

Local Audit Update

Cabinet Member for Finance, Procurement and Revenues & Benefits

Date: 22 September 2021
Agenda Item: 6
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Key Decision? NO
Local Ward Members Full Council



**Audit and Member
Standards
Committee**

1. Executive Summary

- 1.1. To provide the Audit and Member Standards Committee with an update on the various elements of the Local Audit Framework.

2. Recommendations

- 2.1. To note the contents of the Report and the requirement to decide whether to opt in to the PSAA sector led procurement by Full Council by January 2022.

3. Background

The Redmond Review

- 3.1. The Committee received a report on 3 February 2021 in relation to the recommendations of the Redmond Review and the Government's response published on 17 December 2020.
- 3.2. The recommendations of the Redmond Review are explained in the following paragraphs.

External Audit Regulation

- 3.3. A new Office for Local Audit Regulation (OLAR) which will:
 - regulate the local audit sector
 - draft the code of audit practice
 - take over the responsibilities of the Public Sector Audit Appointments (PSAA) for procuring and managing audit contracts
 - monitor and review audit performance
 - produce an annual report on the state of local audit
 - A key role that OLAR will not have is to actually carry out audits – the Review does not appear to have addressed the question whether there is a role for public audit and assumes work will be contracted out in its entirety to private firms.
- 3.4. The involvement of PSAA, Institute of Chartered Accountants of England and Wales (ICAEW), Financial Reporting Council (FRC) and the National Audit Office (NAO) in the framework will end.
- 3.5. Local authority governance arrangements to be reviewed with the purpose of:
 - full council receiving an annual report from the external auditor – to the first meeting after 30 September, even if the audit is not certified closed
 - appointment of a suitably qualified independent member to the Audit Committee
 - Formalising meetings of the Chief Executive, Monitoring Officer and the Chief Finance Officer (Section 151) with the audit partner at least annually.

3.6. In terms of other recommendations:

- All auditors to be provided with the requisite skills and training to audit a local authority.
- Audit quality to be consistent with the highest standards of audit within the revised fee structure – OLAR to have scope to apply proportionate sanctions in the event of serious or persistent breaches.
- No firm with the requisite capacity, skills and experience to be excluded from bidding for contracts.
- Internal audit to be recognised as a key support for external audit.
- Consideration to be given to moving the date for publication of audited accounts back to 30 September.
- Changes to the arrangements for Value for Money (VFM) auditing made in the 2020 Code of Audit Practice to be endorsed (reporting on and making recommendations in relation to financial sustainability, governance and improving VFM).

Financial Resilience

3.7. The specific recommendations in relation to financial resilience were:

- Ministry of Housing and Local Government (MHCLG) to review its framework for seeking assurance about the sustainability of individual authorities.
- Auditors to share key concerns with Ofsted, Care Quality Commission, etc., before completing their annual report.

Transparency of Financial Reporting

3.8. The specific recommendations in relation to financial reporting were:

- An audited statement of service information and costs (with budget comparisons) to be presented alongside the statement of accounts.
- Chartered Institute of Public Finance and Accountancy (CIPFA)/Local Authority (Scotland) Accounts Advisory Committee (LASAAC) to be required to review the requirements for the statutory accounts in light of the information to be covered in the statement of service information.

