

AUDIT, GOVERNANCE AND STANDARDS COMMITTEE MEETING

Date: Monday 18 November 2019
Time: 6.30 p.m.
Venue: Town Hall, High Street, Maidstone

Membership:

Councillors Adkinson (Vice-Chairman), Brindle, Coulling (Parish Representative), Cox, Daley, Fissenden, Harvey (Chairman), McLoughlin, Perry, Round and Titchener (Parish Representative)

The Chairman will assume that all Members will read the reports before attending the meeting. Officers are asked to assume the same when introducing reports.

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3. Urgent Items	
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5. Disclosures by Members and Officers	
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7. To consider whether any items should be taken in private because of the possible disclosure of exempt information	
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Issued on Friday 8 November 2019

Continued Over/:

Alison Broom

Alison Broom, Chief Executive

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PUBLIC SPEAKING AND ALTERNATIVE FORMATS

If you require this information in an alternative format please contact us, call **01622 602899** or email committee@maidstone.gov.uk.

In order to speak at this meeting, please contact Democratic Services, using the contact details above, by 5 p.m. one clear working day before the meeting (i.e. Thursday 14 November 2019). If asking a question, you will need to provide the full text in writing. If making a statement, you will need to tell us which agenda item you wish to speak on. Please note that slots will be allocated on a first come, first served basis.

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MAIDSTONE BOROUGH COUNCIL

AUDIT, GOVERNANCE AND STANDARDS COMMITTEE

MINUTES OF THE MEETING HELD ON 16 SEPTEMBER 2019

Present: Councillor Harvey (Chairman) and
Councillors Adkinson, Mrs Blackmore, Brindle, Daley,
English, Perry and Titchener (Parish Representative)

26. APOLOGIES FOR ABSENCE

It was noted that apologies for absence had been received from Councillors Cox, Fissenden, McLoughlin and Round.

27. NOTIFICATION OF SUBSTITUTE MEMBERS

The following Substitute Members were noted:

Councillor Mrs Blackmore for Councillor McLoughlin
Councillor English for Councillor Cox

28. URGENT ITEMS

There were no urgent items.

29. NOTIFICATION OF VISITING MEMBERS

There were no Visiting Members.

30. DISCLOSURES BY MEMBERS AND OFFICERS

There were no disclosures by Members or Officers.

31. DISCLOSURES OF LOBBYING

There were no disclosures of lobbying.

32. EXEMPT ITEMS

RESOLVED: That the items on the agenda be taken in public as proposed.

33. MINUTES OF THE MEETING HELD ON 30 JULY 2019

RESOLVED: That the Minutes of the meeting held on 30 July 2019 be approved as a correct record and signed.

34. QUESTION AND ANSWER SESSION FOR MEMBERS OF THE PUBLIC

There were no questions from members of the public.

35. COMMITTEE WORK PROGRAMME 2019/20

The Committee considered its work programme for the remainder of the Municipal Year 2019/20.

RESOLVED: That the Committee work programme for the remainder of the Municipal Year 2019/20 be noted.

36. ANNUAL COMPLAINTS REPORT 2018/19

The Information and Corporate Policy Officer introduced his report providing an overview of how the Council had performed in responding to service complaints during the financial year 2018/19. The report also included details of the Local Government and Social Care Ombudsman Annual Review Letter 2019. It was noted that:

- The Council had received 568 stage 1 complaints in 2018/19 compared to 728 in the previous year, a decrease of 22%. Of the 568 stage 1 complaints, 181 (31.9%) were upheld and 109 were escalated to the second stage of the Council's complaints process. Of the 109 stage 2 complaints, 18 (16.5%) were upheld.
- The services with the highest volume of stage 1 complaints were Waste, Parking, Council Tax and Development Management. Parking Services and Waste Services responded to all complaints received within 10 working days. Only 2 complaints (3.8%) about Development Management were not responded to within the target of 10 working days of receipt. The services with the highest stage 2 escalation rates were Development Management, Parking, Waste and Planning Enforcement. When a complaint was escalated to stage 2, an investigation was conducted by the Head of Policy, Communications and Governance, and a response was provided within 20 working days. Against this target, 99 (90.8%) stage 2 complaints were responded to in time.
- The Local Government and Social Care Ombudsman had reviewed 38 complaints and made decisions on 37 complaints in 2018/19. There were 9 detailed investigations and 3 complaints were upheld.

During the discussion, concerns were expressed about the efficiency of the Council's telephone system and also about the need to improve user experience of the Council's website. It was suggested that it was sometimes difficult to address complaints to the correct department.

The Director of Finance and Business Improvement replied that the aim was to ensure that customers have a positive experience when contacting the Council. The Council did monitor the number of telephone calls that are dropped and the time taken to answer them, and he had regular

discussions with the Customer Services Manager about the statistics. There were other channels for reaching the Council such as email, direct lines and voicemail. There was also dialogue with Councillors about the website. It was under continual development and maintained in-house so it could be adapted in response to any issues.

In response to questions, the Officers explained that:

- In 2018/19 a total of £723 in monetary compensation was offered to complainants. This included a payment of £250 in respect of a complaint received and upheld by the Local Government and Social Care Ombudsman. The Council also offered other remedies such as extending subscriptions or waiving fees. Advice and guidance was being offered to Service Managers to ensure that compensation payments are recorded correctly.
- In terms of benchmarking performance against that of other Boroughs, further data was awaited to enable a full comparison to be made.
- The complaints policy had been amended to make the definition of a complaint clearer to ensure that the correct process is followed and the desired outcome is not delayed.
- Judicial reviews were not treated as part of the complaints process, the final stage of which was referral to the Local Government and Social Care Ombudsman.

Members expressed satisfaction with the Council's performance in responding to complaints and were pleased to note the number of compliments that had been received.

RESOLVED: That the Council's performance on complaint management in 2018/19 and the Local Government and Social Care Ombudsman's Annual Review Letter 2019 be noted.

37. COMPLAINTS RECEIVED UNDER THE MEMBERS' CODE OF CONDUCT AND INVESTIGATION INTO THE RELEASE OF EXEMPT INFORMATION CONTRARY TO PART I OF SCHEDULE 12A TO THE LOCAL GOVERNMENT ACT 1972

The Head of Legal Partnership and Monitoring Officer presented a report providing an update on complaints received under the Members' Code of Conduct during the period 15 January 2019 to date. The report also set out the results of an investigation into the release of exempt information contrary to paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972 and actions to be taken to help manage the risk of exempt information being made public. It was noted that:

- Since the last report to the Committee on 14 January 2019, there had been 5 new Parish Council complaints. One complaint was rejected because it failed the Legal Jurisdiction Criteria Test; one complaint

was rejected because it failed the Local Assessment Criteria Test, but there was a recommendation that appropriate training be undertaken; two complaints were resolved informally and the Subject Members undertook training; and the outcome of Police inquiries was awaited before the assessment of the fifth allegation was completed.

- The investigation into the release of exempt information had not been able to establish, based on the balance of probabilities, who was, or who may have been, responsible for the exempt information being leaked to the press.

Rather than noting, the Committee approved the actions to be taken to help manage the risk of exempt information being made public and requested that the actions be referred to the Democracy and General Purposes Committee to review how they are implemented.

RESOLVED:

1. That the contents of the report be noted.
2. That the following be approved as a result of the investigation into the release of exempt information. Actions to help manage the risks will be taken as follows:
 - i. A training course will be made available to Members on Media training and insight;
 - ii. Officers will be provided with training from Democratic Services on how to structure reports to minimise the information required to be taken in Part II of a meeting;
 - iii. Regular meetings with Communications will be offered to all Group Leaders to review, plan and schedule public relations, as appropriate, for Council activities; and
 - iv. Tighter control of exempt information, via named checking in of information after a meeting, will be implemented by Democratic Services.
3. That the actions be referred to the Democracy and General Purposes Committee to review how they are implemented.

38. UPDATE TO THE COVERT SURVEILLANCE AND ACCESS TO COMMUNICATIONS DATA POLICY AND GUIDANCE NOTES

The Trainee Lawyer Corporate Governance introduced his report outlining proposed amendments to the Covert Surveillance and Access to Communications Data Policy and Guidance Notes (the "Policy") to address the recommendations set out in the report of the Investigatory Powers Commissioner's Office following their inspection in June 2018. It was noted that:

- The revised Policy incorporated the up to date guidance produced by the Surveillance Commission and also amendments to the Regulation of Investigatory Powers Act (RIPA) in relation to communications data.

- The Council had not authorised any activity under RIPA since 2012. However, there was a risk of litigation and challenge if authorisations were incorrectly given in the future without proper understanding of the current requirements. The actions set out in the Inspector’s report and the Officer’s report to the Committee would mitigate any such risks.

In response to questions by Members, the Head of Legal Partnership advised the Committee that she could not comment on surveillance equipment used by Parish Councils if indeed they did undertake covert activities. As local authorities, it would be their responsibility to comply with the legislation. She would review the report to see whether amendments were required to reflect the use of mobile CCTV systems by the Council and equipment part funded by the Council or used by contractors working on behalf of the Council, and report back to the Committee. She would also review the Policy to ensure that it is gender neutral.

It was suggested and agreed that the Officers be requested to arrange for an item to be included on the agenda for the next meeting of the Parish Liaison Committee to highlight Parish Councils’ obligations under RIPA.

RESOLVED:

1. That subject to the points raised in the discussion, the revised Covert Surveillance and Access to Communications Data Policy and Guidance Notes (“the Policy”) be approved in order to meet the recommendations set out in the IPCO’s report, specifically:
 - a) the addition at section 4.2 of the Policy that urgent oral authorisations can no longer be relied upon;
 - b) the update at section 2.7.3 of the Policy to remove reference to urgency provisions and add the requirement to record the date that any authorisations are given;
 - c) the addition at section 1.8 of the Policy highlighting the requirement for the Co-ordinating Officer to ensure training is carried out at regular intervals; and
 - d) the addition at section 1.39 of the Policy that a register shall be kept in the Central Record containing a list of all online Council profiles utilised and a record of their use when carrying out surveillance of social media sites.
2. That the Officers be requested to arrange for an item to be included on the agenda for the next meeting of the Parish Liaison Committee to highlight Parish Councils’ obligations under RIPA.

39. CONTRACT MANAGEMENT UPDATE

The Head of Commissioning and Business Improvement introduced her report setting out details of progress on the planned improvements to contract management across the Council following an Internal Audit review completed in November 2018. It was noted that:

- Contract management received a Weak level of assurance from an Internal Audit review in November 2018. The Internal Audit report concluded that, whilst there was clearly good practice in the management of the leisure and culture contracts, improvement in contract management was required corporately.
- An update on contract management was presented to the Committee in March 2019. Good progress had been made in the six months since that last report. All but one of the recommendations from the Internal Audit review had been fully addressed and significant progress had been made on the one outstanding recommendation. The Internal Audit team had now reassessed the assurance rating for contract management to Sound.

In response to a question about the Internal Audit assurance rating and whether there was scope for further improvement, the Head of Audit Partnership explained that there were four assurance ratings: Poor, Weak (adverse ratings), Sound and Strong. Sound was a level that the Council should be satisfied with, but contract management, like all areas of the Council's business, remained in the Audit Universe and would be revisited periodically at which point it might receive a Strong assurance rating. For the purpose of correcting deficiencies, the aim was to achieve a positive assurance level and allow the Service to move on from there.

RESOLVED: That progress to improve contract management corporately be noted.

40. ANNUAL ACCOUNTS 2018/19 UPDATE

The Interim Head of Finance introduced his report updating the Committee on the completion of the external audit of the Council's 2018/19 Statement of Accounts and setting out the External Auditor's updated Audit Findings Report. It was noted that:

- An unqualified audit opinion on the Accounts was issued by Grant Thornton (the External Auditor) on 16 August 2019. As the date of issue was beyond the statutory publication deadline of 31 July 2019, full compliance with the Accounts and Audit Regulations 2015 was not possible. The primary reason for the late opinion was the exceptional resourcing pressures experienced by the External Auditor. The circumstances that led to the delayed opinion were not unique to Maidstone with the professional press reporting that over 40% of opinions missed the deadline nationally this year.
- The updated Audit Findings Report identified two adjustments to the financial statements that resulted in a £3,531,000 adjustment to the Comprehensive Income and Expenditure Statement, but there was no impact on the General Fund outturn.

In response to questions, the Director of Finance and Business Improvement advised the Committee that:

- At the meeting of the Committee held on 30 July 2019, the representative of the External Auditor said that it was anticipated that the audit opinion would be issued the following day. In his view, the External Auditor had underestimated the amount of work they still needed to do and it was very disappointing that it had taken until 16 August 2019 to conclude the outstanding audit work and issue an opinion. It would be reasonable for Members to challenge the representatives of Grant Thornton who would be present at the next meeting as to the reasons for the delay.
- He did not think there was anything the Council could have done because it had acted in good faith based on what the External Auditor had said. There was a wider issue which had been addressed in the local government press that auditors, not just Grant Thornton, who had been auditing local authorities had struggled to deliver audits with the reduced fees they were now charging. The Council would be seeking assurances from Grant Thornton that this situation would not occur next year.
- The Council had not been charged any additional audit fees in connection with the delayed opinion.
- From a client perspective, going forward, it was necessary to have a reliable set of accounts ready for the External Auditor to look at, to obtain a firm commitment from the External Auditor on the timing of the audit and to allow sufficient time before 31 July for proper consideration by the Committee.
- A full actuarial valuation of the Pension Fund was required every three years. The latest full actuarial valuation was completed in 2016 so a full actuarial valuation would be taking place this year.

Members indicated that they wished to ask questions of representatives of the External Auditor relating to the delay in issuing the audit opinion.

RESOLVED: That the External Auditor's updated Audit Findings Report, attached as Appendix 1 to the report of the Interim Head of Finance, be noted.

41. BUDGET STRATEGY - RISK ASSESSMENT UPDATE

The Director of Finance and Business Improvement introduced his report providing an update on the budget risks facing the Council.

