

HIGH PEAK BOROUGH COUNCIL

Audit & Regulatory Committee

30 September 2021

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| TITLE: | Redmond Review Update |
| EXECUTIVE COUNCILLOR: | Councillor Alan Barrow - Executive Councillor for Corporate Services and Finance |
| CONTACT OFFICER: | John Betts - Interim Executive Director Finance and Revenues & Benefits |
| WARDS INVOLVED: | Non Specific |

Appendices Attached – Table of Redmond review recommendations and MHCLG response / progress

1. Reason for the Report

- 1.1 Concern has been growing within local government (and elsewhere) regarding the effective provision of external audit services. This report updates the committee on various national reviews affecting local public audit and their implications for the Local Authority as well as updates on options and the timetable for appointing future external auditors set by the Public Sector Audit Authority (PSAA).

2. Recommendations

2.1 That the Committee:

- Notes the progress that the Ministry for Housing, Communities and Local Government (MHCLG) has made in responding to Sir Tony Redmond's review into the effectiveness of external audit and transparency of financial reporting in local authorities
- Approves the proposal for further reports to this committee recommending any changes locally to current audit and governance processes, once MHCLG has finalised its proposed actions nationally
- Notes the need for a recommendation by this committee to Council by Friday 11th March 2022 to formally respond and accept (or decline) the opt-in invitation from Public Sector Audit Authority (PSAA) to join the procurement of bulk external audit services (this will be the subject of a separate report)

3. Executive Summary

- 3.1 The current local audit environment is a fragile system. The National Audit Office has recently concluded that the local audit system has worsened since 2019, with an increase in late audit opinions, concerns about audit quality and doubts over audit firms' willingness to continue to audit local authorities all highlighting that the situation needs urgent attention. System wide changes are required. A number of reviews recently commissioned by central Government have attempted to respond to this (or have influenced thinking on proposed solutions). The most important of these has been Sir Tony Redmond's review into the effectiveness of external audit and transparency of financial reporting in local authorities. A summary of the Redmond review was previously reported to this committee in November 2020.
- 3.2 Since then, the Ministry for Housing, Communities and Local Government (MHCLG) has responded to the review. A summary of the response and progress to date is given at Annex A to this report. Little has been finalised, other than a two year extension to the deadline for publishing audited local authority accounts. An additional £15 million has also been provided to help meet the anticipated increase in audit fee costs in 2021/22 and to support with new burdens relating to implementing Redmond's recommendations. Most of the other recommendations are subject to further consultation with key national stakeholders. Further reports will be required so that this committee can respond appropriately to all recommendations, when MHCLG finalises its responses.
- 3.3 One key decision by MHCLG was to reject Redmond's recommendation for a new, independent "systems leader" body, the Office of Local Audit and Regulation (OLAR). Instead, the Audit, Reporting and Governance Authority (ARGA), which is the successor regulatory authority to the Financial Reporting Council (FRC), will be strengthened with new powers over local government audit. The existing Public Sector Audit Appointments (PSAA) will continue as the appointing body for local audit, in charge of procurement and contract management for local government auditors. It is unclear how this solution responds effectively to Redmond's concerns regarding system-wide leadership, audit supply and market instability, and practical issues such as accelerating qualification of new auditors and building attractive career paths. This is a concern shared by the House of Commons Public Accounts Committee (PAC).
- 3.4 The Council will need to make an important decision about its external audit arrangements for the period commencing from the financial year 2023/24. In relation to appointing auditors, it can:
- arrange its own procurement

- make the appointment itself or in conjunction with others
- join the national collective scheme (currently administered by Public Sector Audit Appointments [PSAA])

3.5 PSAA will publish a prospectus for the proposed, new national scheme in late September 2021 and the Local Authority will have until Friday 11th March 2022 to formally respond and accept (or decline) the opt-in invitation to nationally brokered local audit contracts (as it currently does). If it is well designed and implemented, the national scheme should be simpler and likely to deliver lower fees with less administrative cost and less effort, than would be achievable through a local procurement. However, a more formal report will come to the committee in February 2022 (with a recommendation to Council in the same month), once the PSAA prospectus is received and analysed.

4. How this Report Links to Corporate Priorities

4.1 An effective external audit service will help ensure the Council uses resources effectively and provide value for money.

5. Options and Analysis

5.1 The report is primarily for information at this stage, but the options available for procuring external audit services are summarised in para. 3.4 above and a further report will recommend a way forward.