The Government's Response to the Redmond Review

- 3.9. The response by MHCLG was published on 17 December 2020. The main points are set out below:
- The date for publication of audited accounts is to be 30 September for 2020/21 and 2021/22, but could then return to 31 July if MHCLG decides that other improvements following the Review have made this a viable and sustainable option. There is no mention of the deadline for publication of unaudited accounts moving from 31 May.
 - MHCLG will engage with local government to better understand the **barriers to timely completion of accounts** attributable to capacity and capability of finance teams and consider how they might be addressed.
 - MHCLG will explore how **standardised statements of service information** should be communicated to all tax payers and service users, and will explain how this can be done, for example, alongside or with Council Tax bills from 2022. The wish is that statements should be short and accessible (two pages) and subject to audit.
 - MHCLG is to work with Chartered Institute of Public Finance and Accountancy (CIPFA)/Local Authority (Scotland) Accounts Advisory Committee (LASAAC) to **remove accounts disclosures** that may no longer be necessary, with a target of making a start in the 2022/23 Accounting Code.
 - There will be **£15 million** additional funding for authorities in 2021/22 to meet **higher audit fees and costs of preparing for the standardised statement of service costs**.
 - There will be **no Office of Local Audit** until the Government understands in more detail how a system leader could resolve the weaknesses in the local audit system, and can ensure that any consequences of its establishment, such as potential conflicts of interest within the organisation, are identified and can be mitigated. A boost to OLAR's prospects would be if the regular production of **analysis highlighting trends in local audit findings** could inform and strengthen MHCLG's framework for seeking assurance that financial sustainability in each local authority is maintained.
 - A decision is to be made by spring 2021 as to whether PSAA will be the **future appointing body for local authority audit**, and (whoever it may be) how the appointing body can most effectively carry out its functions.
 - MHCLG will work with CIPFA, ICAEW and the FRC to help improve the update of **local audit training**.
 - MHCLG to work with the FRC and ICAEW to review whether **entry requirements for Key Audit Partners** are too high, with the objective of making it easier for new firms to enter the market.
 - The Government will consider whether and how **a new corporate auditing profession** (recommended for the commercial sector by the Brydon Report) could continue to generate auditors with skills that are transferable to public sector audit.
 - MHCLG will look for an opportunity to legislate for the Redmond Review's recommendation that the external auditor be required to present an **annual audit report to a Full Council meeting**.

Local authority Financial Reporting and External Audit: Spring update

- 3.10. The MHCLG response in December 2020 set out proposed actions to implement the majority of the Redmond Review recommendations and also made a commitment to provide a full response in the spring, on the options for systems leadership, after further consideration.
- 3.11. The spring update was published on 19 May 2021. The key points of the update were:
- There is to be a systems leader, but it is not the Office of Local Audit Regulation. Instead, a department will be established within the Audit, Reporting and Governance Authority (ARGA) (the successor to the FRC). It will also take on responsibility for the Code of Audit Practice.
 - ARGA will chair a Liaison Committee of senior stakeholders, and forums will be established for engaging with local bodies and firms to ensure that audits are properly focused on areas of most risk, and that firms have a clear understanding of priorities for the sector and are able to escalate issues and concerns where necessary.
 - PSAA stays as the auditor appointing body (for those that do not opt out of the next contracting round).

The House of Commons Committee on Public Accounts Report on Local Auditor Reporting on Local Government

- 3.12. This report was published on 16 March 2021 and was initiated as a result of the missed audit deadlines (in terms of opinions, 87% were issued in 2017/18, 57% were issued in 2018-19 and 45% were issued in 2019-20 by the deadline). However the report's recommendations cover a wider range of issues and these are explained below.
- 3.13. MHCLG to write to Public Accounts Committee (PAC) by September 2021 explaining:
- a detailed plan and timetable for getting local audit timeliness back on track
 - what contingencies it has in place should audit firms leave the market at the end of their contracts in 2023
 - how it will address the need for strong system leadership now, while ARGA is being set up and established
 - how it will work with Department of Business, Enterprise and Industrial Strategy (BEIS) to set up Audit, Reporting and Governance Authority (ARGA), the accountability and governance arrangements, and how its performance will be monitored and evaluated
 - detailed plans for agreeing with stakeholders ways to focus local authority accounts and audits on areas of greatest risk and concern to citizens
- 3.14. PSAA's 2023/24 procurement exercise to support a fee regime which is appropriately funded, and which brings fees into line with the costs of the work
- 3.15. MHCLG to work with the FRC and the accountancy institutions to implement accelerated training and accreditation to increase the supply of qualified auditors quickly, and to build attractive career paths in local audit