The Director of Finance and Business Improvement explained that:

- The two principal budget risks continued to be uncertainty about future local government funding arrangements and the potential financial consequences of a disorderly Brexit.
- There had been one further development since the report was written which was that the Chancellor had announced next year's spending

round. It was now known that the Government was assuming a Council Tax referendum limit of 2% although that was still subject to consultation and had not been finally agreed. The Business Rates baseline was going to be increased by the rate of inflation. There was, therefore, more certainty for next year, but there was still a risk in the longer term about the funding of local government so it was not proposed to change the rank rating of the risk at this time.

RESOLVED: That the updated risk assessment of the Budget Strategy, attached as Appendix A to the report of the Director of Finance and Business Improvement, be noted.

42. INTERNAL AUDIT CHARTER

The Head of Audit Partnership introduced his report proposing an updated Internal Audit Charter. The Head of Audit Partnership explained that the Charter was a key document setting out the roles and responsibilities of the Council's Internal Audit service and its relationships with Officers and Members. It had been updated to reflect changes in Public Sector Internal Audit Standards (the "Standards") and audit practice, most notably to reflect the Committee's expressed wish to have greater engagement with service areas which receive adverse (i.e. weak or poor) Internal Audit opinions.

In response to questions, the Head of Audit Partnership advised the Committee that:

- He was satisfied that there was sufficient Internal Audit resource in terms of both quantity and expertise to deliver the 2019/20 Internal Audit Plan. The proposed approach to dealing with adverse Internal Audit opinions would involve a small amount of additional work in producing the reports, but it could be managed without compromising any other areas of work.
- Each of the Audit Partnership authorities would be updating their Internal Audit Charters to reflect changes in the Standards and practice.
- The Charter made no changes to the everyday mechanics of the Internal Audit approach and detailed current practice. The Charter and its obligations were referred to in the Internal Audit Plan and as part of the material provided to audit sponsors (Heads of Service etc.) at audit planning stage and when undertaking audits. He was satisfied that the obligations within the Charter were complied with. There was an obligation to regularly review and update the Charter and, in terms of quality, the Internal Audit Service would undergo an External Quality Assessment on conformance with the Standards later in the year and the findings of the assessment would be reported to the Committee in the spring of 2020.

During the discussion on this item, the Head of Audit Partnership was congratulated on the production of the updated Charter and thanked for his work and that of the Internal Audit team.

RESOLVED: That the updated Internal Audit Charter, attached as Appendix 1 to the report of the Head of Audit Partnership, be approved.

43. DURATION OF MEETING

6.30 p.m. to 8.30 p.m.

2019/20 WORK PROGRAMME

	Committee	Month	Lead	Report Author
Updated Anti-Money Laundering Policy	AGS	13-Jan-20	Mark Green	Chris Hartgrove
Data Protection Act 2018 Update	AGS	13-Jan-20	Angela Woodhouse	Angela Woodhouse
Annual Governance Statement Update	AGS	13-Jan-20	Angela Woodhouse	Angela Woodhouse
Member Declarations Audit Action Plan - Update	AGS	13-Jan-20	Patricia Narebor	TBC
Budget Strategy - Risk Assessment	AGS	13-Jan-20	Mark Green	Mark Green
Risk Management Annual Report	AGS	13-Jan-20	Rich Clarke	Rich Clarke
Counter-Fraud Strategy	AGS	13-Jan-20	Rich Clarke	Rich Clarke
Housing Benefit Grant Claim	AGS	13-Jan-20	Sheila Coburn	Sheila Coburn
Treasury Management Strategy 2020/21	AGS	13-Jan-20	Chris Hartgrove	John Owen
Audit & Assurance Plan	AGS	16-Mar-20	Rich Clarke	Rich Clarke
Budget Strategy - Risk Assessment	AGS	16-Mar-20	Mark Green	Mark Green
Complaints Received Under the Members' Code of Conduct	AGS	16-Mar-20	Patricia Narebor	Christine Nuttall
Review of Standards Procedures in the Constitution	AGS	16-Mar-20	Patricia Narebor	Christine Nuttall
External Audit Update Report March 2020	AGS	16-Mar-20	Mark Green	Chris Hartgrove

2019/20 WORK PROGRAMME

	Committee	Month	Lead	Report Author
External Auditor's Audit Plan 2019/20	AGS	16-Mar-20	Mark Green	Chris Hartgrove
Risk Management Process	AGS	TBA	Rich Clarke	

Agenda Item 11

Audit, Governance and Standards Committee

18 November 2019

Annual Audit Letter (year ended 31 March 2019)

Final Decision-Maker	Audit, Governance and Standards Committee
Lead Head of Service/Lead Director	Mark Green, Director of Finance and Business Improvement
Lead Officer and Report Author	Chris Hartgrove, Interim Head of Finance
Classification	Public
Wards affected	All

Executive Summary

The Annual Audit Letter (**Appendix 1**) sets out the key findings from the work undertaken by the external auditors (Grant Thornton) for the year ended 31 March 2019, and concludes the audit process for 2018/19.

Timetable

Meeting	Date
Audit, Governance and Standards Committee	18 November 2019

This report makes the following recommendations to the Committee:

1. That the external auditor's (Grant Thornton) Annual Audit Letter for the year ended 31st March 2019 (**Appendix 1**) be noted.

Annual Audit Letter (year ended 31 March 2019)

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The recommendations will by themselves not materially affect achievement of corporate priorities. However, the Council is committed to delivering on its corporate priorities and securing value for money through effective governance. This Annual Audit Letter is one measure of how effective the council has been in delivering against this commitment.	Director of Finance & Business Improvement
Cross Cutting Objectives	As noted above, the Council is committed to delivering on its corporate priorities (and securing value for money through effective governance). The Council's corporate priorities include a range of cross-cutting objectives.	Director of Finance & Business Improvement
Risk Management	Detailed within Section 5.	Director of Finance & Business Improvement
Financial	The financial implications arising from the work of external audit are detailed within Appendix 1 .	Director of Finance & Business Improvement
Staffing	No implications identified.	Director of Finance & Business Improvement
Legal	The terms of reference for the Audit, Governance and Standards Committee require the Committee to consider the external auditor's Annual Audit Letter.	Director of Finance & Business Improvement

Issue	Implications	Sign-off
Privacy and Data Protection	No implications identified.	Director of Finance & Business Improvement
Equalities	No implications identified.	Director of Finance & Business Improvement
Public Health	No implications identified.	Director of Finance & Business Improvement
Crime and Disorder	No implications identified.	Director of Finance & Business Improvement
Procurement	No implications identified.	Director of Finance & Business Improvement

2. INTRODUCTION AND BACKGROUND

- 2.1 The Annual Audit Letter sets out the key findings from the work external audit work undertaken for the year end 31st March 2019 by Grant Thornton. Representatives from Grant Thornton will be in attendance at the meeting to present the document and respond to any questions which Committee members may have.
- 2.2 It is recommended that this document is considered by the Committee in accordance with the terms of reference detailed within the Council's Constitution.
- 2.3 Key findings to note in the Annual Audit Letter at Appendix 1 include:
- The external auditor gave an unqualified opinion on the Council's 2018/19 Statement of Accounts on 16th August 2019; and
 - The external auditor is satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31st March 2019.

3. AVAILABLE OPTIONS

- 3.1 The report is for noting only.

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The report is for noting only.

5. RISK

5.1 The report is presented for information only and has no risk management implications.

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 No formal consultation has been undertaken in relation to this report.

6.2 The Committee previously considered the Grant Thornton's Audit Findings Report for the year ending 31st March 2019 as part of the formal adoption of the annual financial statements for the 2018/19 financial year (30th July 2019).

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 The Annual Audit Letter concludes the audit process for 2018/19. There are no further steps.

8. REPORT APPENDICES

8.1 The following document is published with this report and forms part of the report:

- Appendix 1 – "Annual Audit Letter (year ended 31st March 2019)"
TO FOLLOW
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9. BACKGROUND PAPERS

9.1 None.

Agenda Item 12

Audit, Governance and Standards Committee

18 November 2019

Audit Progress Report & Sector Update (year ended 31 March 2020)

Final Decision-Maker	Audit, Governance and Standards Committee
Lead Head of Service/Lead Director	Mark Green, Director of Finance and Business Improvement
Lead Officer and Report Author	Chris Hartgrove, Interim Head of Finance
Classification	Public
Wards affected	All

Executive Summary

Members of the Committee are invited to consider the external auditor's (Grant Thornton) report which provides an update on progress with the 2019/20 audit and offers a summary of emerging national issues and developments of relevance to the local government sector.

Representatives from Grant Thornton will be in attendance at the meeting to present their report and respond to any questions.

Timetable

Meeting	Date
Audit, Governance and Standards Committee	18 November 2019

This report makes the following recommendations to the Committee:

1. That the external auditor's (Grant Thornton) Audit Progress Report & Sector Update for the year ended 31st March 2020 (**Appendix 1**) be noted.

Audit Progress Report & Sector Update (year ended 31 March 2020)

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The report is focused on ensuring that the auditor's opinion on the 2019/20 financial statements and value for money conclusion are issued by the statutory deadline of 31st July 2020.	Director of Finance & Business Improvement
Cross Cutting Objectives	No implications identified.	Director of Finance & Business Improvement
Risk Management	Detailed within Section 5.	Director of Finance & Business Improvement
Financial	There are no direct financial implications arising from the report, although the opinion on the Statement of Accounts and Value for Money conclusion are one mechanism through which the Council demonstrates financial accountability.	Director of Finance & Business Improvement
Staffing	No implications identified.	Director of Finance & Business Improvement
Legal	No implications identified.	Director of Finance & Business Improvement
Privacy and Data Protection	No implications identified.	Director of Finance & Business Improvement
Equalities	No implications identified.	Director of Finance & Business Improvement

Issue	Implications	Sign-off
Public Health	No implications identified.	Director of Finance & Business Improvement
Crime and Disorder	No implications identified.	Director of Finance & Business Improvement
Procurement	No implications identified.	Director of Finance & Business Improvement

2. INTRODUCTION AND BACKGROUND

- 2.1 External audit services are provided by Grant Thornton for the 2019/20 financial year following their appointment by Public Sector Audit Appointments Ltd (PSAA) for the period from 2018/19 to 2022/23.
 - 2.2 The report attached at **Appendix 1** provides an update on progress with the 2019/20 audit and informs committee Members of a number of relevant emerging issues and sector developments.
-

3. AVAILABLE OPTIONS

- 3.1 The report is for noting only.
-

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

- 4.1 The report is for noting only.
-

5. RISK

- 5.1 The report is presented for information only and has no risk management implications.
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6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 No formal consultation has been undertaken in relation to this report.

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 The next steps are outlined in Appendix 1.

8. REPORT APPENDICES

8.1 The following document is published with this report and forms part of the report:

- Appendix 1 – “Audit Progress Report & Sector Update (year ended 31st March 2020)”
-

9. BACKGROUND PAPERS

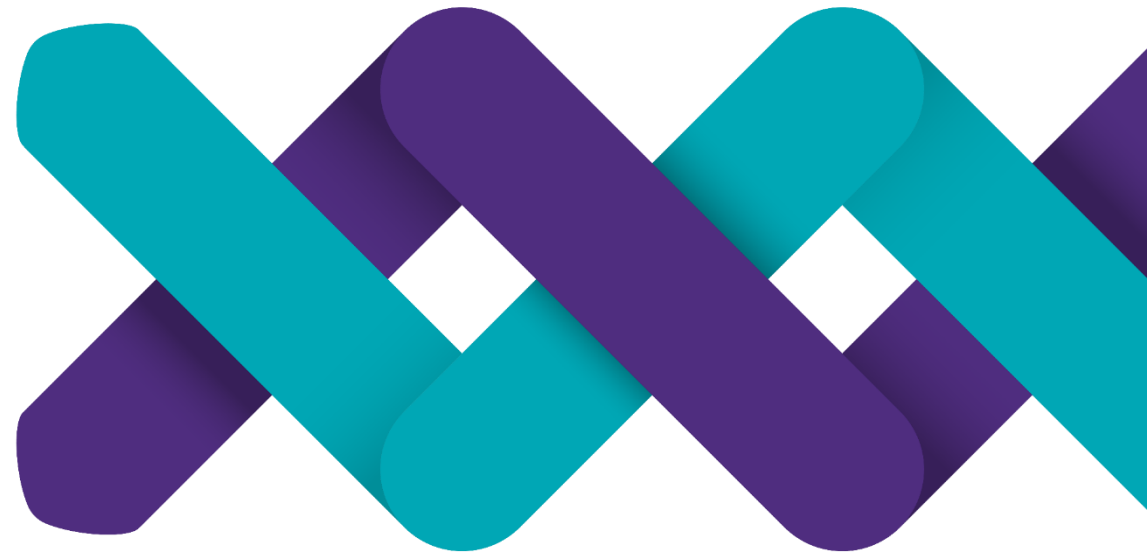
9.1 None.

APPENDIX 1

Audit Progress Report and Sector Update

Maidstone Borough Council
Year ending 31 March 2020

18 November 2019



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Introduction



Liz Jackson

Engagement Lead

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This paper provides the Audit, Governance and Standards Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

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Tina James

Engagement Manager

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Members of the Audit, Governance and Standards Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk ..

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at November 2019

Financial Statements Audit

We issued our opinion on your 2018/19 Statement of Accounts on 16 August 2019. We will begin our planning for the 2019/20 audit in December and will issue a detailed audit plan, setting out our proposed approach to the audit of the Council's 2018/19 financial statements.

We will begin our interim audit in January 2020. Our interim fieldwork includes:

- Updated review of the Council's control environment
- Updated understanding of financial systems
- Review of Internal Audit reports on core financial systems
- Early work on emerging accounting issues
- Early substantive testing

We will report our work in the Audit Findings Report and aim to give our opinion on the Statement of Accounts by the statutory accounts publication date of 31 July 2020.

