

REPORT OF THE CITY SOLICITOR

TO THE AUDIT & ACCOUNTS COMMITTEE

WEDNESDAY 29th SEPTEMBER 2021

TITLE: GOVERNMENT RESPONSE TO THE REDMOND REVIEW

RECOMMENDATIONS:

1. That Members note and comment on the report below.
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EXECUTIVE SUMMARY: In June 2019, Sir Tony Redmond was asked by the Ministry of Housing, Communities and Local Government to undertake a review of the effectiveness of local audit and the transparency of local authority financial reporting. His report contained 23 recommendations. The Government subsequently provided an initial response to the Review and its recommendations in December 2020.

This Committee report provides members with an overview of the background to the Redmond Review, the key findings and the recommendations. This report also provides an overview of the Government's response to Sir Tony Redmond's report and the next steps.

BACKGROUND DOCUMENTS: N/A

KEY DECISION: No

DETAILS:

Background to the Redmond Review

In June 2019, Sir Tony Redmond was asked by the Ministry of Housing, Communities and Local Government to undertake a review of the effectiveness of local audit and the transparency of local authority financial reporting. The main driver for the review was concern that the local public audit market was not operating effectively following the changes brought in by the Local Audit and Accountability Act 2014 ("The Act").

The Act abolished the Audit Commission and allocated its responsibilities to six different bodies:

- Local Government Association (LGA) – sector improvement and peer challenge
- PSAA Ltd – set up by the LGA, is the appointing body for 98% of local authority audits
- Comptroller and Auditor General / National Audit Office – sets the Code of Local Audit Practice
- Financial Reporting Council – sets UK accounting standards; quality monitoring for larger local authority accounts
- ICAEW – registration of local authority Key Accounting Partners (those accountants with the ability to sign off a local authority's accounts)
- CIPFA – sets the Code of Local Accounting Practice and sector specific good practice guidance.

By 2019, the two main concerns about the operation of this model were that:

- It had not succeeded in its aim of bringing more participants into the local public audit market – only eight firms were in the market, with two of these (EY and Grant Thornton) being responsible for 70% of local authority audits
- Local authority accounts had become more complex, particularly in relation to their borrowings, investments and financial instruments – largely as a response to reduced central funding.

There were also a number of other concerns related to these two key issues:

- There was no current “system leader” for local public audits, with oversight of procurement, quality and regulation
- Audits becoming increasingly late in being completed – 40% missed statutory deadline 18/19. Local authorities receiving their Audit Planning reports too late for them to act on any risks identified.
- Number and size of fee variation requests increased – there had been no new risk assessment of local authorities in 10 years, so fee size not in line with relative risk profiles of local authorities.
- Audit fees for local authority audits have decreased, but increased in other sectors – consequently local public audit has become less attractive for accountants (compressed workload, low profitability), leading to a fall in the number of KAPs. Concerns from local authorities that auditors lack skills relevant to the new more commercial environment, also issues with continuity and visibility of staff.
- FRC criticised audit firms over their local audit processes, identifying a number of significant improvement issues around asset valuations, fraud risk assessments, completeness and accuracy of expenditure.
- Currently no mechanism for individual local authorities to complain about the quality of auditor's service.

Key findings of the Redmond Review

The Redmond Review sought the views of key stakeholders, including local authorities and audit firms. The report, published in September 2020, echoed the issues identified above and also came to the following conclusions:

- Audit work doesn't really cover the most important areas of the accounts from the point of view of the external stakeholders and the public. Local authorities stated there was too much emphasis on pensions and asset valuations and not enough on systems / internal controls / Value for Money. There was also scope to make greater use of the experience and knowledge of internal auditors.
- Local authority accounts are overly complicated – legal reporting requirements make the Statement of Accounts too complex for anyone to understand properly.
- No statutory basis for auditors to consider financial resilience – auditors only look at the Medium Term Financial Plan if they have identified significant risks in their audit.
- Auditors only review the Annual Governance Statement to ensure consistency with the accounts.
- No requirement for anyone to produce an annual report summarising the work of local public auditors.

The report also contained some findings directly relating to local authorities' own governance arrangements:

- In some cases, significant governance issues were not being passed on to Full Council after having been reported to an Audit Committee.
- Lack of relevant experience amongst some Audit Committee members enabling them properly to challenge audit findings.

Redmond Review Recommendations

The report on the Redmond Review contained 23 recommendations relating to: external audit regulation; smaller authorities audit regulation; financial resilience of local authorities and transparency of financial reporting. The key recommendations were:

- New regulatory body (the Office of Local Audit and Regulation) to be responsible for procurement, contract management, regulation and oversight of local public audit (including responsibility for the Code of Practice) – and to hold auditors accountable for performance.
- Formalise engagement between auditors and other inspectorates (e.g. OFSTED , CQC), to share relevant findings and identify wider governance failures.
- Revise the fee structure to ensure adequate resourcing and remove any existing statutory barriers for new entrants to the local public audit market.
- Simplified statement of service information and costs, showing original budgets and variations; removal of unnecessary disclosures.
- Final accounts deadline to be put back to 30 September - Auditors to provide an annual report to full Council after this date.

- Audit committees to have appropriate skills to be able to consider reports – and have at least one suitably qualified Independent Member.
- Internal Audit to be a key support to the Auditor, where consistent with the Code of Practice.

Shortly after the publication of the report, 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.

The government response to the review

The government provided an initial response to the Review and its recommendations in December 2020. As part of its response, the government agreed to extend the deadline for publishing audited local authority accounts to 30 September for the years 2020/21 and 2021/22, with the timetable to be reviewed at the end of this period for future years.