6. Implications

6.1 Community Safety - (Crime and Disorder Act 1998)
None.

6.2 Workforce
None.

6.3 Equality and Diversity/Equality Impact Assessment
No Equality Impact Assessment (EIA) is required.

6.4 Financial Considerations
There are no direct financial implications from this report, although the likelihood is that audit fees will increase. Nationally, the Government has pledged £15 million to contribute towards the additional costs associated with implementing Redmond's recommendations.

6.5 Legal
Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of the Council.

6.6 Sustainability
None.

6.7 External Consultation
None

6.8 Risk Assessment

There are no immediate risks to the Council, but if nationally the new regime fails to provide effective system-wide leadership then there is the risk that audit firms will leave the market, meaning viable external audit of local government becomes unviable. There are no actions that a single Local Authority can do to mitigate this risk; hence the need for system-wide leadership.

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**Web Links and
Background Papers**

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Update on Reviews, Progress & Impact of Proposed Changes to the Local Audit System

7. Background

- 7.1. From 1 April 2015, local public bodies in England have been required to appoint their own auditors to audit their accounts annually. This system was introduced by the Local Audit and Accountability Act 2014, and came into being following the abolition of the Audit Commission. As part of that overhaul, there was a shift to a position which involved private audit firms bidding for blocks of work (previously there had been a mix of public and private).
- 7.2. The 2014 Act allowed the Government to nominate a body to appoint auditors to those local authorities which 'opt in' to its joint procurement arrangement. In 2016, the Government appointed a body called Public Sector Audit Appointments (PSAA) to make these appointments. PSAA is a subsidiary company of the Local Government Association (LGA) and 98% of relevant local bodies opted in to the PSAA arrangements for the period from 2018 to 2023¹. This included the Alliance authorities.
- 7.3. Local audit comprises two elements. Firstly, there is an opinion on whether the statutory financial accounts, produced in accordance with CIPFA's Code of Practice on Local Authority Accounting, are true and fair, in accordance with statutory duties. As well as the financial audit, legislation also requires a further, value for money opinion from public audit, which includes an assessment on whether the auditor is satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Public auditors also have additional powers and duties to make Public Interest Reports and Statutory Recommendations, which places an additional burden and cost.
- 7.4. Concern has been growing within local government (and elsewhere) regarding the effective provision of external audit services. The rest of this report updates the committee on various national reviews affecting local public audit and their implications for the Local Authority as well as updates on options and the timetable for appointing future external auditors set by PSAA.

8. Current Position

- 8.1. The current local audit environment is a fragile system². The National Audit Office has recently concluded³ that the local audit system has worsened since

¹ The House of Commons Briefing Paper 07420 (April 2021) "Local audit in England" provides a useful overview <https://researchbriefings.files.parliament.uk/documents/CBP-7240/CBP-7240.pdf>

² PSAA "Summary of the response to PSAA's consultations on its initial thinking of proposed arrangements for the appointing period starting April 2023" <https://www.psaa.co.uk/wp-content/uploads/2021/08/Summary-of-the-response-to-PSAA-consultations-on-its-proposed-arrangements-for-the-appointing-period-starting-April-2023-FINAL.pdf>

2019, with the increase in late audit opinions, concerns about audit quality and doubts over audit firms' willingness to continue to audit local authorities all highlighting that the situation needs urgent attention. System wide changes are required. That is, more work is required nationally to design and implement a system for local audit which is more stable, resilient and sustainable. This is evidenced partly by the large proportion of local audits that are being delivered late. 55% of local authorities' March 2020 accounts had not received an audit opinion by the revised deadline of 30 November 2020. However, it is also reflected in the number of reviews recently commissioned by central Government:

- the Kingman review of audit regulation
- the Competition and Markets Authority review of the audit market
- the Brydon review of the quality and effectiveness of audit
- the Redmond review of local audit and financial reporting

8.2. Sir John Kingman's review (of the Financial Reporting Council)⁴ recommended its replacement with a new, better resourced independent regulator with significantly expanded powers and objectives. This new regulator is named the Audit, Reporting and Governance Authority (ARGA). Since then, the proposal is that ARGA will also have oversight of local public audit. The Competition and Markets Authority (CMA)⁵ proposed that Audit committees should report directly to the ARGA throughout the audit tender process and audit engagement (it is not clear whether this would apply to local government) and also proposed an operational split of firms' audit and non-audit functions. Sir Donald Brydon's considered how the audit process and product could be developed to better serve the wider public interest, but was focussed primarily on listed companies and credit and insurance firms (rather than public sector bodies). The largest impact, though, came from Sir Tony Redmond's review into the effectiveness of external audit and transparency of financial reporting in local authorities.