Value for Money

The scope of our work is set out in the guidance issued by the National Audit Office. The Code requires auditors to satisfy themselves that; "the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

The guidance confirmed the overall criterion as: "in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

The three sub criteria for assessment to be able to give a conclusion overall are:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

Details of our initial risk assessment to determine our approach will be included in our Audit Plan.

We will report our work in the Audit Findings Report and aim to give our Value For Money Conclusion by the statutory accounts publication date of 31 July 2020.

Progress at November 2019 (Cont.)

Other areas

Certification of claims and returns

We certify the Council's annual Housing Benefit Subsidy claim in accordance with procedures agreed with the Department for Work and Pensions. The certification work for the 2018/19 is in progress and will be completed by the 29 November deadline. We will report our findings to the Audit Committee in our Certification Letter in January 2020.

Meetings

We met with Finance Officers in October and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Council. Further details of the publications that may be of interest to the Council are set out in our Sector Update section of this report.

Audit Fees

During 2017, PSAA awarded contracts for audit for a five year period beginning on 1 April 2018. 2019/20 is the second year of that contract. Since that time, there have been a number of developments within the accounting and audit profession. Across all sectors and firms, the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing.

Our work in the Local Government sector in 2018/19 has highlighted areas where financial reporting, in particular, property, plant and equipment and pensions, needs to improve. There is also an increase in the complexity of Local Government financial transactions and financial reporting. This combined with the FRC requirement that all Local Government audits are at or above the "few improvements needed" (2A) rating means that additional audit work is required.

We are currently reviewing the impact of these changes on both the cost and timing of audits. We will discuss this with your s151 Officer including any proposed variations to the Scale Fee set by PSAA Limited, before communicating fully with the Audit, Governance and Standards Committee.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting.

Audit Deliverables

2018/19 Deliverables	Planned Date	Status
<p>Audit Findings Report</p> <p>The Audit Findings Report was reported to the July Audit Committee.</p>	July 2019	Complete
<p>Auditors Report</p> <p>This is the opinion on your financial statement, annual governance statement and value for money conclusion.</p>	August 2019	Complete
<p>Annual Audit Letter</p> <p>This letter communicates the key issues arising from our work.</p>	August 2019	Complete
2019/20 Deliverables	Planned Date	Status
<p>Fee Letter</p> <p>Confirming audit fee for 2018/19.</p>	April 2019	Complete
<p>Accounts Audit Plan</p> <p>We are required to issue a detailed accounts audit plan to the Audit, Governance and Standards Committee setting out our proposed approach in order to give an opinion on the Council's 2019-20 financial statements.</p>	March 2020	Not yet due
<p>Interim Audit Findings</p> <p>We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.</p>	March 2020	Not yet due
<p>Audit Findings Report</p> <p>The Audit Findings Report will be reported to the July Audit, Governance and Standards Committee.</p>	July 2020	Not yet due
<p>Auditors Report</p> <p>This is the opinion on your financial statement, annual governance statement and value for money conclusion.</p>	July 2020	Not yet due
<p>Annual Audit Letter</p> <p>This letter communicates the key issues arising from our work.</p>	August 2020	Not yet due

Sector Update

Councils are tackling a continuing drive to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider local government and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- [Grant Thornton Publications](#)
- [Insights from local government sector specialists](#)
- [Reports of interest](#)
- [Accounting and regulatory updates](#)

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local
government

CIPFA – CFO confidence survey

In July, the Chartered Institute of Public Finance and Accountancy (CIPFA) reported the results of their annual confidence survey.

The survey found that the majority of local government finance officers have lost confidence in their future financial positions over the last year.

Seventy per cent of respondents said they were either slightly less or much less confident in their financial position this year compared to 2018-19.

The survey also found that 68% said they were either slightly less or much less confident in their ability to deliver services in 2020-21. Sixty-two per cent expressed equal confidence in their financial position for 2019-20 as they had last year.

CIPFA found that the area of greatest pressure for top tier authorities was children's social care, with the number of authorities rating it as the biggest pressure rising by six percentage points.

For districts the greatest pressures were housing, cultural services and environmental services.

Rob Whiteman, CIPFA chief executive, said: "Local government is facing greater demand pressures than ever before, with particularly pressures in adults' and children's social care and housing. Local authorities also lack certainty about their future financial positions, so it's unsurprising to see confidence on the decline."

"We have repeatedly pointed out that local government is in need of a sustainable funding solution, but meeting this demand requires more than pennies and pounds. The sector as a whole must come together to address the challenges of effective service delivery."

CIPFA's survey received a total of 119 responses from authorities in the UK - 56 top tier authorities, 47 English districts, 12 Scottish authorities, and 4 Welsh authorities.



On the same theme, a Local Government Association (LGA) survey, also reported in July, found that almost two-thirds of councils believe cash for services like adult social care, child protection and preventing homelessness will dry up by 2024-25.

The survey got responses from 141 of the 339 LGA member councils in England and Wales.

It also found that 17% of councils were not confident of realising all of the savings they had identified this year (2019-20).

The LGA said that councils needed a guarantee they will have enough money to meet growing demand pressures in particular in adult social care, children's services, special educational needs, homelessness support and public health.



Financial confidence



Challenge question:

How confident over its' financial position is your Authority? Has this changed from previous years?

MHCLG – Independent probe into local government audit

In July, the then Communities secretary, James Brokenshire, announced the government is to examine local authority financial reporting and auditing.

At the CIPFA conference he told delegates the independent review will be headed up by Sir Tony Redmond, a former CIPFA president.

The government was “working towards improving its approach to local government oversight and support”, Brokenshire promised.

“A robust local audit system is absolutely pivotal to work on oversight, not just because it reinforces confidence in financial reporting but because it reinforces service delivery and, ultimately, our faith in local democracy,” he said.

“There are potentially far-reaching consequences when audits aren’t carried out properly and fail to detect significant problems.”

The review will look at the quality of local authority audits and whether they are highlighting when an organisation is in financial trouble early enough.

It will also look at whether the public has lost faith in auditors and whether the current audit arrangements for councils are still “fit for purpose”.

On the appointment of Redmond, CIPFA chief executive Rob Whiteman said: “Tony Redmond is uniquely placed to lead this vital review, which will be critical for determining future regulatory requirements.

“Local audit is crucial in providing assurance and accountability to the public, while helping to prevent financial and governance failure.”

He added: “This work will allow us to identify what is needed to make local audit as robust as possible, and how the audit function can meet the assurance needs, both now and in the future, of the sector as a whole.”

In the question and answer session following his speech, Brokenshire said he was not looking to bring back the Audit Commission, which appointed auditors to local bodies and was abolished in 2015. MHCLG note that auditing of local authorities was then taken over by the private, voluntary and not-for-profit sectors.

He explained he was “open minded”, but believed the Audit Commission was “of its time”.

Local authorities in England are responsible for 22% of total UK public sector expenditure so their accounts “must be of the highest level of transparency and quality”, the Ministry of Housing, Local Government and Communities said. The review will also look at how local authorities publish their annual accounts and if the financial reporting system is robust enough.

Redmond, who has also been a local authority treasurer and chief executive, is expected to report to the communities secretary with his initial recommendations in December 2019, with a final report published in March 2020. Redmond has also worked as a local government boundary commissioner and held the post of local government ombudsman.



National Audit Office – Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfill their statutory responsibilities under the Local Audit and Accountability Act 2014. 'Relevant authorities' are set out in Schedule 2 of the Act and include local councils, fire authorities, police and NHS bodies.

Local auditors must comply with the Code of Audit Practice.

Consultation – New Code of Audit Practice from 2020

Schedule 6 of the Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, and the maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come in to force no later than 1 April 2020.

In order to determine what changes might be appropriate, the NAO is consulting on potential changes to the Code in two stages:

Stage 1 involves engagement with key stakeholders and public consultation on the issues that are considered to be relevant to the development of the Code.

This stage of the consultation is now closed. The NAO received a total of 41 responses to the consultation which included positive feedback on the two-stage approach to developing the Code that has been adopted. The NAO state that they have considered carefully the views of respondents in respect of the points drawn out from the [Issues paper](#) and this will inform the development of the draft Code. A summary of the responses received to the questions set out in the [Issues paper](#) can be found below.

[Local audit in England Code of Audit Practice – Consultation Response \(pdf – 256KB\)](#)

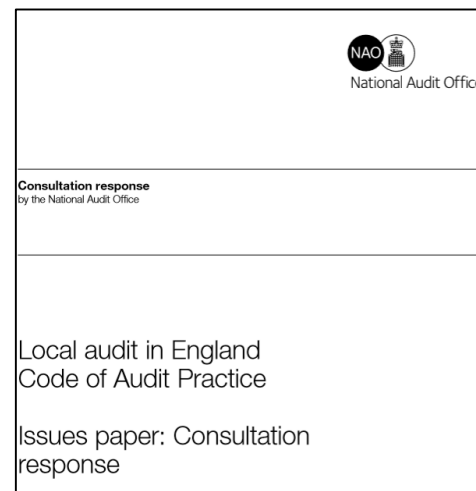
Stage 2 of the consultation involves consulting on the draft text of the new Code. To support stage 2, the NAO has published a consultation document, which highlights the key changes to each chapter of the draft Code. The most significant changes are in relation to the Value for Money arrangements. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances. The Code proposes three specific criteria:

- Financial sustainability: how the body plans and manages its resources to ensure 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.

The consultation document and a copy of the draft Code can be found on the NAO website. The consultation is open until 22 November 2019. The new Code will apply from audits of local bodies' 2020-21 financial statements onwards.

Link to NAO webpage for the Code consultation:

<https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/>



Local Government Association – Profit with a purpose – delivering social value through commercial activity

The Local Government Association (LGA) report 'Profit with a purpose' focuses on some of the practicalities of how councils can deliver social value through their commercial activity.

Through 'key questions' to ask, the guidance supports councils to face the challenge of how to undertake commercial activity and achieve greater value for the public purse in ways that better meet society's needs and outcomes for people and communities.

In addition, the publication features a number of short case studies highlighting some of the innovative commercial practice already achieving results for communities.

The LGA comments that the best approaches ensure the generation of social value is the primary factor driving commercial activity; from the initial decision to develop a commercial vision to how the approach is developed, and implemented, councils which are pulling ahead ensure social value is placed centre stage.

The guidance starts with an overview of what the LGA understands by 'profit with a purpose', the guidance explores different types of social value and the role of councils in driving social value alongside their commercial ambition.

The guidance then looks at how consideration and delivery of social value should be practically considered when deciding on whether to embark on commercial activity, the need for social value to be prioritised alongside financial return and the key questions councils should consider when embarking on a commercial initiative.

Following on from this, there are specific chapters on; embedding social value in governance of alternative service delivery vehicles, the role of procurement in contracting services that deliver social value and finally how to contract and performance manage social value through your service providers.

Each chapter outlines the factors that need to be considered and the 'key questions' councils should be asking themselves.

In addition, a number of short case studies are provided to highlight some of the innovative commercial practice already achieving results for communities.

The report can be downloaded from the LGA website:

<https://www.local.gov.uk/profit-purpose-delivering-social-value-through-commercial-activity>



Profit with a purpose

Delivering social value through commercial activity

Profit with a purpose



Challenge question:

If your Authority is looking at commercial activity, have you considered the LGA report?

Public Accounts Committee – Local Government Governance and Accountability

The Public Accounts Committee has found that the Government has not done enough to ensure that, at a time when local authority budgets are under extreme pressure, governance systems are improved.

The Ministry of Housing, Communities & Local Government (the Department) is responsible for: ensuring that this framework contains the right checks and balances, and changing the system if necessary. The Secretary of State also has powers to intervene in cases of perceived governance failure. The framework includes: officers with statutory powers and responsibilities; internal checks and balances such as audit committees and internal audit; and external checks and balances such as external audit and sector-led improvement overseen by the Local Government Association. These arrangements represent a significant reduction in the level of central oversight in recent years following the government's decision to abolish the Audit Commission and the Standards Board for England as part of a broader reform of local audit, inspection and reporting.

The Public Accounts Committee report summary notes “Local authorities have a good overall track record with governance arrangements generally robust across the sector, and there is evidence that local authority governance compares favourably to that of the health sector. However, this is not universal and in some authorities governance is under strain, as funding reduces and responsibilities and exposure to commercial pressures change. We are worried to hear about audit committees that do not provide sufficient assurance, ineffective internal audit, weak arrangements for the management of risk in local authorities’ commercial investments, and inadequate oversight and scrutiny. This is not acceptable in the more risky, complex and fast-moving environment in which local authorities now operate.

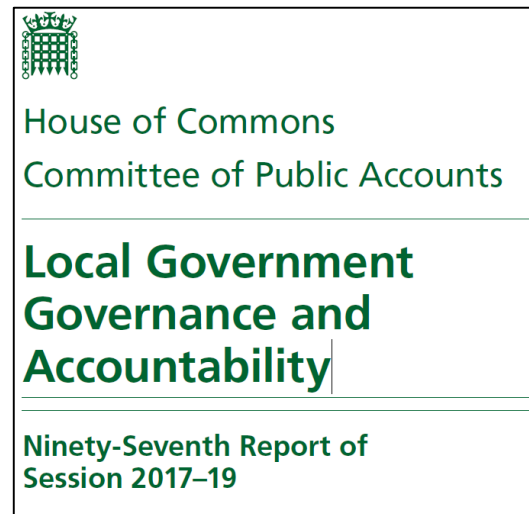
The Department has been reactive and ill-informed in its approach to oversight of the local governance system. However, the Department has now recognised that the network of bodies with responsibility for the local governance framework is fragmented and lacking the leadership needed to drive change. Encouragingly, the Department has now committed to enhancing its oversight role and producing a proactive work programme to deliver this change. We urge the Department to ensure that this activity leads to concrete actions and outcomes on a timely basis. When a local authority fails this has a significant impact on local people and the Department has a responsibility to work with local government to ensure that problems are caught early and that it can pinpoint at-risk councils. Since the abolition of the Audit Commission and other changes culminating in the Local Audit and Accountability Act 2014 there is no central assessment of value for the money, which means the Department's work is fundamental.”