The Local Audit Framework Consultation

3.16. MHCLG announced on 28 July 2021 a consultation, on its proposals as part of the government's response to the Redmond Review, that covered:

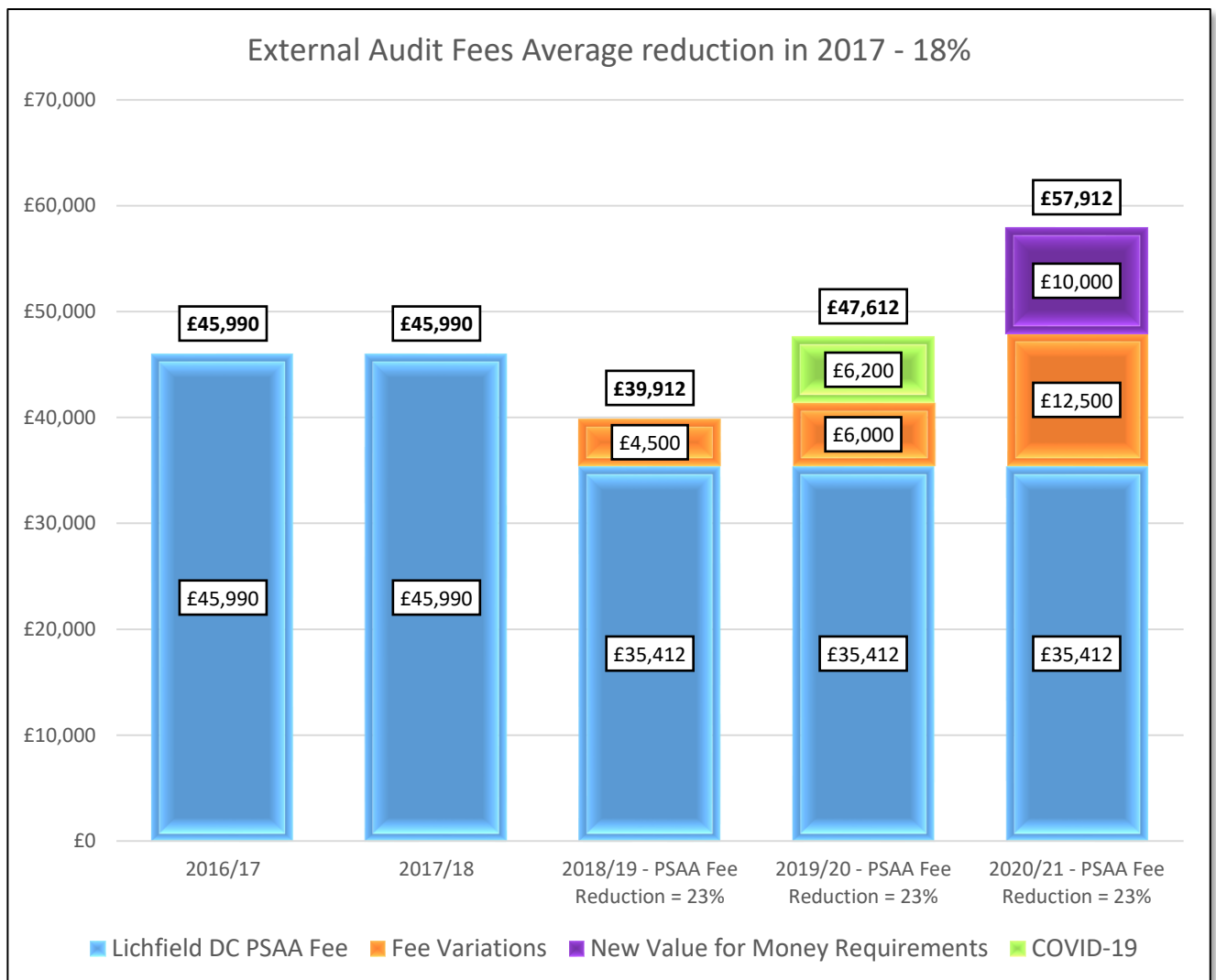
- **A new system leader for the local audit framework** – the intention is that the Audit, Reporting and Governance Authority (ARGA) will be the system leader. This will involve taking over the National Audit Office's responsibility for the Code of Audit practice and the provision of technical guidance to auditors. A new role will be to chair a liaison Committee of senior stakeholders that will coordinate local audit efforts and be proactive in managing risks. ARGA will have a nominated board member with responsibility for local audit
- **Proposals to strengthen audit committee arrangements within councils** – consideration is being given as to whether it should be a statutory requirement to have an Audit Committee. There is particular interest in making sure the Audit Committee has an effective position in the overall committee structure, the ability to be heard by full council, the duty to report significant issues, knowledge/expertise/training for members, enhanced input from independent members, and facilities for auditors to meet privately with the Audit Committee or Council. The Accounts and Audit Regulations will be amended so that auditors will present their annual audit findings to full council, accompanied by a report from the Audit Committee with responses to the findings. This would take place at the first meeting of full council after the Audit Committee has considered the findings. Consideration will also be given to how external auditors can best reflect that authorities are required, by the Accounts and Audit Regulations, to have an effective internal audit to evaluate the effectiveness of risk management, control and governance processes.
- **Measures to address ongoing capacity issues on the pipeline of local auditors** - Work is ongoing to determine whether alternative routes to becoming a Key Audit Partner are feasible, without lowering standards, and whether it would be advisable to allow ICAEW greater discretion in determining the suitability of the experience gained by applicants. There is also consideration of options for offering additional training and specialist support. This could include top-up qualifications for prospective KAPs and a technical advisory service to provide advice on difficult areas of judgement particularly regarding quasi-judicial functions and undertake hot and/or cold file reviews. It is recognised that there is a need to foster a greater understanding between the preparers and users of the accounts and the auditors
- **Action to further consider local audit functions for smaller bodies** – Parish Councils.

