**Epping Forest  
District Council**

**Portfolio:** Finance & Economic Development

**Subject:** The Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting (the “Redmond Review”)

**Responsible Officer:** Andrew Small (01992 564278).

**Democratic Services:** Gary Woodhall (01992 564243).

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## Recommendations/Decisions Required:

- (1) To note the contents of the report, which outlines the findings, conclusions and recommendations contained in the Redmond Review published in September 2020, including **Appendix A** (*Review Recommendations*).

## Executive Summary:

The *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting* (“the Redmond Review”) was published on 8th September 2020.

The Review examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It also considered whether the current means of reporting an authority’s annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of an authority are sound.

Redmond notes “serious concerns” were expressed (by consultees) about the state of the local audit market and the ultimate effectiveness of the work undertaken by audit firms. Specifically, whether such audit reports deliver full assurance on the financial sustainability and value for money of every authority subject to audit; in particular, evidence submitted to the review noted concerns about the balance of price and quality in the structure of audit contracts.

The fragmentation of the existing local government accounting and audit framework following the demise of the Audit Commission in 2015 was pinpointed as key area for reform, with the creation of a new regulatory body – “the Office of Local Audit and Regulation” (OLAR) – recommended; the new body would have specific responsibility for procurement, contract management, regulation, and oversight of local audit.

The Review was also critical of the current size of audit fees (which have fallen dramatically in recent years) and recommends extending the deadline for the publication of audited accounts to 30th September (compared to the current 30th July deadline).

Governance arrangements also came under the spotlight, including Audit Committees and the assurance given by auditors in their audit opinions. Consequently, a review of the composition of Audit Committees is recommended, and the switch to a narrative report – including a financial resilience assessment – on the value-for-money (VFM) opinion, which is included in the updated National Audit Office (NAO) Audit Code 2020 is supported. Redmond urges statutory status for the

principles in CIPFA's Financial Management Code as a means of better judging financial resilience.

In terms of financial reporting, Redmond highlights what many perceive as the "impenetrable" nature of local government accounts and recommends a simplified statement of service information and costs be prepared alongside the statutory accounts (and be subject to audit).

The implementation of the recommendations would, in part, require regulatory or legislative change and Redmond's report is now being considered by the Government.

## **Reasons for Proposed Decision:**

To update members of the Audit and Governance Committee on important developments affecting the local authority accounting and audit regime.

### **1) INTRODUCTION AND BACKGROUND**

1.1 In June 2019, Sir Tony Redmond was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. The review commenced with the publication of a "Call for Views" in September 2019. It was the start of an extensive consultation and review process, which ultimately considered 156 consultation responses, along with more than 100 interviews conducted as part of the review process. The *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting* ("the Redmond Review") was published on 8th September 2020.

1.2 The Review examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It also considered whether the current means of reporting an authority's annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of an authority are sound.

### **2) DIRECTION, REGULATION, PROCUREMENT AND PERFORMANCE**

2.1 The Local Audit and Accountability Act 2014 (the 2014 Act) introduced a new local government accounting and audit regime, replacing the previous role of the Audit Commission. This now entails six different entities, each with a statutory role in overseeing and/or regulating the different elements of the framework; no single entity is required to act as 'system leader' or to make sure that the framework operates in a joined-up and coherent manner.

2.2 Public Sector Audit Appointments Ltd. (PSAA) is the appointing body for 98% of local authority audits and manages the audit contracts. However, there are widespread concerns as to the way in which the PSAA role is working, with 40% of audits failing to meet the reporting deadline in 2018/19 being one example highlighted by the Review.

2.3 Audit fees were identified as a significant detrimental factor (e.g. since 2015, audit fees paid by local authorities have dropped by 42.25% in cash terms) with the review concluding that "an increase in fees must be a consideration" with serious concerns expressed about the fee structure and the ability of auditors to fulfil their role.

2.4 Extending the audit deadline to 30th September is a proposal supported, although it is argued that this will only partly address the quality problem (e.g. which is manifesting itself in areas such as a pattern of declining knowledge, experience and continuity in audit staff).

- 2.5 The fragmentation of the existing framework is also seen as a major impediment and Redmond therefore states that a coherent local audit function can only be achieved by creating a body, which can co-ordinate all stages of the audit process.
- 2.6 Consequently, a headline recommendation is the creation of a new regulatory body – “the Office of Local Audit and Regulation” (OLAR) – responsible for procurement, contract management, regulation, and oversight of local audit. That body would:
- Liaise with the Financial Reporting Council (FRC) regarding its role in setting auditing standards
  - Engage audit firms to perform the local audit role; and
  - Oversee a new price/quality regime to ensure that audits were performed by auditors who possessed the skills, expertise and experience necessary to fulfil the audit of local authorities.
- 2.7 Auditors would be held accountable for performance by the new regulator, underpinned by an updated Code of Local Audit Practice. Engagement between local audit and Inspectorates would also be formalised.
- 2.8 The new regulator would be supported by a Liaison Committee comprising key stakeholders and chaired by the MHCLG.
- 2.9 Whilst the additional costs arising from fee increases are self-evident (although the report does not include an estimate), Redmond cites annual running costs in the region of £5 million for the new regulatory body.