The report makes five conclusions, with associated recommendations:

- 1) The Department is not yet providing effective leadership of the local governance system.
- 2) The Department does not know why some local authorities are raising concerns that external audit is not meeting their needs.
- 3) The Department lacks reliable information on key governance risks, or relies on weak sources of information, meaning it has no way of pinpointing the at-risk councils.
- 4) The Department's monitoring is not focused on long-term risks to council finances and therefore to services.
- 5) There is a complete lack of transparency over both the Department's informal interventions in local authorities with financial or governance problems and the results of its formal interventions.

The Government response is available on the website below:

<https://www.parliament.uk/documents/commons-committees/public-accounts/Gov-response-to-Public-Accounts-on-the-93-98-reports.pdf>



Agenda Item 13

AUDIT, GOVERNANCE & STANDARDS COMMITTEE

**18 NOVEMBER
2019**

Internal Audit Interim Report 2019/20

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service	Rich Clarke, Head of Audit Partnership
Lead Officer and Report Author	Rich Clarke, Head of Audit Partnership
Classification	Public
Wards affected	All

Executive Summary and Purpose of Report

The report summarises, for Member information, progress towards delivering the 2019/20 Audit & Assurance Plan approved by this Committee on 19 March 2019.

This report makes the following recommendations to this Committee:

1. That progress so far on completing the 2019/20 Audit and Assurance Plan be noted.

Timetable

<i>Meeting</i>	<i>Date</i>
Audit, Governance & Standards Committee	18 November 2019

Internal Audit Interim Report 2019/20

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	We do not expect the recommendations will by themselves materially affect achievement of corporate priorities. However, they will support the Council's overall achievement of its aims by promoting good governance.	Rich Clarke Head of Audit Partnership 7 November 2019
Cross Cutting Objectives	The report recommendation supports achievement of cross cutting objectives by supporting good governance.	
Risk Management	No additional implications.	
Financial	We will continue towards delivering the plan within already agreed budgets.	
Staffing	We will continue towards delivering the plan within agreed staffing levels.	
Legal	Accepting the recommendation will help the Council towards meeting its obligations under the Accounts & Audit Regulations 2015.	
Privacy and Data Protection	No new implications.	
Equalities	No new implications	
Public Health	No new implications	
Crime and Disorder	No new implications	
Procurement	No further procurement exercises required.	

2. INTRODUCTION AND BACKGROUND

2.1 This Committee approved the 2019/20 Audit and Assurance Plan at its meeting on 19 March 2019. This report summarises progress towards delivering the plan up to the end of October, as it works towards culminating in a Head of Audit Opinion in July 2020.

3. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

3.1 We present the report for Member information and for noting.

4. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

4.1 The format and information presented in the report builds on Committee feedback to previous audit summary reports.

5. REPORT APPENDICES

- Appendix 1: Internal Audit Interim Report 2019/20
-

6. BACKGROUND PAPERS

Full audit reports supporting the summarised findings are available on request.

APPENDIX 1

INTERNAL AUDIT INTERIM REPORT 2019/20

Interim Internal Audit & Assurance Report



November 2019
Maidstone Borough Council



MID KENT AUDIT

Introduction

1. The Institute of Internal Audit gives the mission of internal audit: to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.
2. The mission and its associated [code of ethics](#) and [Standards](#) govern over 200,000 professionals in businesses and organisations around the world. Within UK Local Government, authority for internal audit stems from the [Accounts and Audit Regulations 2015](#). The Regulations state services must follow the [Public Sector Internal Audit Standards](#) – an adapted and more demanding version of the global standards. Those Standards set demands for our reporting:

2060 Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility and performance relative to its plan and on its conformance with the *Code of Ethics* and the *Standards*. Reporting must also include significant risk and control issues, including fraud risks, governance issues and other matters that require the attention of senior management and/or the board.

Interpretation:

The frequency and content of reporting are determined collaboratively by the chief audit executive, senior management and the board. The frequency and content of reporting depends on the importance of the information to be communicated and the urgency of the related actions to be taken by senior management and/or the board.

The chief audit executive's reporting and communication to senior management and the board must include information about:

- The audit charter.
- Independence of the internal audit activity.
- The audit plan and progress against the plan.
- Resource requirements.
- Results of audit activities.
- Conformance with the *Code of Ethics* and the *Standards*, and action plans to address any significant conformance issues.
- Management's response to risk that, in the chief audit executive's judgment, may be unacceptable to the organisation.

Audit Charter

3. This Committee approved our *Audit Charter* in September 2019 and it remains in place through the audit year.

MID KENT AUDIT

Independence of internal audit

4. Mid Kent Audit works as a shared service between Ashford, Maidstone, Swale and Tunbridge Wells Borough Councils. A Shared Service Board including representatives from each council supervises our work based on our collaboration agreement.
5. Within Maidstone BC during 2019/20 we have continued to enjoy complete and unfettered access to officers and records to complete our work. On no occasion have officers or Members sought or gained undue influence over our scope or findings.
6. I confirm we have worked with full independence as defined in our Audit Charter and Standard 1100.

Management response to risk

7. We include the results of our work in the year so far later in this report. In our work we often raise recommendations for management action. During the year so far management have agreed to act on all recommendations we have raised. We report on progress towards implementation in the section titled *Recommendation Follow Up Results*.
8. There are no risks we have identified in our work that we believe management have unreasonably accepted.

Resource Requirements

9. We reported in our plan presented to this Committee in March 2019 an assessment on the resources available to the audit partnership for completing work at the Council. That review decided:

...we believe we have enough resource to deliver the 2019/20 plan
10. Since that plan we have had considerable changes in staffing, including losing two (and possibly three) members of the team to other internal audit services in Kent. However, considering extra contractor support available to us through the Apex Contract managed by LB Croydon, new recruits to the team and people returning from maternity leave we remain content we have enough resource to deliver the plan.

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Audit Plan Progress

11. This Committee approved our *Annual Audit & Assurance Plan 2019/20* on 18 March 2019. The plan set out an intended number of days devoted to each of various tasks. We began work on the plan during May 2019 and expect completing enough to form our *Annual Opinion* by June 2020.
12. The table below shows progress in total number of days delivered against the plan (figures are up to end of October 2019, about 40% through the audit year).

Category	2019/20 Plan Days	Outturn at Interim	Days Remaining
2018/19 Assurance Projects	0	28	n/a
2019/20 Assurance Projects	331	74	257
Non project assurance work ¹	159	60	99
Unallocated contingency	50	39	11
Totals (19/20 Work Only)	540	173	367

13. Based on resources available to the partnership for the rest of the year we forecast delivery of around 335 further audit days. This creates a forecast total of 508, or 94% of planned days.
14. We detail the specifics, and results, of this progress further within this report.

¹ Non-assurance project work includes our work in the fields of Risk Management, Counter Fraud and Investigative Support, following up recommendations and annual audit planning.

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Results of Audit Work

15. The tables below summarise audit project findings and outturn up to the date of this report. Where there are material matters finished between report issue and committee meeting we will provide a verbal update. (* = days split between partners, MBC only shown).

Completed Assurance Projects Since Annual Report in June 2019

	Title	Days Spent	Report Issue	Assurance Rating	Notes
2018/19 Plan Projects Issued after 1 June 2019					
	Licensing Administration	8*	Jun-19	Sound	Reported to Members July 2019
	Building Control	30	Jun-19	Sound	Reported to Members July 2019
	Revenues & Benefits Compliance Team	9*	Jul-19	Sound	Reported to Members July 2019
	Declarations of Interest	16	Jul-19	Weak	Reported to Members July 2019
	General Data Protection Regulations	6*	Jul-19	N/A	Reported to Members July 2019
I	Council Tax Reduction Scheme	8*	Aug-19	Sound	
II	Transformation	30	Aug-19	Sound	
IV	Cyber Security	8*	Oct-19	Sound	
2019/20 Plan Projects Issued up to Report Date					
III	Corporate Credit Cards	15	Oct-19	Sound	
V	Recruitment	8*	Oct-19	Sound	

MID KENT AUDIT

Assurance Projects Underway

Title	Days So Far	Expected Final Report	Notes / Stage
Planning Enforcement	15	Nov-19	Draft report issued
Civil Parking Enforcement	10*	Nov-19	Draft report issued
Commercial Waste	19	Nov-19	Fieldwork complete
Parks	11	Dec-19	Fieldwork complete
Health & Safety	21	Dec-19	Fieldwork complete
Council Tax Billing	3*	Dec-19	Fieldwork underway
Discretionary Housing Payments	1*	Jan-20	Planning
Social Media	2	Jan-20	Planning

Assurance Projects Yet to Begin But Scheduled

Title	Expected Start	Expected Report	Notes
Treasury Management	Quarter 3	Feb-20	
Planning Discharge Conditions	Quarter 3	Feb-20	
ICT Technical Support	Quarter 3	Feb-20	Joint with SBC & TWBC
Universal Credit	Quarter 3	Mar-20	Joint with TWBC
Waste Crime Team	Quarter 4	Apr-20	
Information Management	Quarter 4	Apr-20	Cross partnership
Network Security	Quarter 4	May-20	Cross partnership
Planning Administration	Quarter 4	May-20	Joint with SBC

We will continue to keep these projects under review because of our available resources and the changing risk position at the authority.

MID KENT AUDIT

Audit Project Summary Results

I: Council Tax Reduction Scheme (August 2019)

16. Our opinion based on our audit work is that the Service has **Sound** controls in place to manage its risks and support achievement of its objectives relating to the council tax reduction scheme.
17. The council tax reduction scheme has been appropriately approved and is being monitored through appropriate performance indicators which are regularly reported to appropriate levels within both Councils.
18. Our testing found that all claims sampled were verified, assessed and awarded in line with the scheme. However, the Data Protection declaration present on the Council Tax Support application form did not include all required text recommended by the Information Commissioners Office in the most recent guidance on privacy statements.

Recommendation summary

Critical (Priority 1)	0
High (Priority 2)	0
Medium (Priority 3)	1
Low (Priority 4)	1
Advisory	0

II: Transformation (August 2019)

19. Our opinion based on our audit work is that the Council has **SOUND** controls in place to manage its risks and support achievement of its objectives.
20. Reviews are assessed on receipt, in line with the Council's priorities and resources available. Projects are well governed with a project board or relevant officers oversee them. Recommendations are tracked and update reports on the progress and implementation of actions is communicated to the project board. The team reflect upon lessons learnt to improve future reviews.
21. Records of key decisions for individual reviews, such as agreement of objectives are not retained. There is no monitoring of planned dates against dates when projects were delivered, so there is no way to identify project overruns retrospectively. Where the Trello board is used there was a clearer link between the evidence and findings than when working papers are stored on the shared drive.

MID KENT AUDIT

Recommendation Summary

Critical (Priority 1)	0
High (Priority 2)	0
Medium (Priority 3)	0
Low (Priority 4)	10
Advisory	1

III: Corporate Credit Cards (October 2019)

22. Our opinion based on our audit work is that the Service has **Sound** controls in place to manage its risks and support achievement of its objectives relating to Corporate Credit Cards.
23. It is the responsibility of Finance to provide oversight of the corporate credit card process, and for cardholders to uphold the conditions outlined in the Council's Corporate Credit Card (CCC) policy, which was last refreshed in November 2018. The CCC policy must be upheld in conjunction with the Council's Financial Procedures, Gifts & Hospitality, Travel & Subsistence, and Non-Cash Reward Policies.
24. The audit confirmed that generally the CCC policy is followed with effective controls in place which ensure segregation of duties and to detect contravention. Our testing returned largely positive results but did identify a few minor findings with opportunities to tighten application of the controls. These include reminding cardholders to provide receipts or to complete a 'Card Purchase – No Receipt' form to substantiate all credit card transactions and periodically reviewing cardholder limits to ensure they are appropriate.

Recommendation Summary

Critical Priority 1)	0
High (Priority 2)	0
Medium (Priority 3)	0
Low (Priority 4)	3
Advisory	0

MID KENT AUDIT

IV: Cyber Security (October 2019)

25. Following recent cyber-related attacks experienced by well-established organisations including Councils and the NHS, cyber security has become a high-profile risk at many organisations concerned about suffering a similar attack themselves.
26. The HMG Cyber Essentials framework has been developed by Government and industry to provide a clear statement of the basic controls that all organisations should implement to mitigate the risk from internet-based threats, within the context of the 10 Steps to Cyber Security. The Cyber Essentials scheme defines a set of controls which, when correctly implemented, will provide organisations with basic protection from the most prevalent forms of threats derived from the Internet. In particular, it focuses on threats which require low levels of attacker skill, and which are widely available online.
27. Risk management is a vital starting point for organisations to act to protect their information and data. However, given the nature of the threat, the government believes that action should begin with a core set of security controls which all organisations – large and small – should implement. However, it does not offer a solution to remove all cyber security risk; for example, it is not designed to address more advanced, targeted attacks and hence organisations facing these threats will need to implement additional measures as part of their security strategy.
28. There is a Cyber Essentials Assurance Framework that offers a mechanism for organisations to demonstrate to customers, investors, insurers and others that they have taken these essential precautions. The level one Cyber Essentials certification is awarded on the basis of a verified self-assessment. An organisation undertakes their own assessment of their implementation of the Cyber Essentials control themes via a questionnaire, which is approved by a senior executive such as the CEO. This questionnaire is then verified by an independent accredited Certification Body to assess whether an appropriate standard has been achieved, and certification can be awarded. The level two (Cyber Essentials Plus) certification requires an independent vulnerability assessment to validate the effectiveness of controls declared in the self-assessment questionnaire.
29. Please note this audit was carried out based on the cyber essential principles.
30. Our opinion based on our audit work is that the IT service has **SOUND** controls in place to manage its risks and support achievement of its objectives.