3.17. The deadline for response is 11.45pm on 22 September 2021 and the Council's proposed response, following consultation with the Chair and Vice Chair of the Committee, is shown at **APPENDIX A**.

3.18. **Any comments Committee Members would like to be considered for incorporation will need to be made in advance of the meeting given the deadline.**

Grant Funding to Support Anticipated Rises in Fees

- 3.19. The Government's response to the Redmond Review identified £15m of funding in 2021/22 to meet higher audit fees and costs of preparing for the standardised statement of service costs.
- 3.20. A consultation was announced on 20 April 2021 that identified five different methodologies for allocating the £15m.
- 3.21. The Council responded to the consultation on 21 April 2021 indicating that it agreed with the Government's preferred methodology that would utilise 2019/20 fee scales for both opted in bodies such as Lichfield District Council (552 out 561 bodies) and opted out bodies.
- 3.22. The Government announced the allocations on the 29 July 2021 based on their preferred approach. The Council received an allocation of **(£18,255)**.
- 3.23. The trend of the level of External Audit Fees over the last five years is shown in the chart below:



- 3.24. This chart shows that current external audit fees for 2020/21 have increased by **£22,500 (+64%)** compared to the scale fee of **£35,412**.

The PSAA Local Audit Procurement

- 3.25. The Council opted into the PSAA led procurement of External Audit, at Full Council on 13 December 2016, for the five year period 1 April 2018 to 31 March 2023.
- 3.26. PSAA published its draft prospectus for the award of audits for the five years, from 1 April 2023 in June 2021, using a sector led approach with individual authorities deciding to opt in to the process.
- 3.27. The draft prospectus included a consultation that the Council responded to on 6 July 2021.
- 3.28. In terms of opting out from the sector led procurement, the biggest risk is whether an authority managing its own procurement will be able to secure competitive bids. Auditors can only be appointed from a short (and currently shrinking list maintained by the ICAEW and there is currently only one Key Audit Partner (KPA) that does not work for one of the big firms).
- 3.29. However, there would be some scope to work with firms active in the local area (or who might wish to be) to register new key audit partners (KPAs). PSAA is promising to work to increase the pool of KPAs and Government is considering how barriers to entry could be reduced.
- 3.30. In addition to planning the procurement process and drawing up a contract, the substantial additional burden of self-appointment is having to establish an auditor panel.
- 3.31. The potential gain would be to have control over the appointment of your auditors. The PSAA route has been promoted as guaranteeing auditor independence. However the independence that matters in this context is that auditors should not be under undue influence to be forgiving in their audit work. It does not have to mean that authorities give up all influence over how auditors work, in particular in relation to the timing and staffing of audits and the determination of fees. With self-appointment, you would be able to secure commitment from the auditors. Of course, the more authorities that opt out of the PSAA arrangements, the less the capacity for auditors to agree to such commitments.