The government also committed to providing £15 million to local authorities in 2021/22, to reflect anticipated increases in audit fees. It also confirmed that Public Sector Audit Appointments will continue as the appointing body for local audit, in charge of procurement and contract management for local government auditors.

The government provided a more detailed response to all of the recommendations in May 2021. In this, the government expressed disagreement with the recommendation about the establishment of the Office of Local Audit and Regulation (OLAR), stating that it is not its intention to create new arm's-length bodies. Instead, it has proposed that the responsibilities envisaged to be assigned to the OLAR should instead be taken on by the Audit, Reporting and Governance Authority (ARGA), which is the new body that is intended to take over the functions of the Financial Reporting Council. The government has proposed establishing a new department within ARGA to take on responsibility for local audit-related work, including oversight and inspection.

The Review identified an “expectations gap” between what auditors are required to do, and what local authorities and taxpayers expect, when auditors are assessing the financial resilience of local authorities. The government considers that the new value for money requirements in the updated Code of Audit Practice, which include a new commentary on governance, arrangements for achieving financial sustainability, and improving economy, efficiency and effectiveness - should help to address this.

In response to the concerns about the fragility of the local public audit market, government will expect that the next procurement exercise, for audits starting in 2023/24, will include a strong focus on market development, to support the long-term competitiveness and sustainability of the local public audit market. The exact details of this are still to be agreed, but consideration is being given to changing the number of contract bidding lots, and adjusting the price:quality ratio used for assessing bids.

In June 2021, the government ran a consultation on proposed changes to the Local Audit (Appointing Person) Regulations 2015, covering the Redmond review recommendations relating to the appointment of auditors and the fee-setting arrangements.

In response, the government has committed to introducing secondary legislation to amend the Local Audit (Appointing Person) Regulations 2015 to:

- extend the regulatory deadline by which scale fees need to be set to before 30 November of the financial year to which the scale of fees relates.
- enable the appointing person to set standardised fee variations for additional work that will affect all bodies or groupings of bodies, subject to sufficient evidence, research and consultation.
- provide clarification on the ability of the appointing person (PSAA) to approve requests for fee variations during the audit.
- provide clarification on the ability of the appointing person to appoint an auditor for a contract of shorter duration than the compulsory appointing period

The intention is that the updated regulations will come in force this autumn.

Next steps

MHCLG currently have a further consultation open on proposals for the implementation of the other recommendations in the Report. This covers such areas as:

- The role and powers of the ARGA as the system leader for local public audit, including health audits.
- Assessing whether the new value for money narrative requirement will lead to more effective external audit consideration of financial resilience and value for money matters.
- Annual reporting requirements for ARGAs on the state of the local public audit market, and summarising the results of audits.
- The continuation of PSAA as the appointing body for audits, with the ability of local authorities to opt in to the procurement arrangement.
- Updating the CIPFA document *Audit Committees: Practical Guidance for Local Authorities*, particularly in the areas covering: requirements for independent members; knowledge, expertise and training; interacting with Full Council and raising the profile of the Audit Committee.
- Auditors reporting findings to Full Council, with the Audit Committee reporting on its responses to the auditor's findings.

We will report back to Audit and Corporate Governance Committee in due course on the outcome of this consultation.

A recent Public Accounts Committee Report on "Local auditor reporting on local government in England" has expressed concern that the proposed ARGAs will not be set up until 2023 at the earliest, raising the risk that measures to improve the "current failings in the market for auditing local authorities" will not be implemented in a timely manner. The Committee has requested that MHCLG report back to it by September 2021, setting out how it intends to address these issues in the period before the ARGAs are operational.

Conclusion

The implementation of the Redmond Review recommendations is intended to deliver a step change in the local public audit market, with the aim of delivering timely, quality audits to improve accountability to taxpayers and other council stakeholders. We will

provide the Audit and Accounts Committee with regular updates on progress with the recommendations at key stages in the next two years.

KEY COUNCIL POLICIES: None noted

EQUALITY IMPACT ASSESSMENT AND IMPLICATIONS: None noted

ASSESSMENT OF RISK:

An effective and timely audit process is key to providing assurance to local tax payers and other stakeholders that the council is managing public money effectively and efficiently. A lack of adequate capacity within the audit market increases the risk of councils' accounts not being audited within statutory timescales.

LEGAL IMPLICATIONS Supplied by: Nicky Smith, Senior Solicitor

Regulation 6(1)(a) of the Accounts and Audit Regulations 2015 requires an authority to conduct a review at least once in a year of the effectiveness of its system of internal control and prepare an annual governance statement. To assist authorities in 2020/21, CIPFA has produced a summary that incorporates the essential elements of an AGS, which the Council has taken into account in preparing this. As explained in the report, the Committee will be updated with regard to any changes brought into force following the Redmond Review, including any secondary legislation on which Legal can provide any guidance as necessary.

FINANCIAL IMPLICATIONS Supplied by: Chris Hesketh, Head of Financial Management

The Government recognises that there will be an impact on fees charged by external auditors. It has committed to distributing £15m to local authorities in 2021/22, in proportion to current scale fees paid. We await further details. It is not yet clear what compensation might be distributed after 2021/22. The impact of the Government's further consultation, reported on in "next steps" in the report, will be evaluated in due course.

PROCUREMENT IMPLICATIONS Supplied by: N/A

There are no known procurement implications with this report.

HR IMPLICATIONS Supplied by: N/A

There are no known HR implications with this report.

CLIMATE CHANGE IMPLICATIONS Supplied by: N/A

OTHER DIRECTORATES CONSULTED: All Service Group Strategic Directors and Corporate Management Team.

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WARDS TO WHICH REPORT RELATES: N/A