MID KENT AUDIT

Recommendation summary

Critical (Priority 1)	0
High (Priority 2)	0
Medium (Priority 3)	3
Low (Priority 4)	0
Advisory	0

V: Recruitment (October 2019)

31. Our opinion based on our audit work is that there are **Sound** controls in place to manage risks and support achievement of objectives in relation to Recruitment.
32. We found the majority of the council's controls, to mitigate the risk of being unable to recruit staff with the right skills to deliver priorities, are well designed and fully operating.
33. Our testing established the service maintains a workforce strategy at each council and joint recruitment and selection policy/procedures, which are regularly reviewed. These key documents provide a framework upon which the recruitment process is based.
34. Recruitment roles are clearly defined and both Council's offer extensive staff rewards, which are continuously reviewed for appropriateness and adequacy.
35. Our testing of the recruitment process established compliance with procedures in all areas apart from training and retention of interview notes. Not all interview panels have an officer who has received recruitment and selection training. It is also unclear if they have instead satisfied the training requirement based on their experience.
36. Evidence of interview notes were not always saved, without these we could not establish if the selection process was completely fair and transparent. We have made recommendations to address these areas.

Recommendation summary

Critical (Priority 1)	0
High (Priority 2)	0
Medium (Priority 3)	1
Low (Priority 4)	1
Advisory	0

MID KENT AUDIT

Agreed Actions Follow Up Results

37. Our approach to agreed actions is that we follow up each as it falls due in line with the plan agreed with management when we finish our reporting. We report progress on implementation to Corporate Leadership Team each quarter. This includes noting any matters of continuing concern and where we have revisited an assurance rating (typically after addressing key actions).
38. In total, we summarise in the table below the current position on following up agreed actions:

Project	Total	High Priority	Medium Priority	Low Priority
Actions brought into 2019/20	33	10	12	11
New actions agreed in 2019/20	68	10	28	30
Total Actions Agreed	101	20	40	41
Fulfilled by 30 September 2019	52	13	22	17
Actions cfwd past 30 September	49	7	18	24
Not Yet Due	34	3	10	21
Delayed but no extra risk	15	4	8	3
Delayed with risk exposure	0	0	0	0

39. The four deferred high priority actions fall between three reviews.
- **Animal Welfare Controls:** The Council has experienced delays in re-procuring its stray dog collection service. We now expect these actions before the end of 2019/20. In the meantime the Council continues close supervision of its existing supplier.
 - **Declarations of Interest:** The Legal Service leading this work has sought to extend the timing for action to allow it to develop a more sustainable long term platform for managing declarations than a simple spreadsheet or listing. Action is underway and we will follow up again early in the New Year.
 - **Licensing:** The service has reissued one of the incorrect licenses that formed the basis of our finding and is seeking further legal advice on the other. It is working towards the training and system improvements that reduce the risk of future recurrence. We will follow up again early in the New Year.

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40. The table below shows distribution of outstanding recommendations across the Council (filtered to show only recommendations relevant to Maidstone). Note the numbers will not tally exactly with the table above because this includes recommendations raised in draft reports and therefore not yet final.

	Ashford Borough Council	Maidstone Borough Council	Swale Borough Council	Tunbridge Wells Borough Council	Shared Services
Accounting & Finance	-	3	-	-	1
Communications	-	-	-	-	-
Community Safety	-	2	-	-	1
Corporate	-	13	-	-	15
Culture & Economy	-	1	-	-	-
Democracy	-	-	-	-	-
Environment	-	1	-	-	-
Environmental Health	-	-	-	-	-
Estate Management	-	-	-	-	-
Housing & Landlord	-	-	-	-	-
Human Resources	-	-	-	-	9
Information Technology	-	-	-	-	3
Parking	-	-	-	-	6
Planning	-	10	-	-	-
Revenues & Benefits	-	-	-	-	-

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Other Audit Service Work

Risk Management Update

41. We will present a full update on risk management at the next meeting of this Committee.

Counter Fraud Update

42. We consider counter fraud and corruption risks in all of our audit engagements when considering the effectiveness of control. We also undertake distinct work to assess and support the Council's arrangements.

Investigations

43. We have liaised with a specialist division of the Police Service, the National Investigation Service (NATIS) concerning a long running investigation. We hope to provide more information on this investigation in due course.
44. We have also investigated a specific allegation from a member of the public concerning bribery and corruption within the Council's planning service. We found no evidence to substantiate the allegation.

Whistleblowing

45. The Council's whistleblowing policy names internal audit as one route through which Members and officers can safely raise concerns on inappropriate or even criminal behaviour.
46. We have so far had no matters raised with us through the Whistleblowing Policy this year.

National Fraud Initiative

47. We continue to coordinate the Council's response to the National Fraud Initiative (NFI). NFI is a statutory data matching project and we must send in various forms of data to the Cabinet Office who manage the exercise.

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48. We have looked into matches from non-revenues datasets. The Cabinet Office assigns a 'risk' rating to each match on a percentage scale. Our approach is to review all matches in sets with less than 20 to examine, and to look at first to matches rated over 50% risk in larger data sets. The Cabinet Office does not expect authorities to look into every match.

49. The table below sets out results so far for the data sets within Mid Kent Audit's scope:

Dataset	Matches to investigate	Completed	Frauds	Errors	Value
Creditors	112	57	0	0	0
Payroll	8	7	0	0	0
Housing Waiting List	43	36	0	1	0
Procurement	8	2	0	0	0
Licensing	6	6	0	0	0
Totals	177	108	0	1	0

50. We are working towards completing the investigations by the end of the year. The Cabinet Office plans to issue a new data set in January 2021.

Other Audit and Advice Work

51. We also continue to undertake a broad range of special and scheduled consultancy and advice work for the Council. Examples include our attendance at Information Governance and Corporate Governance Groups and as part of the Wider Management Team. We have also completed specific reviews looking at individual parts of the Council's control environment at the request of officers.

52. We have undertaken two serious case reviews for the Council as commissioned by the Kent Safeguarding Board. These follow serious, often fatal, incidents and co-ordinate across agencies to consider how each served and worked with the family involved. We will attend a final panel meeting on one of these reviews in December.

53. One by-product of the new external audit arrangements is that the housing benefit certification exercise now falls outside central contracts and authorities must separately commission the review from a relevant accountant (which cannot be the Council's internal auditors). In Mid Kent Audit, though, we have significant housing benefit expertise including a Head of Audit Partnership who formerly led the Audit Commission's regional work on housing benefits and two auditors who formerly worked as benefits assessors.

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54. After reaching agreement with the Council's external auditors we took on a significant proportion of the testing the Council would otherwise have paid Grant Thornton to complete. That work is nearly completion ahead of the 30 November claim deadline and will have saved the Council around £8,000.
55. We have also led and contributed to a series of Member briefings at the Council on issues of governance interest. We are keen to hear from Members on any other areas of interest which may form future briefing sessions.
56. We remain engaged and flexible in seeking to meet the assurance needs of the Council. We are happy to discuss opportunities large and small where the Council can usefully employ the experience and expertise of the audit team.

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Code of Ethics and Standards Compliance

Code of Ethics

57. This Code applies specifically to internal auditors, though individuals within the team must comply with similar Codes for their own professional bodies. Also the Standards also direct auditors in the public sector to consider the Committee on Standards in Public Life's *Seven Principles of Public Life* (the "Nolan Principles").
58. We have included the Code within our Audit Manual and training for some years. We also have policies and guidance in place on certain specifics, such as managing and reporting conflicts of interest.
59. We can report to Members we remain in conformance with the Code.

Public Sector Internal Audit Standards & External Quality Assessment

60. Under the Public Sector Internal Audit Standards we must each year assess our conformance to those standards and report the results of that assessment to Members.
61. As described in previous updates, 2019/20 is the fifth year since we underwent an external independent assessment and so we require a fresh review. We aim to put this work out to contract before the end of November working towards having a final report complete in the spring.
62. Based on our self-assessments we continue to work in full conformance with the Standards.

Acknowledgements

63. We achieve these results through the hard work and dedication of our team and the resilience that comes from working a shared service across four authorities.
64. As a management team in Mid Kent Audit, we wish to send our public thanks to the team for their work through the year so far.
65. We would also like to thank Managers, Officers and Members for their continued support as we complete our audit work during the year.

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Annex: Assurance & Priority level definitions

Assurance Ratings 2019/20 (Unchanged from 2014/15)

Full Definition	Short Description
<p>Strong – Controls within the service are well designed and operating as intended, exposing the service to no uncontrolled risk. There will also often be elements of good practice or value for money efficiencies which may be instructive to other authorities. Reports with this rating will have few, if any; recommendations and those will generally be priority 4.</p>	<p>Service/system is performing well</p>
<p>Sound – Controls within the service are generally well designed and operated but there are some opportunities for improvement, particularly with regard to efficiency or to address less significant uncontrolled operational risks. Reports with this rating will have some priority 3 and 4 recommendations, and occasionally priority 2 recommendations where they do not speak to core elements of the service.</p>	<p>Service/system is operating effectively</p>
<p>Weak – Controls within the service have deficiencies in their design and/or operation that leave it exposed to uncontrolled operational risk and/or failure to achieve key service aims. Reports with this rating will have mainly priority 2 and 3 recommendations which will often describe weaknesses with core elements of the service.</p>	<p>Service/system requires support to consistently operate effectively</p>
<p>Poor – Controls within the service are deficient to the extent that the service is exposed to actual failure or significant risk and these failures and risks are likely to affect the Council as a whole. Reports with this rating will have priority 1 and/or a range of priority 2 recommendations which, taken together, will or are preventing from achieving its core objectives.</p>	<p>Service/system is not operating effectively</p>

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Recommendation Ratings 2019/20 (unchanged from 2014/15)

Priority 1 (Critical) – To address a finding which affects (negatively) the risk rating assigned to a Council strategic risk or seriously impairs its ability to achieve a key priority. Priority 1 recommendations are likely to require immediate remedial action. Priority 1 recommendations also describe actions the authority **must** take without delay.

Priority 2 (High) – To address a finding which impacts a strategic risk or key priority, which makes achievement of the Council's aims more challenging but not necessarily cause severe impediment. This would also normally be the priority assigned to recommendations that address a finding that the Council is in (actual or potential) breach of a legal responsibility, unless the consequences of non-compliance are severe. Priority 2 recommendations are likely to require remedial action at the next available opportunity, or as soon as is practical. Priority 2 recommendations also describe actions the authority **must** take.

Priority 3 (Medium) – To address a finding where the Council is in (actual or potential) breach of its own policy or a less prominent legal responsibility but does not impact directly on a strategic risk or key priority. There will often be mitigating controls that, at least to some extent, limit impact. Priority 3 recommendations are likely to require remedial action within six months to a year. Priority 3 recommendations describe actions the authority **should** take.

Priority 4 (Low) – To address a finding where the Council is in (actual or potential) breach of its own policy but no legal responsibility and where there is trivial, if any, impact on strategic risks or key priorities. There will usually be mitigating controls to limit impact. Priority 4 recommendations are likely to require remedial action within the year. Priority 4 recommendations generally describe actions the authority **could** take.

Advisory – We will include in the report notes drawn from our experience across the partner authorities where the service has opportunities to improve. These will be included for the service to consider and not be subject to formal follow up process.

ⁱ Photograph of the River Medway running through Maidstone courtesy of Louise Taylor of the Mid Kent Audit Team.

Agenda Item 14

AUDIT, GOVERNANCE & STANDARDS COMMITTEE

18 November 2019

Maidstone Property Holdings Ltd - Governance

Final Decision-Maker	Council
Lead Head of Service	Mark Green, Director of Finance and Business Improvement
Lead Officer and Report Author	Mark Green, Director of Finance and Business Improvement
Classification	Public
Wards affected	All

Executive Summary

This report updates the Committee on the outcomes of a review of the governance arrangements at Maidstone Property Holdings Limited. This review has resulted in confirmation of the Company's future aims and objectives, an amended draft Business Plan and various other company documents, clarity on the Service Agreement required and clarity on the different roles of the Company and the Council. Policy and Resources Committee has agreed to recommend to Council a number of measures to implement the findings of the governance review.

This report makes the following recommendations to this Committee:

1. That the report is noted.

Timetable

Meeting	Date
Audit, Governance and Standards Committee	18 November 2019

Maidstone Property Holdings Ltd - Governance

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	<p>The four Strategic Plan objectives are:</p> <ul style="list-style-type: none"> • Embracing Growth and Enabling Infrastructure • Safe, Clean and Green • Homes and Communities • A Thriving Place <p>Maidstone Property Holdings Limited supports priorities 2, 3 and 4 as it improves and increases the provision of homes for rent in the borough and provides a quality letting management service.</p>	Director of Finance and Business Improvement
Cross Cutting Objectives	<p>The four cross-cutting objectives are:</p> <ul style="list-style-type: none"> • Heritage is Respected • Health Inequalities are Addressed and Reduced • Deprivation is Reduced and Social Mobility is Improved • Biodiversity and Environmental Sustainability is respected <p>Through the provision of high quality rented accommodation, which is well managed, the recommendations support the achievement of all of the objectives.</p>	Director of Finance and Business Improvement
Risk Management	Refer to section 7 of the report.	Director of Finance and Business Improvement
Financial	<p>The property acquired by the Council under its housing development and regeneration investment plan is leased to Maidstone Property Holdings Limited on market terms and then operated by the company. The income and expenditure associated with the Company is therefore factored into investment appraisals for housing development and regeneration. Regular reports on the company are presented to Policy and Resources Committee as part of the quarterly financial monitoring report.</p>	Director of Finance and Business Improvement
Staffing	Maidstone Property Holdings Limited is managed	Director of

	through a combination of our current staffing and external support through Sibley Pares, who have been procured to provide property management support.	Finance and Business Improvement
Legal	It is accepted law through various legislation, including s1 of the Localism Act that councils can form and operate local authority wholly owned trading and commercial companies. Many councils now have at least one commercial company, usually for housing and property.	Principal Solicitor, Corporate Governance
Privacy and Data Protection	As a wholly Council owned Maidstone Property Holdings Limited is subject to the requirements of FOI and data protection and account has been taken of these requirements in the drafting of the company documents	Director of Finance and Business Improvement
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment	Director of Finance and Business Improvement
Public Health	In providing high quality rental housing through the operation of the company, which is well managed, the Council intends to have a positive impact on the health, security and well-being of the population of the borough.	Director of Finance and Business Improvement
Crime and Disorder	There is unlikely to be any impact in this area and, if anything, the impact will be positive.	Director of Finance and Business Improvement
Procurement	As a non-Teckal company, the company will have to compete in the open market in future to provide additional services – if any – to the council. The company is a commercial outward facing company and is not intended to be subject to the public procurement rules when it is acting as a purchaser.	Director of Finance and Business Improvement

2. INTRODUCTION AND BACKGROUND

- 2.1 In September 2016, the Council incorporated a wholly owned company limited by shares called Maidstone Property Holdings Limited (“the Company”). The Company was established to hold property leased to it by the Council and to undertake other property development/management activities.
- 2.2 In December 2017, the Company’s structure was subject to a report by Internal Audit. The report identified a number of areas for improvement within the Company’s governance structure and assurance mechanisms which would need to be addressed as the scope of the Company’s activities expanded. A report to this Committee on 19th November 2018 described the Internal Audit findings and referred to a forthcoming review of the Company’s aims, objectives and governance structure. It was agreed that the outcomes of this review would be reported back to the Committee.