9. The Redmond Review

9.1. In summary, the significant findings of Redmond's review were as follows:

- There was a lack of coherence in local audit arrangements, including no coherence in the approach to procure audit and concerns regarding the effectiveness of local audit, partly linked to fee structures
- There was a view that the costs of local audit were less than they should be (perhaps by up to 25%) and as a result the quality of auditors has

³ National Audit Office "Timeliness of local auditor reporting on local government in England, 2020" (March 2021) <https://www.nao.org.uk/report/timeliness-of-local-auditor-reporting-on-local-government-in-england-2020/>

⁴ Available at: <https://www.gov.uk/government/publications/financial-reporting-council-review-2018>

⁵ Available at:

https://assets.publishing.service.gov.uk/media/5c17cf2ae5274a4664fa777b/Audit_update_paper_S.pdf

reduced, because generally they don't have the experience or knowledge of local authorities

- There was an issue of whether Audit Committees understood various issues sufficiently to question and challenge in an effective way and there were low numbers of independent Audit Committee Members, with little communication between the Audit Committee and Inspectors and no formal exchange of views and little relationship to Full Council
- Internal Audit is not used much by External Audit as the code of practice does not require them to liaise with internal audit work
- Current arrangements make it difficult for the public to properly understand what is important in the accounts. More can be done to improve transparency of what local authorities do

9.2. As a result, the key recommendations coming from the report were as follows:

- A new '*Office of Local Audit Regulation*' be established and have responsibility for procuring, managing, overseeing and regulating local audits
- Fee structure needs to be revised to reflect the true cost with local audit firms
- At least 1 independent member will be required on each Audit Committee.
- A requirement for the three statutory officers (Monitoring Officer, Section 151 officer, Head of Paid Service) to meet External Audit annually.
- Audit Committee members will have a requirement to be trained.
- Audit completion will move to 30 September from 31 July.
- An annual report to be presented to the first Council meeting after 30 September from the External Auditor.
- Auditors must have skills and training, but also there needs to be training in place for Local Authority finance staff.
- The National Audit Office *Code of Practice on Value For Money* to be endorsed

9.3. The Ministry for Housing, Communities and Local Government (MHCLG) initially published a statement in May 2021 which provided further detail on its plan to reshape local audit and then in July it produced its more detailed response to the recommendations from the Redmond Review.

9.4. A large proportion of Redmond's recommendations were accepted by MHCLG and the department's response and progress to date is summarised in Annex 1 to this report. Importantly, though, MHCLG rejected the proposal for a new, independent "systems leader" body, the Office of Local Audit and Regulation (OLAR). This body would have had responsibility for procurement, contract management, regulation, and oversight of local audit. MHCLG appeared concerned with creating a new Audit Commission type body, so they have announced that the Audit, Reporting and Governance Authority (ARGA), which is the new regulator being established to replace the Financial Reporting Council (FRC), will be strengthened with new powers over local

government audit. The new regulator will contain a standalone local audit unit, bringing all regulatory functions into one place. ARGA will also provide annual reports on the state of local audit and take over responsibility for the updated Code of Local Audit Practice – which are the guidelines Councils are required to follow. The government also confirmed that Public Sector Audit Appointments (PSAA) would continue as the appointing body for local audit, in charge of procurement and contract management for local government auditors.

- 9.5. The announcement of a systems leader for local audit was broadly welcomed across local government. However, it is difficult to see how MHCLG's proposal to use ARGA will address ongoing concerns regarding audit supply and market instability. Three firms cover over 80% of local audit and a withdrawal by one would create considerable instability. Any change to the local audit system will need to balance this, including addressing the position of the large audit firms and the requirement for well trained, appropriately paid external audit staff working on public sector audits, alongside the need for higher quality audits in the short and longer term.
- 9.6. Local audit scale fees reduced by 40% between 2014/15 and 2018/19, whilst central government and FTSE100 fees have increased by 20%. That reduction in cost seems to have come at the expense of a reduction in quality and timeliness (accepting that Covid-19 has also had a substantial impact). Until recently, the NAO's Code of Audit Practice required auditors to give a binary opinion on whether the proper value for money (VFM) arrangements were in place (or not). Now auditors are required to provide a narrative statement on the arrangements in place. This will increase the cost of local audit and so Government has provided £15m to help meet the increased cost of audit in 2021/22. However, such work has capacity implications for audit firms, at a time when there are issues relating to delays in the completion of audits and, more broadly, the future pipeline of auditors.
- 9.7. Irrespective of the changes to VFM arrangements, it seems inevitable that any new scale audit fees will need to rise from their current levels. This is where PSAA will need to be effective.