- 3.32. If the Council were to consider opting out, we would need to be confident that self-appointment will work, as the opting-in deadlines are fast approaching. PSAA is proposing to invite authorities to be part of the second round in September this year, with a closing date in **January 2022 (with approval required by Full Council prior to this date)**. Note, though, that there is a backstop if a self-appointment exercise is unsuccessful as the Secretary of State will be required to intervene if an appointment has not been made by 31 December 2022.
- 3.33. In addition to the Audit of the Accounts and the Value for Money Assessment External Audit role covered by the PSAA procurement, the Council has a separate and parallel arrangement with Grant Thornton to provide certification of the Housing Benefit Subsidy.
- 3.34. This role was inadvertently not included in the legislation and therefore the Council had to procure this directly from Grant Thornton for the same period 1 April 2018 to 31 March 2023 because of the synergies with the Statement of Accounts Audit.
- 3.35. The procurement of this role will also need to be considered in parallel to the PSAA sector led procurement.
- 3.36. The sector led approach through opt in to the PSAA arrangements is the recommended approach for the reasons identified in the paragraphs above.**

Alternative Options	To establish an auditor panel and conduct our own procurement. This is not recommended as it will be a far more resource intensive process and, without the bulk buying power of the sector led procurement, would be likely to result in a more costly service.
Consultation	The Audit and Member Standards Committee were provided with an update on the Redmond Review and the Government's initial response on 3 February 2021.

Financial Implications	These are shown in the background section of the report.
Approved by Section 151 Officer	Yes

Legal Implications	The Council will need to decide whether it opts in to the PSAA sector led procurement of external auditors by January 2022.
Approved by Monitoring Officer	Yes

Contribution to the Delivery of the Strategic Plan	The MTFs and sound Governance underpins the delivery of the Strategic Plan.
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Equality, Diversity and Human Rights Implications	No Equality, Diversity or Human Rights Implications.
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Crime & Safety Issues	No Crime and Safety Issues.
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Environmental Impact	No specific environmental impact.
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GDPR / Privacy Impact Assessment	No GDPR/Privacy Impact Assessment implications.
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	Risk Description & Risk Owner	Original Score (RYG)	How We Manage It	Current Score (RYG)
A	The Council does not have an appointed External Auditor for the 2023/24 Accounts	Likelihood: Green Impact: Red Severity: Yellow	To either opt in to the PSAA sector led procurement by January 2022 or to procure an external auditor directly	Likelihood: Green Impact: Yellow Severity: Yellow
B	The Council does not have a Housing benefit Certification Auditor in place from 2023/24	Likelihood: Yellow Impact: Red Severity: Yellow	To procure an external auditor to fulfil this role and consider using the same auditor who fulfils the Audit of Accounts role	Likelihood: Yellow Impact: Yellow Severity: Yellow

Background documents	Redmond Review Report to Audit and Member Standards Committee 3 February 2021
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Relevant web links	
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Local Audit Framework Lichfield District Council Response
(to be submitted)

Question 1: Do you agree with the proposed functions which the system leader for local audit needs to enable a joined-up response to challenges and emerging priorities across local audit? Please let us know any comments you have on the proposal.