- 2.3 The review, which has been undertaken with the assistance of external solicitors, Anthony Collins Solicitors LLP, has resulted in confirmation of the Company's future aims and objectives, an amended draft Business Plan and various other company documents, clarity on the Service Agreement required, clarity on the different roles of the Company and the Council. Details are set out in sections 3 to 6 below.
- 2.4 In the meantime, the outcomes of the review have been reported to Policy and Resources Committee at their meeting on 23rd July 2019. Policy and Resources Committee agreed to recommend to Council a number of measures, intended to implement the findings of the governance review. These are as follows:
- to delegate to the Company Board, Policy and Resources Committee, and the Director of Finance and Business Improvement the various reserved matters set out in the schedule to the Operational Agreement
 - to approve the updated business plan of Maidstone Property Holdings Limited
 - to approve the amended Operational Agreement (including reserved matters)
 - to approve the amended Articles of Association
 - to approve the Service Agreement
 - to approve the relevant addition to the Terms of Reference of Policy and Resources Committee and to authorise the Head of Legal Partnership to make any necessary changes to the Constitution
 - to authorise the Director of Finance and Business Improvement to take all decisions he considers necessary (following consultation with the Head of Legal Partnership) to implement the changes outlined above and the documents referred to, to include making all shareholder decisions.
- 2.5 It is intended to table these recommendations at the meeting of Council on 18th December 2019.

3 THE PURPOSE OF THE COMPANY

- 3.1 The Company will be a vehicle through which market rented accommodation will be provided to a high standard and which will be affordable to its target market. It will aim to provide a more balanced housing market in the borough. It will assist with the regeneration of brownfield sites and stimulate local economy growth through creation of additional jobs.
- 3.2 As the Company's aims are commercial, it will not be a "Teckal" Company. A "Teckal" Company is one which is set up by a local authority primarily to provide its own services in a more commercial way, back to the Council itself. Such a company has severe limits on its ability to trade externally.

The intention for MPH Ltd is that it will have freedom to operate commercially in the market. In exchange for this freedom, the Council's relationship with the Company must be on arms length commercial terms.

3.3 These aims and objectives are set out in the draft Business Plan.

4 THE ROLE OF THE COUNCIL

4.1 The Council is the sole shareholder of the Company and the Company is wholly owned by the Council. This means that the Company will be included in the consolidated accounts of the Council, once it achieves a material level of activity. The Council will therefore have financial auditing requirements in respect of the Company and the Company's finances will appear in the Council's accounts and will be subject to external financial auditing.

4.2 As shareholder, the Council is responsible for certain functions in respect of the Company. These are called the "reserved matters" and are set out in a schedule at the back of the Operational Agreement. The schedule sets out those matters which the Council will delegate to the Board and which will be reserved to the Council to decide. It is proposed that the Council delegates the function to make shareholder decisions to the Policy and Resources Committee. This Committee already makes various decisions on behalf of the Council in respect of the Company and receives reports on the Company's business. However, there is nothing formal setting out in the Committee's terms of reference. It is therefore proposed to amend the wording of the terms of reference to include specific reference to its responsibility for shareholder decisions.

4.3 Although Policy and Resources Committee will receive regular reports on the Company's business and operations, it is not feasible for the committee to constantly meet to make the decisions required as shareholder. Therefore, it is proposed that the Committee delegates certain shareholder reserved matters to a nominated officer, who, it is suggested, should be the Director of Finance and Business Improvement. The extent of the delegation is shown in additional wording to the terms of reference of Policy and Resources Committee.

5 THE OPERATION OF THE COMPANY

5.1 The 2017 Audit report highlighted a number of areas where it was appropriate to formalise the operation of the Company. The amended arrangements include the following:

5.2 There will be four directors. They will be: the Director of Regeneration and Place, the Head of Housing and Community Services, the Head of Commissioning and Business Improvement and a senior member of the legal team (the precise person yet to be confirmed). There is provision for alternate directors. This means that if a director is not available at a board meeting, another director may vote on his/her behalf, as proxy. There is also provision for representatives of the Council to attend and observe Board meetings. It is agreed that this will generally be the Director of

Finance and Business Improvement. He will also represent the Council at the Annual General Meeting.

- 5.3 There will be regular Board meetings at least once a quarter. At the first meeting, the directors will formally adopt the new company documents and the Business Plan. They will also make any declarations of interests as Directors, which will formally be recorded. Democratic Services will provide a company secretarial function. There will be no extra remuneration for the directors, members of democratic services or any officer who undertakes work for the Company but the work will be recharged to the Company through agreement under the Services Agreement. Any travel expenses claimed on behalf of company business will be claimed at the usual rates through the Council's iTrent system and will be recharged to the Company. Reporting lines for the Company to the shareholder will be via regular reports to Policy and Resources Committee. In general, the operation of the Company is set out more clearly in the Operational Agreement and Articles of Association.

6 SERVICES AGREEMENT

- 6.1 The Internal Audit report recommended that there be a mechanism to record and re-charge the work that officers do for the Company. It is proposed therefore to adopt a Services Agreement. The Services Agreement contains a schedule detailing the work and the costs to be charged to the Company. For the time being, the following areas are listed: Finance, Legal, Housing Management, Democratic Services and Directors' time.

7 RISK

- 7.1 Maidstone Property Holdings is subject to a range of business risks arising from its property management activities. These are outside the scope of this report, being addressed generally as part of the Housing Development and Regeneration Investment Plan, and then in relation to individual properties as and when they are acquired.
- 7.2 The risks specifically addressed by this report concern compliance with legislation and the Council's own constitution. The purpose of the measures set out in this report is to minimise the risk of non-compliance and fully establish the Company as a commercial undertaking separate from the Council in its dealings. Any support from the Council to the Company will be on commercial terms. The proposed measures are based on professional advice from Mid Kent Legal Services and external solicitors Anthony Collins Solicitors LLP, which ensures that the risk is mitigated as much as possible. Going forward, adopting these measures and operating them on a regular basis will likewise minimise the risk of non-compliance.

8 CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

- 8.1 The report follows on from several meetings between the current Company directors, the Council's external legal advisor and MKLS, and a meeting of Policy and Resources Committee on 23 July 2019.

9 NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

- 9.1 A report will be presented to Council on 18 December 2019 to formally approve the new company documents, amend the terms of reference of Policy and Resources Committee and amend the delegations in the Constitution.

10 REPORT APPENDICES

None

11 BACKGROUND PAPERS

None

AUDIT, GOVERNANCE & STANDARDS COMMITTEE

18 November 2019

Treasury Management Mid-Year Review 2019/20

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service/Lead Director	Chris Hartgrove – Interim Head of Finance
Lead Officer and Report Author	John Owen – Finance Manager
Classification	Public
Wards affected	All

Executive Summary

This report sets out the activities of the Treasury Management Function for the first 6 months of the 2019/20 financial year in accordance with CIPFA’s Code of Practice on Treasury Management in Local Authorities.

This report makes the following recommendations to this Committee:

That:

1. The position of the Treasury Management Strategy as at 30 September 2019 be noted.
2. No amendments to the current procedures are necessary as a result of the review of activities in 2019/20.

Timetable

Meeting	Date
Audit, Governance & Standards Committee	18 November 2019

Treasury Management Mid-Year Review 2019/20

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Treasury Management Function ensures the safeguard of Council finances and the liquidity of funds when liabilities become due to support the strategic plan objectives.	Interim Head of Finance
Cross Cutting Objectives	The report recommendations supports the achievements of all the cross cutting objectives as stated above.	Interim Head of Finance
Risk Management	Covered in the risk section of this report.	Interim Head of Finance
Financial	This report relates to the financial activities of the council in respect of treasury management and specific financial implications are therefore detailed within the body of the report.	Section 151 Officer & Finance Team
Staffing	None.	Interim Head of Finance
Legal	The legal implications are detailed within the body of the report which is compliant with statutory and legal regulations such as the CIPFA Code of Practice on Treasury Management in Local Authorities.	Team Leader (Corporate Governance), MKLS
Privacy and Data Protection	None	Policy and Information Team
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment	Equalities and Corporate Policy Officer
Public Health	We recognise that the recommendations will not negatively impact on population health or that of individuals.	Public Health Officer
Crime and Disorder	None	Interim Head of Finance
Procurement	None	Interim Head of Finance Section 151 Officer

2. INTRODUCTION AND BACKGROUND

- 2.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.
- 2.2 The Authority's treasury management strategy for 2019/20 was approved at Council on 27th February 2019. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.
- 2.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
 - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
 - Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year
 - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
 - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit, Governance and Standards Committee.
- 2.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
 - An economic update for the first part of the 2019/20 financial year;
 - A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
 - A review of the Council's investment portfolio for 2019/20;
 - A review of the Council's borrowing strategy for 2019/20;
 - A review of compliance with Treasury and Prudential Limits for 2019/20.

2.5 Economics and interest rates

- 2.5.1 The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.
- 2.5.2 As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.
- 2.5.3 With regard to the labour market, despite the contraction in quarterly GDP growth of -0.2% quarter on quarter, (+1.3% year on year), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

2.5.4 The Council’s treasury advisor, Link Asset Services, has provided the following forecast. This forecast includes the increase in margin over gilt yields of 100bps introduced on 9.10.19.

Link Asset Services Interest Rate View										
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

2.5.5 The above forecasts have been based on an assumption that an agreed deal on Brexit is implemented. In the run-up to a General Election, this remains a key assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks and months.

2.5.6 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That is shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a “gradual pace and to a limited extent” is now also conditional on “some recovery in global growth”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

2.5.7 There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields.

2.6 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.6.1 The Treasury Management Strategy Statement, (TMSS), for 2019/20 was approved by this Council on 28th February 2019. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

2.7 Investment Portfolio

- 2.7.1 The Council held £27.98m of investments as at 30th September 2019 (£15.0m at 31 March 2019) and the investment portfolio yield for the first 6 months of the year is 0.82%. The Council will aim to achieve optimum return on investments after having satisfied proper levels of security and liquidity. It was agreed to keep investments short term with highly credit rated financial institutions, using the creditworthiness list, information provided by the Council's investment advisors, Link Asset Services, along with information sharing from other local authorities and being mindful of market intelligence. A full list of investments can be found in **Appendix A**.
- 2.7.2 The Director of Finance and Business Improvement confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2019/20.
- 2.7.3 The Council's investment return as at 30th September 2019 is £106,000 against a budgeted amount for the year of £150,000. The performance for the year to date is in line with the budget.
- 2.7.4 The current investment counterparty criteria selection approved in the TMS is meeting the requirement of the treasury management function.

2.8 Prudential and Treasury Indicators

- 2.8.1 It is a statutory duty for the Council to determine and keep under review 'Affordable Borrowing Limits.' During the first six months of financial year 2019/20, the Council has operated within the prudential and treasury indicators set out in the Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury indicators can be found in **Appendix B**.

2.9 Borrowing

- 2.10 The Council's capital financing requirement (CFR) for 2019/20 is £52.6m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.
- 2.11 The Council has yet to enter into the borrowing market and funded all expenditure from its internal balances, due to the fact there has been no need to borrow as at 30th September 2019 and the cost of carry and credit risk would increase.
- 2.12 It is predicted that the Council will borrow before the end of the financial year. Given the recent increase in rates charged by the PWLB, the Council would investigate a range of possible sources of borrowing in terms of finance and risk.

3. AVAILABLE OPTIONS

- 3.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2019/20.
- 3.2 The Audit, Governance and Standard Committee proposes changes to the current procedures as a result of a review of activities with the first 6 months of 2019/20.
-

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

- 4.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2019/20 as there are no justifications to make any changes.
-

5. RISK

- 5.1 Detailed risk management policies are included within the Treasury Management Practices to which the Council adheres to. A brief description of these risks along with the Council's actions to mitigate these risks are as follows:
- **Liquidity Risk** - Liquidity risk is the risk that cash not be available when it is required. The Council has sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. The Council also has an overdraft facility with Lloyds Bank of £500,000 plus the option of short term borrowing.
 - **Interest Rate Risk** - Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council will seek to minimise this risk by seeking expert advice on forecasts of interest rates from treasury management consultants and agreeing with them its strategy for the coming year for the investment and debt portfolios. It will also determine appropriate limits and trigger points which are set out in the annual Treasury Management Strategy Statement .
 - **Exchange Rate Risk** - Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council has a minimal exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currency for treasury management purposes.
 - **Inflation Risk** - Inflation risk is the risk that unexpected changes in inflation expose the Council to greater costs or a shortfall in income than have been budgeted for. Inflation both current and projected will form part of the debt and investment decision-making criteria both within the strategy and operational considerations

- **Credit and Counterparty Risk** - Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties. Due to volatility of the financial market, Treasury Management staff will use information from various sources, eg brokers, Treasury Management Consultants and other local Authority experience to determine the credit worthiness of an institution and to decide if funds are at risk and agree best course of action with Director of Finance & Business Improvement.
 - **Refinancing Risk** - Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets. The Council is currently debt-free, however it will soon be looking to borrow to fund its capital programme in the coming years. In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on council tax. It will also take into account affordability in the longer term beyond this three year period.
 - **Legal and Regulatory Risk** - Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss. The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The Authority will provide written evidence of its powers and authorities to any counterparty that requests us to do so. Counterparties will also provide their details to the Authority as a matter of course.
 - **Fraud, Error and Corruption Risk** - Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements which identify and prevent losses through such occurrences. The Council will seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal checks which minimises such risks along with maintaining records of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out. Delegated members of staff have the responsibility for the treasury management function for the Council and the Director of Finance & Business Improvement authorises who these are. The Council also has a Fidelity Guarantee insurance policy with Zurich Insurance which covers against loss of cash through fraud or dishonesty of employees.
-

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 None.