10. Public Sector Audit Authority (PSAA) & Procuring a New Auditor

- 10.1. PSAA's responsibilities are to appoint auditors to opted in bodies, set scales of fees, and manage contracts with audit firms for delivery of external audit services to opted in bodies. "Opted in" here refers to the process whereby the Local Authority indicates its willingness to sign up to a co-ordinated procurement process. PSAA recently undertook a consultation on its proposed approach to the next round of auditor appointments, acknowledging that procurement alone cannot resolve the systemic issues faced across the local public audit system. PSAA's intention is to continue prioritising new longer-term contracts, which makes sense in terms of providing greater certainty for audit firms. It also wants to open up the market to more entrants, although the mechanism for doing this is still being debated.

- 10.2. However, PSAA's suggestion that some existing contracts may be extended received mixed responses (presumably based primarily on quality concerns from Local Authorities as well as audit firm concerns regarding financial sustainability). PSAA also intend to evaluate tender submissions on the basis an 80% weighting for the quality aspects and just a 20% weighting for price (currently the split is 50:50).
- 10.3. Local Authorities will need to make important decisions about their external audit arrangements for the period commencing from the financial year 2023/24. In relation to appointing auditors, the Local Authority has the option to:
- arrange its own procurement
 - make the appointment themselves or in conjunction with others
 - join the national collective scheme (currently administered by Public Sector Audit Appointments [PSAA])
- 10.4. The position is further complicated, as the Government is reviewing the public sector procurement regulations, following the UK's withdrawal from the European Union. Generally, the national scheme (if well designed and implemented) should be simpler and likely to deliver lower fees with less administrative cost and less effort, than would be achievable through a local procurement.
- 10.5. Officers will attend webinars run by PSAA in the Autumn to improve understanding about the preparations for the new appointing period including the opt-in process and auditor appointment process, as well as seeking to increase awareness of PSAA's role and remit. PSAA will publish a prospectus for the proposed, new national scheme in late September 2021 and the Local Authority will have until Friday 11th March 2022 to formally respond and accept (or decline) the opt-in invitation. Under the Regulations this is a decision that needs to be taken by Full Council. A further report will be brought to the committee recommending a way forward.

11. View of the Public Accounts Committee

- 11.1. Despite reviewing the various changes highlighted above, a report from the House of Commons Public Accounts Committee (PAC) in July 2021 still casts doubt on the integrity of the local government audit market, the ability of the current system to deliver audit on time and whether the proposed new arrangements will deliver "leadership". The PAC adds that there is concern about the high risk of collapse for the audit market and what contingency plans the government may have.
- 11.2. It also notes councils have become increasingly unattractive as clients and it wants government to work with the regulator and accountancy institutes to "accelerate" qualification of new auditors and "build attractive career paths" to bolster audit firms. The PAC also doubt whether the proposed oversight arrangements for audit will work. They express concern that as long as

functions remains split between the FRC or ARGA managing quality and content and the PSAA procuring audit appointments, there will be none of the proper systems leadership required (despite Redmond's recommendations). Lastly, the PAC called for the audits to be recalibrated to focus on areas of "greatest risk and concern to citizens." PAC argue that some of the work currently undertaken is "disproportionate" to the risk facing councils.

- 11.3. Certainly the experience across the Alliance is that increased challenges on professional valuations on balance sheet items (such as those for property, plant and equipment and pensions liabilities), exhorted by the FRC, has questionable value to the local taxpayer. They do not feed into general fund balances and add little credence to local understanding of the financial standing of the local authority, but take up a lot of time and effort.

12. Summary & Conclusions

- 12.1. It is positive that Government has recognised the systemic issues associated with local public audit since the dissolution of the Audit Commission. The Redmond review was welcomed as a response to the situation. MHCLG's response to a large number of Redmond's recommendations remain "in progress" or are only partly accepted, so it is difficult to predict how this committee will need to respond to any final proposals. A number of the recommendations require substantial input from other key stakeholders (for example, the Local Government Association, National Audit Office, Chartered Institute of Public Finance & Accountancy, Institute of Chartered Accountants England & Wales, Financial Reporting Council) and organising this will take time. Locally, some areas (such as training for committee members) are already in train. Further reports will be required so that the committee can respond appropriately to all final recommendations.
- 12.2. In the short term, the committee will need to consider whether to "opt in" to nationally brokered local audit contracts (as it currently does). Initial analysis suggests that the PSAA scheme (if well designed and implemented) should be simpler and likely to deliver lower fees with less administrative cost and less effort, than would be achievable through a local procurement. For this to be effective it will also be important that the Alliance has the same external auditor for both Councils. A more formal report on the "opt in" decision will come to the committee in February 2022 (with a recommendation to Council in the same month).