### **3) GOVERNANCE**

- 3.1 The composition of Audit Committees also came under the spotlight of the review. Local authority accounts are very complex and the review highlights what appears to be a significant difference between the assurance that external auditors provide and public expectations. Redmond cites growing evidence (from sources such as the Financial Reporting Council) of a mixed picture nationally in the level of capacity and engagement amongst Audit Committees, with 60% having no independent members.
- 3.2 The review concludes that Audit Committee membership should be reviewed in order to ensure that the required knowledge and expertise are always present when considering reports, together with the requirement that at least an annual audit report should be submitted to full Council.....“this demonstrates transparency and accountability from a public perspective which is currently lacking in many authorities” argues Redmond.
- 3.3 Audit work on the financial resilience of local authorities was also an area of focus. In England, appointed auditors are required to provide two audit opinions; a ‘financial opinion’ and a ‘value-for-money opinion’. Both opinions are ‘binary’ in nature and neither provides an opinion on whether a local authority is financially sustainable. Redmond argues that “it is legitimate to expect the auditor to examine the ability of the local authority to provide resources sufficient to deliver the statutory services for which it is responsible”.
- 3.4 The Review is therefore supportive of the revised narrative opinion proposed in the new NAO Audit Code. The 2020 Code sets out three reporting criteria:

- Financial Sustainability – how the body plans and manages its resources to ensure that it can continue to deliver its services
- Governance – how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving Economy, Efficiency and Effectiveness – how the body uses information about its costs and performance to improve the way it manages and delivers its services.

3.5 The Review explores the potential audit work required on financial resilience, suggesting “a new model for England” that would utilise the following:

- CIPFA’s “Pillars of Financial Resilience” (published 2017) – covering financial management, benchmarking, delivering savings and managing reserves; and
- CIPFA’s “Financial Management Code” (published 2019) – providing a set of standards against which auditors could assess value for money and financial resilience. Redmond argues that the principles of the Code should be given statutory status and that would enhance the consistency of local authority financial management.

#### **4) FINANCIAL REPORTING**

4.1 Local authority accounts are very lengthy compared to accounts prepared in other sectors (e.g. they are nearly always in excess of 50 pages for shire districts).

4.2 It is also argued that they are more complex and more challenging for service users to understand than accounts produced by other parts of the public sector; this is primarily due to the difference between the budget analysis of information for Council Tax purposes and the statutory basis of year-end accounts.

4.3 It is therefore not surprising that feedback from review consultees revealed that current statutory accounts prepared by local authorities are considered “impenetrable” to the public.

4.4 A simplified (“summary”) statement of service information and costs is therefore recommended by the review, prepared in a way which enables comparison with the annual budget and Council Tax set for the year. The new statement would be prepared in addition to the statutory accounts (which themselves could be simplified).

4.5 In addition, Redmond argues that “all means of communicating such information should be explored to achieve access to all communities”.

#### **5) CONCLUSION AND IMPLEMENTATION**

5.1 In Redmond’s words, the review is aimed at delivering “a new framework for effective local audit and an annual financial statement which enables all stakeholders to hold local authorities to account for their performance, together with a robust and effective audit reporting regime”.

5.2 The implementation of the recommendations would, in part, require regulatory or legislative change, but Redmond emphasises that the issues identified in the report “require urgent attention”.

5.3 The Review report is now in the hands of the Government, with the Secretary of State for Local Government, the Rt Hon Robert Jenrick MP stating....“I will consider the findings and recommendations carefully and remain committed to strengthening the local audit system so that it works more effectively for taxpayers and councils”.

5.4 The Review recommendations are listed in full in **Appendix A**.

### **Legal and Governance Implications:**

Local authority financial reporting and external audit exist within a clear legal framework, which is covered in the report.

### **Safer, Cleaner and Greener (SCG) Implications:**

There are no direct SCG implications contained within the report.

### **Consultation Undertaken:**

The “Call for Views” consultation exercise ran from 17th September to 20th December 2019.

### **Background Papers:**

The *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting* (Sir Tony Redmond, September 2020) can be viewed via the following link...  
[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/916217/Redmond\\_Review.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916217/Redmond_Review.pdf)

### **Risk Management:**

There are a range of risks associated with local authority accounting and audit ranging from reputational damage to the Council through to the loss of public funds through fraud and error and a lack of accountability; the accounting and audit regime should act as a key mitigating control.

## **Redmond Review Recommendations (September 2020)**

### **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.
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**

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.
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. 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.