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 The Audit, Governance and Standards Committee agree that no amendments to current procedures of the Treasury Management function are necessary, there will be no further action.

8. REPORT APPENDICES

8.1 The following documents are to be published with this report and form part of the report:

- Appendix A: List of Council Investments as at 30th September 2019
 - Appendix B: Prudential and Treasury Indicators
-

9. BACKGROUND PAPERS

9.1 None

Maidstone Borough Council Investments as at 30th September 2019

Counterparty	Type of Investment	Principal £	Start Date	Maturity Date	Rate of Return	Link Asset Management Credit Limits	
						Suggested Term	Maximum Deposit
FEDERATED INVESTORS (UK)	ENHANCED CASH FUND	2,000,000			1.09%	2 Years	£8,000,000
LONDON BOROUGH OF CROYDON	DEPOSIT - LA	2,000,000	01/05/2018	01/05/2020	1.05%	5 Years	£5,000,000
LLOYDS BANK PLC	NOTICE ACCOUNT	3,000,000			0.95%	1 Year	£3,000,000
GOLDMAN SACHS INT'L BANK	NOTICE ACCOUNT	2,000,000			0.90%	6 months	£3,000,000
FEDERATED INVESTORS (UK)	MONEY MARKET FUND	6,000,000			0.74%	2 Years	£8,000,000
ABERDEEN STANDARD FUND	MONEY MARKET FUND	8,000,000			0.73%	2 Years	£8,000,000
NATIONWIDE BUILDING SOCIETY	FIXED TERM DEPOSIT	3,000,000	15/08/2019	22/11/2019	0.69%	6 months	£3,000,000
GOLDMAN SACHS MMF	MONEY MARKET FUND	690,000			0.67%	2 Years	£8,000,000
SVENSKA HANDELSBANKEN	NOTICE ACCOUNT	1,290,000			0.60%	1 Year	£3,000,000

27,980,000

PRUDENTIAL INDICATORS

Capital Expenditure

2019/20 Original Estimate £,000	2019/20 Actual £,000	2019/20 Estimate £,000
23,122	4,608	51,754

Actual capital expenditure as at 30th September 2019.

Capital Financing Requirement

2019/20 Original Estimate £,000	2019/20 Actual £,000	2019/20 Estimate £,000
39,293	5,637	52,603

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. A negative figure shows the Authority has more than sufficient reserves to fund its capital programme at this point.

Treasury Indicators

Authorised Limit for External Debt

	2019/20 Original Estimate £,000	2019/20 Actual £,000	2019/20 Estimate £,000
Borrowing	36,246	0	49,556
Other Long Term Liabilities	3,047	3,047	3,047
Total	39,293	3,526	52,603

This is the main limit which is set as a maximum for external borrowing. It fulfils the requirements under section 3 of the Local Government Act 2003.

Operational Limit for External Debt

	2019/20 Original Estimate £,000	2019/20 Actual £,000	2019/20 Estimate £,000
Borrowing	17,884	0	31,194
Other Long Term Liabilities	3,047	3,047	3,047
Total	20,931	3,526	34,241

This limit should be the focus of day to day treasury management. It is similar to the Authorised Limit but excludes the allowance for temporary cash flow borrowing as perceived as not necessary on a day to day basis. This limit acts as a warning but can be breached temporarily.

Maturity Structure of New Fixed Rate Borrowing

	Lower Limit %	Upper Limit %	2019/20 %
Under 12 months	0	0	0
12 months to under 24 months	0	0	0
24 months to under 5 years	0	0	0
5 years to under 10 years	0	0	0
10 years and over	0	0	0

There was no new fixed long term borrowing as at 30th September in 2019/20

Principal Invested for more than 364 Days

2019/20 Original Estimate £,000	2019/20 Actual £,000	2019/20 Estimate £,000
5,000	2,000	2,000

This indicator shows the Council shows the level of investments which over 364 days to maturity. The Council has invested £2m for a period of 48 months from May 2018. There is no intention to invest longer term during the year

Agenda Item 16

AUDIT, GOVERNANCE AND STANDARDS COMMITTEE

18 November 2019

Budget Strategy – Risk Assessment Update

Final Decision-Maker	Audit, Governance and Standards Committee
Lead Head of Service/Lead Director	Mark Green, Director of Finance and Business Improvement
Lead Officer and Report Author	Mark Green, Director of Finance and Business Improvement
Classification	Public
Wards affected	All

Executive Summary

This report provides an update on the budget risks facing the Council. Recent government announcements have provided reassurance about the funding position for local government in the short term. However, over the medium term there continues to be uncertainty about funding arrangements. The risk of a disorderly exit from the EU, with the consequent adverse financial consequences, has receded. The increased cost of PWLB borrowing may make it more difficult to fund the capital programme.

This report makes the following recommendations to this Committee:

That the Audit Governance and Standards Committee notes the updated risk assessment of the Budget Strategy provided at Appendix A.

Timetable

Meeting	Date
Audit, Governance and Standards Committee	18 November 2019

Budget Strategy – Risk Assessment Update

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Medium Term Financial Strategy and the budget are a re-statement in financial terms of the priorities set out in the strategic plan. They reflect the Council's decisions on the allocation of resources to all objectives of the strategic plan.	Director of Finance and Business Improvement
Cross Cutting Objectives	The cross cutting objectives are reflected in the MTFS and the budget.	Director of Finance and Business Improvement
Risk Management	Matching resources to priorities in the context of the significant pressure on the Council's resources is a major strategic risk. Specific risks are set out in Appendix A.	Director of Finance and Business Improvement
Financial	The budget strategy and the MTFS impact upon all activities of the Council. The future availability of resources to address specific issues is planned through this process.	Director of Finance and Business Improvement
Staffing	The process of developing the budget strategy will identify the level of resources available for staffing over the medium term.	Director of Finance and Business Improvement
Legal	The Council has a statutory obligation to set a balanced budget and development of the MTFS and the	Director of Finance and Business Improvement

	strategic revenue projection in the ways set out in this report supports achievement of a balanced budget.	
Privacy and Data Protection	No implications.	Director of Finance and Business Improvement
Equalities	The Council's budgeted expenditure will have a positive impact as it will enhance the lives of all members of the community through the provision of resources to core services. In addition it will affect particular groups within the community. It will achieve this through the focus of resources into areas of need as identified in the Council's strategic priorities.	Director of Finance and Business Improvement
Public Health	None identified.	Director of Finance and Business Improvement
Crime and Disorder	None identified.	Director of Finance and Business Improvement
Procurement	None identified.	Director of Finance and Business Improvement

2. INTRODUCTION AND BACKGROUND

2.1 The remit of the Audit Governance and Standards Committee includes consideration of risk. Members have requested that the Budget Risk Matrix and Risk Register be updated and reported to each meeting of the Committee, so that it continues to be fully briefed on factors likely to affect the Council's budget position.

Delivering the revenue budget

2.2 The immediate risks to delivering the revenue budget include:

- failure to contain expenditure within agreed budgets

- failure to deliver planned savings
- shortfall in fees and charges against budgeted income
- failure of commercial initiatives (eg property investment, income generating activities in parks).

For the current financial year, current projections indicate that a balanced budget position will be achieved. However, there are some areas of budget overspend, notably in the Planning Service, that need to be addressed.

Delivering the capital budget

- 2.3 The capital programme plays a vital part in delivering the Council's corporate objectives and helps to secure revenue income generation. The Council will have to borrow to fund the capital programme, for the first time, this year. The availability of funding is therefore important.
- 2.4 The main source of funding for local authorities has been the Public Works Loan Board. However, on 9th October 2019, the PWLB's rates were increased for all loans, such that the 50 year maturity rate went up from 1.8% to 2.8%. In the absence of other sources of funding, this could lead to some potential local authority capital investments ceasing to be viable. In practice, there are cheaper sources of borrowing available for short-term loans and it is expected that the market will start to compete more actively for local authority business. In the medium term, it is likely that local authority bonds will become more popular.
- 2.5 For Maidstone Borough Council, the increased cost of PWLB borrowing has had no immediate impact. Our planning assumption for finance costs has been reasonably cautious, at 2.5%. We will in any case investigate options which may be cheaper than the PWLB before borrowing.

External factors

- 2.6 The main source of risk to the Council arises from factors that are outside its direct control. In recent reports, the adverse financial consequences from a disorderly Brexit have been highlighted as a 'red' risk. This is because there would be direct financial costs arising from Brexit that are not fully covered by government grants, and, in the longer term, there may be adverse effects on the UK economy from Brexit.
- 2.7 Although not yet endorsed by parliament, the EU withdrawal agreement negotiated by the government in October may allow the UK to leave the EU on an agreed basis on 31 January 2020. However, there is no guarantee that the General Election will return a parliament that would approve the withdrawal agreement, and in the absence of an agreed alternative approach, there remains the risk of a disorderly Brexit.
- 2.8 The other significant risk in the budget risk register is the potential for an adverse impact from changes in the local government funding regime. Although Maidstone Borough Council is now largely dependent on locally generated resources, the amount of business rates that we are allowed to retain at a local level is a key variable in budget setting. There is also a risk that negative Revenue Support Grant, which was due to be levied on the

Council in 2019/20 before political pressure forced it to be withdrawn, may be resurrected, even if in another guise.

- 2.9 The government has now announced that it will roll forward the existing local government funding arrangements from 2019/20 to 2020/21, with updating to reflect inflation. However, the implications of any new local government funding regime, effective from 2021/22, remain unclear.
- 2.10 In summary, whilst the Council has been successful in managing risks over which it has some control locally, it remains subject to further risks arising in the wider economic and political environment.
- 2.11 The Budget Risk Register has been reviewed in light of developments since it was last reported to members. A summary of the changes to the risk register is set out below.

	Risk	Factor considered	Implications for risk profile
J	Capital Programme cannot be funded	The government has now effectively rationed PWLB borrowing by increasing its cost.	Impact – very significant (no change) Likelihood – moderate (increased)
N	Adverse financial consequences from a disorderly Brexit	The government has negotiated an EU withdrawal agreement but it has yet to be endorsed by parliament.	Impact – major (no change) Likelihood – possible (reduced)
H	Adverse impact from changes in local government funding	There is now more clarity about the position for 2020/21, but the position from 2021/22 remains unclear.	Impact – major (no change) Likelihood – possible (reduced)

2.12 Appendix A sets out the budget risks in the form of a Risk Matrix and Risk Register. Additionally, at the Committee’s request, the possible monetary impact of the risks has been indicated. Note that it is very difficult to quantify the financial impact of risks in precise terms. The information is provided simply to give an indication of the order of the risks’ financial magnitude.

2.13 Members are invited to consider further risks or to propose varying the impact or likelihood of any risks.

3. AVAILABLE OPTIONS

- 3.1 Option 1 - The Committee may wish to consider further risks not detailed in Appendix A or vary the impact or likelihood of any risks. This may impact the Council's service planning and/or be reflected in the developing Medium Term Financial Strategy.
- 3.2 Option 2 - The Committee notes the risk assessment set out in this report and makes no further recommendations.
-

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

- 4.1 Option 2 - It is recommended that the Committee notes the risk assessment.
-

5. RISK

- 5.1 Risk is addressed throughout this report so no further commentary is required here.
-

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

- 6.1 Each year the council as part of the development of the MTFS and the budget carries out consultation on the priorities and spending of the council. A Residents' Survey has just been completed for the 2020/21 budget and the results will be reported to Service Committees as part of the budget setting process.
-

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

- 7.1 The Audit, Governance and Standards Committee plans to continue keeping the budget risk profile under review at subsequent meetings.
-

8. REPORT APPENDICES

The following document is to be published with this report and forms part of the report:

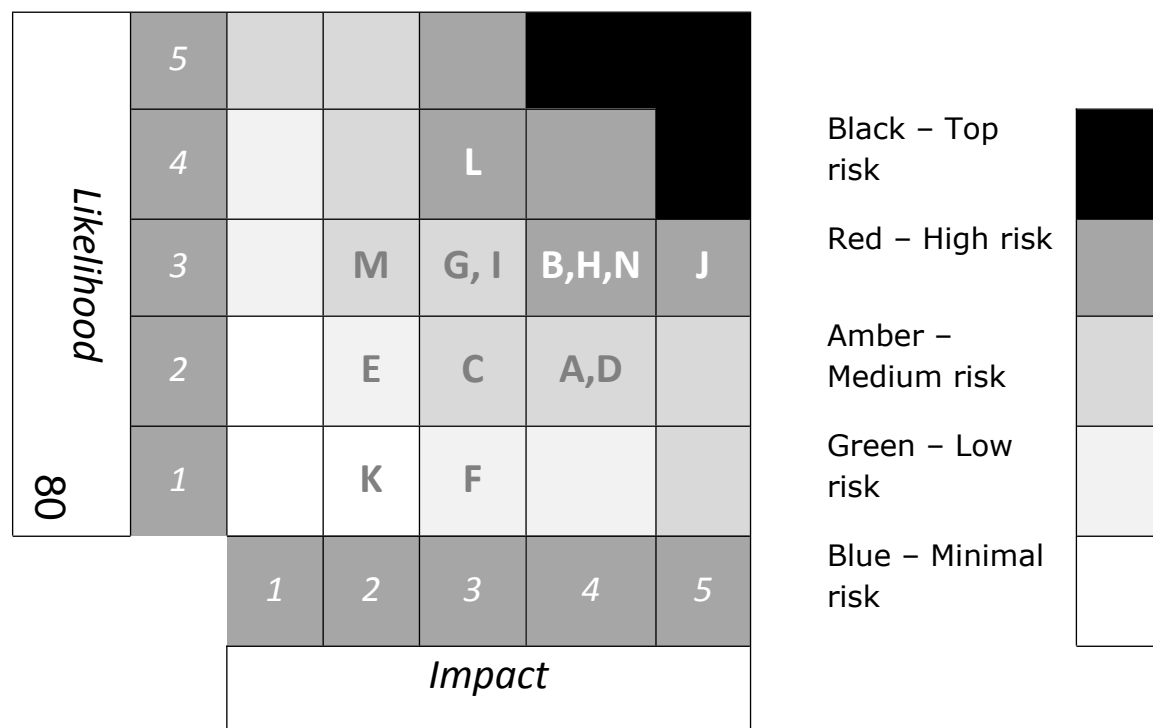
- Appendix A: Budget Strategy Risks
-

9. BACKGROUND PAPERS

None.