Yes we agree however there are a large number of stakeholders and this risks duplication of or gaps in responsibilities therefore codification of responsibilities will be important and the system leader must assume overall accountability for approach including the role and responsibilities of stakeholders. We also believe the need for two separate Government Departments being involved should be reviewed because this adds complexity and erodes accountability.

Question 2: Do you have any comments on the proposed functions that ARGA should have alongside its new system leader responsibilities?

We believe that ARGA should also assume responsibility for audit delivery whether that be through the market or through a public sector audit firm similar to the District Audit Service to ensure the sustainability and value for money of the local audit market.

Question 3: Do you agree that the system leader should conduct a full post implementation review to assess whether changes to the Code of Audit Practice have led to more effective external audit consideration of financial resilience and value for money matters two years after its introduction, with an immediate technical review to be conducted by the NAO? Please let us know any comments you have on the proposal.

Yes we agree these considerations together with lessons learnt from Section 114 notices and Government Support reviews by CIPFA that highlight risks that need to be higher priority in the Code of Audit Practice rather than focusing limited audit capacity on technical pension and PPE valuations that are subject to statutory mitigations.

Question 4: Do you agree with the proposals to ensure that ARGA has sufficient expertise and focus on local audit? Please let us know any comments you have on the proposals.

Yes we agree. However we believe that ARGA should also assume responsibility for audit delivery whether that be through the market or through a public sector audit firm similar to the District Audit Service to ensure the sustainability of the local audit market.

Question 5: Do you agree with the proposed role and scope of the Liaison Committee? Please let us know any comments you have on the proposal.

Yes we agree however given the role identified for ARGA we are not quite sure why there needs to be representation from 4 Government Departments and the NHS given the new local audit framework involves formal relationships with two Government departments and others being considered stakeholders.

Question 6: Do you agree that the responsibilities set out above will enable ARGA to act as an effective system leader for local audit? Are there any other functions you think the system leader for local audit should have?

Yes we agree. However we believe that ARGA should also assume responsibility for audit delivery whether that be through the market or through a public sector audit firm similar to the District Audit Service to ensure the sustainability of the local audit market.

Question 7: What is your view on the proposed statutory objective for ARGA to act as system leader for local audit? Please include any comments on the proposed wording.

We believe that also consideration to adding “and ensures a framework for sustainable local audit provision is in place for all bodies”.

Question 8: Do you agree with the proposal that ARGA will have a responsibility to give regard to the value for money considerations set out in the Local Audit and Accountability Act 2014? Please include any comments on the proposed wording.

Yes we agree. However value for money has a specific context and consideration may need to be given to a separate and specific financial resilience consideration.

Question 9: Do you agree that the proposals outlined above will provide an appropriate governance mechanism to ensure that the new system leader has appropriate regard to the government’s overarching policy aims without compromising its operational and regulatory independence? Please let us know any comments you have on the proposal.

Yes we agree although we question whether there is any role in determining the remit for the Public Accounts Committee given its role in assessing Local Government Financial Resilience.

Question 10: Do you agree that ARGA’s annual reporting should include detail both on the state of the local audit market, and ARGA’s related activities, but also summarising the results of audits? Please include any views on other things you think this should include.

Yes we agree possibly with the addition of a regular assessment and plans to ensure the sustainability of the local audit market.

Question 11: Do you agree with the proposal outlined above relating to board responsibility for local audit? Please let us know any comments you have on the proposal.

Yes we agree however given the importance of this responsibility, appointments must have relevant experience in this area rather than being generalists or corporate sector specialists.

Question 12: Do you agree that ARGA’s local audit functions and responsibilities should be funded directly by MHCLG rather than a statutory levy?

Yes we agree.

Question 13: Do you agree that ARGA should also take on system leader responsibilities for health audit? Please let us know any comments you have on the proposal.

Yes we agree given the current relationship between health and local government and the sharing of audit resources across these two areas, plus the likely greater future integration in these two areas.

Question 14: If you agree that ARGA should assume system leader responsibilities for health audit, do you think any further measures are required to ensure that there is alignment across the broader system?

Yes the sustainability of local audit will need to consider the impact on capacity of competing deadlines across both sectors.

Question 15: Do you agree with the government's proposals for maintaining the existing appointing person and opt-in arrangements for principal bodies but with strengthened governance across the system, including with the new system leader? Please let us know any comments you have on the proposal.

Yes we agree although we believe that sustainability for Local Audit needs to be part of the remit of the new system leader including contingency arrangements in the event of market failure.

Question 16: Do you agree with the proposal for strengthened audit committee guidance? Please let us know any comments you have on the proposal.

Yes we agree although to strengthen Governance the requirement for an Audit Committee and its core responsibilities may need to be a statutory requirement otherwise its role can be subsumed into another Committee or other functions can be added to dilute its effectiveness.

Question 17: Do you have any views on whether reliance on auditors to comment and recommend improvement in audit committee arrangements is sufficient, or do you think the Department should take further steps towards making the committee a statutory requirement?

We believe the requirement should be statutory for an Audit Committee however 'ticking a box' of one being in place will not ensure its effectiveness. Therefore the External Auditor could provide an annual assessment in its VFM assessment or as an objective assessment compared to best practice as part of the annual review of the effectiveness of the Audit Committee.

Question 18: Do you agree with the proposals that auditors should be required to present an annual report to Full Council, and that the Audit Committee should also report its responses to the Auditor's report? Please let us know any comments you have on the proposal.

Yes we agree although from a Governance perspective, the role of Statutory Officers in addition to the response of the Audit Committee will need to be considered.

Question 19: Do you have any comments on the proposals for amending Key Audit Partner guidance or addressing concerns raised about skills and training?

Value for money will always be the key driver, we believe that local government is a special case where the quality of the audit firm is more important than cost. The trouble is that the rules and regulations increase on Councils means considerable training is required which cannot be used elsewhere by auditing firms.

The approach advocated still focuses on a market led supply of auditors and whilst the changes advocated may increase the capacity in the market, it still has the inherent risk of market failure. We believe a public sector audit firm similar to the District Audit Service to ensure the sustainability of the local audit market needs to be considered as a priority to manage the sustainability risk.

Question 20: Are there other changes that might be needed to the Local Audit (Auditor Qualifications and Major Local Audit) Regulations 2014 alongside changes to the FRC's guidance on Key Audit Partners?

We believe the focus of the External Audit needs to change from the technical, sector agnostic approach advocated by the FRC to a more local government specific set of audit standards. The approach must recognise that financial risks in local government are different to those in the corporate world and therefore PPE and pension valuations whilst large material numbers are not as important to financial resilience due to statutory mitigations. The recent Section 114 notices and Councils requiring exceptional Government support identify the type of risks that the Local Audit framework needs to address.

We also believe that greater reliance on Internal Audit plans and assurance should be utilised to reduce duplication and use limited capacity in the most effective way.

Question 21: Are there other changes that we should consider that could help with improving the future pipeline of local auditor supply?

We believe a public sector audit firm similar to the District Audit Service to ensure the sustainability of the local audit market needs to be considered as a priority to manage sustainability risk.

Question 22: Do you have any comments on the proposal to require smaller bodies to publish their budget statements and variance explanations alongside the Annual Governance and Accountability Return to aid transparency for local service users?

No comments.

Question 23: is the current threshold of £6.5 million still right? If you think a different threshold would be more appropriate, please provide evidence to support this.

No comments.

Question 24: Do you have any comments on the proposal for a requirement for smaller bodies to transfer to the Category 1 authority audit regime only once the threshold has been breached for 3 years in succession?

No comments.