Budget Strategy Risks

The risk matrix below provides a summary of the key budget risks. The risk register that follows provides more detail.



A. Failure to contain expenditure within agreed budgets	H. Adverse impact from changes in local government funding
B. Fees and Charges fail to deliver sufficient income	I. Constraints on council tax increases
C. Commercialisation fails to deliver additional income	J. Capital programme cannot be funded
D. Planned savings are not delivered	K. Increased complexity of government regulation
E. Shared services fail to meet budget	L. Collection targets for Council Tax and Business Rates missed
F. Council holds insufficient balances	M. Business Rates pool fails to generate sufficient growth
G. Inflation rate predictions in MTFS are inaccurate	N. Adverse financial consequences from a disorderly Brexit

The budget risks may be ranked, based on the scores shown below, as follows:

Risk	Ranking	Financial impact (in any one financial year)				
		Lower £000	Upper £000	Mid- point £000	Likelihood %	Weighted £000
J. Capital programme cannot be funded	1	500	1,500	1,000	50	500
H. Adverse impact from changes in local government funding	2=	250	750	500	50	250
N. Adverse financial consequences from a disorderly Brexit	2=	250	750	500	50	250
B. Fees and Charges fail to deliver sufficient income	2=	200	600	400	50	200
L. Collection targets for Council Tax and Business Rates missed	5	100	300	200	75	150
D. Planned savings are not delivered	6	250	750	500	25	125
A. Failure to contain expenditure within agreed budgets	7=	200	600	400	25	100
G. Inflation rate predictions in MTFs are inaccurate	7=	100	300	200	50	100
I. Constraints on council tax increases	7=	100	300	200	50	100
C. Commercialisation fails to deliver additional income	10	100	300	200	25	50
M. Business Rates pool fails to generate sufficient growth	11	50	100	75	50	38
E. Shared services fail to meet budget	12	50	150	100	25	25
F. Council holds insufficient balances	13	100	300	200	5	10
K. Increased complexity of government regulation	14	50	150	100	5	5

Budget Strategy Risk Register 2019/20

The following risk register sets out the key risks to the budget strategy 2019/20 onwards. The register sets out the consequences of each risk and the existing controls in place.

Ref	Risk (title & full description)	Consequences	Key Existing Controls	Overall Risk rating		
				I	L	Σ
82	<p>A</p> <p>Failure to contain expenditure within agreed budgets The Council overspends overall against its agreed budget for the year</p>	<p>Failure to meet the budget makes it more likely that the Council will have to rely on short term expedients to balance the budget from year to year, rather than following a coherent long term strategy.</p>	<ul style="list-style-type: none"> - Embedded and well established budget setting process - Medium Term Financial Strategy - Balanced budget agreed by Council for 2019/20. - Strong controls over expenditure and established process for recovering from overspends 	4	2	8
	<p>B</p> <p>Fees & Charges fail to deliver sufficient income Fee charging services may be affected if there is a downturn in the economy, resulting in Fees and Charges failing to deliver the expected level of income.</p>	<p>The total value of all Council income from fees and charges is around £20 million. A loss of income for service budgets will require restrictions on expenditure levels and delivery of all objectives may not be met.</p>	<ul style="list-style-type: none"> - Fees and charges are reviewed each year, paying careful attention to the relevant market conditions - Where the Council is operating in a competitive market, the aim is to ensure price sensitivity does not lead to a loss of income. - Procedures are in place to ensure that fees and charges are billed promptly (or in advance) and that collection is maximised. 	4	3	12
	<p>C</p> <p>Commercialisation fails to deliver additional income The commercialisation strategy, which is now centred on housing and regeneration, does not deliver the expected level of income.</p>	<p>The medium term financial strategy includes a contribution from commercial opportunities, so any shortfall would have an impact on the overall strategy.</p> <p>Income generation from commercial activities supports the revenue budget and is required in</p>	<ul style="list-style-type: none"> - The Council set aside a provision of £0.5m against losses from activities that do not deliver. This provision is cash limited but available to cover short term losses. - Individual risks associated with specific projects within commercialisation strategy 	3	2	6

Ref	Risk (title & full description)	Consequences	Key Existing Controls	Overall Risk rating		
				I	L	Σ
		ordered to pay back capital investment.	will be assessed, both as part of the project appraisal process and during the course of delivering the projects.			
D	<p>Planned savings are not delivered</p> <p>Failure to deliver savings and / or failure to monitor savings means that the Council cannot deliver a balanced budget</p>	<p>The level of saving required to achieve a balanced budget is significant and non-delivery of these savings will have a major consequence on managing financial viability of the organisation.</p> <p>Not achieving savings will impact the overall delivery of the Medium Term Financial Strategy and would require appropriate action, which might include the suspension of some Council services, redundancies, etc.</p>	<p>- The risks associated with delivery of savings proposed in the current Medium Term Financial Strategy have been reviewed as part of the budget setting process.</p> <p>- Savings proposals are separately identified and monitored in the Council's general ledger.</p> <p>- The ability to achieve the targeted savings is monitored quarterly in budget monitoring reports to the Corporate Leadership Team and to Service Committees.</p>	4	2	8
E	<p>Shared Services</p> <p>Shared services, which are not entirely under the Council's control, fail to perform within budgeted levels.</p>	<p>Failure of a shared service to manage within the existing budget will have the same consequences as for any overspending budget, ie it would require appropriate action, which might include the suspension of some Council services, redundancies, etc.</p>	<p>The arrangements governing shared services include a number of controls that minimise the risk of budget overspends and service failure, including quarterly reporting to a Shared Service Board comprising representatives of the authorities involved. The shared services are required to report regularly on financial performance and key indicators.</p>	2	2	4
F	<p>Insufficient Balances</p> <p>Minimum balance is insufficient to cover unexpected events</p> <p>OR</p> <p>Minimum balances exceed the real need and resources are held without identified purpose with low investment returns</p>	<p>Additional resources would be needed which would result in immediate budget reductions or use of earmarked reserves.</p> <p>The Council would not gain best value from its resources as Investment returns are low in the current market.</p>	<p>- The Council has set a lower limit below which General Fund balances cannot fall of £2 million.</p> <p>- At the beginning of the 2019/20 financial year usable reserves stood at £15.1 million.</p>	3	1	3
G	<p>Inflation rate predications in MTFS are inaccurate</p>	<p>Unexpected rises will create an unbudgeted drain upon resources and the Council may not achieve its</p>	<p>- Allowances for inflation are developed from three key threads:</p>	3	3	9

Ref	Risk (title & full description)	Consequences	Key Existing Controls	Overall Risk rating		
				I	L	Σ
	Actual levels are significantly above or below prediction	objectives without calling upon balances. Services have supported the budget strategy through savings. Levels below those expected would result in an increase in balances or unused resources that could be used to achieve strategic priorities.	<ul style="list-style-type: none"> ○ The advice and knowledge of professional employees ○ The data available from national projections ○ An assessment of past experience both locally and nationally <p>- MTFS inflation projections are based on the government's 2% inflation target.</p>			
H 84	<p>Adverse impact from changes in local government funding</p> <p>The financial implications of the new local government funding regime to be introduced in 2021/22 remain unclear.</p>	The Council no longer receives Revenue Support Grant (RSG), but the amount of Business Rates that it retains depends on the funding regime set by central government.	<p>- The Medium Term Financial Strategy to 2023/24 includes an adverse scenario which allows for a significant impact on the Council's resources,</p> <p>- The Council has developed other sources of income to ensure it can maximise its resources while dealing with the consequences of government strategy.</p>	4	3	12
I	<p>Constraints on council tax increases</p> <p>The limit on Council Tax increases means that the Council must manage expenditure pressures even if these potentially give rise to cost increases greater than the referendum limit.</p>	The limit on Council Tax increases means that additional pressures, such as those arising from providing temporary accommodation, have to be absorbed by making savings elsewhere.	<p>- The budget for 2019/20 incorporates a Council Tax increase of 3%.</p> <p>- Budget planning is based around the assumption of a 2% increase in 2020/21.</p>	3	3	9
J	<p>Capital Programme cannot be funded</p> <p>Reduction or total loss of funding sources means that the capital programme cannot be delivered</p>	<p>The main sources of funding are:</p> <ul style="list-style-type: none"> ○ Internal borrowing ○ PWLB borrowing ○ New Homes Bonus ○ Capital Grants ○ Developer contributions (S106) <p>A reduction in this funding will mean that future</p>	<p>- Council has been able to fund the capital programme without recourse to borrowing so far,</p> <p>- Council has confirmed in the past that borrowing is acceptable if it meets the prudential criteria.</p>	5	3	15

Ref	Risk (title & full description)	Consequences	Key Existing Controls	Overall Risk rating		
				I	L	Σ
		schemes cannot be delivered.	- Local authorities continue to be able to access borrowing at relatively low cost through the Public Works Loan Board but there is a risk that this may be subject to restrictions in future.			
K 85	<p>Increased complexity of government regulation</p> <p>Complexity of financial and other regulations along with increasing delays in providing guidance reduce the ability of the Council to identify risks at an early stage.</p>	<p>On a number of occasions, most recently with the introduction of GDPR, the financial consequences of government regulation have been significant. Failure to provide adequate warning would leave the council little time to prepare through the medium term financial strategy.</p> <p>In general these events bring consequences to other agencies and external relationships.</p>	<p>- The Council has formal procedures for monitoring new legislation, consultations and policy / guidance documents.</p> <p>- Our relationships with organisations such as the Council's external auditor provide access to additional knowledge regarding relevant future events.</p>	2	1	2
L	<p>Business Rates & Council Tax collection</p> <p>Council fails to maintain collection targets for business rates and council tax</p>	<p>Failure to achieve collection targets will reduce the level of key resources to ensure a balanced budget. This will mean further cuts in other budgets or the cost of financing outgoing cash flow to other agencies in relation to taxes not yet collected.</p> <p>Business rates amount to around £60 million in 2019/20 and Council Tax due amounts to around £110 million.</p>	<p>- The Council has a good track record of business rates and Council Tax collection.</p> <p>- Steps are taken to maximise collection rates, such as active debt collection, continual review of discounts, etc.</p> <p>- Nonetheless, increasingly difficult trading conditions for some businesses may lead to a deterioration in collection performance.</p>	3	4	12
M	<p>Business Rates pool</p> <p>Changes to rateable value (RV) or instability of business rates growth within the pool may not generate projected levels of income</p>	<p>Changes in RV or instability in growth will result in a reduction in income from business rates and a potential consequence for the Council.</p>	<p>- The pool is monitored quarterly Kent wide and Maidstone is the administering authority. The projected benefit of the pool across Kent as a whole is projected to be around £10m in 2019/20.</p> <p>- Provisions have been made when projecting</p>	2	3	6

Ref	Risk (title & full description)	Consequences	Key Existing Controls	Overall Risk rating		
				I	L	Σ
			business rates income for bad debts and losses on appeal so any loss of income would relate to the excess over the provisions already made.			
N	Adverse financial consequences from a disorderly Brexit. There remains a risk that the UK could leave the EU without a deal on 31 January 2020.	Short term - Increased costs in delivering services, eg arising from traffic congestion Medium term/ long term – Risk of recession, which could lead to a fall in business rates income, increasing pressure on homelessness budgets, and adverse central government funding settlements.	- Thorough preparation for Brexit, with an officer Brexit business continuity planning group to co-ordinate our response and liaise with other Kent authorities	4	3	12

Impact & Likelihood Scales

RISK IMPACT

Level	Service risk	Reputation Risk	H&S	Legal Risk	Financial Risk	En'ment Risk
Catas-trophic (5)	Ongoing failure to provide an adequate service	Perceived as failing authority requiring intervention	Responsible for death	Litigation almost certain and difficult to defend. Breaches of law punishable by imprisonment or significant fines	Uncontrollable financial loss or overspend over £500k	Permanent, major environmental or public health damage
Major (4)	Failure to deliver Council priorities Poor service. Disrupted 5 days+	Significant adverse national publicity	Fails to prevent death, causes extensive perm injuries or LT sick	Litigation expected, but defensible Breaches of law punishable by fines	Financial loss or overspend greater than £250k	Long term major public health or environmental incident (1yr+)
Moderate (3)	Unsatisfactory performance Service disrupted/ stopped 3-5 days	Adverse national publicity or significant adverse local publicity	Fails to prevent extensive, permanent injuries or LT sickness	Complaint likely, litigation possible Breaches of regs or standards	Financial loss or overspend greater than £50k	Medium term major public health or environmental incident (up to 1yr)
Minor (2)	Marginal reduction in performance Service disrupted/ stopped 1-2 days	Minor adverse local publicity	Medical treatment required, potential long term injury or sickness	Unlikely to cause complaint Breaches of local procedures	Financial loss or overspend greater than £10k	Short term public health or environmental incident (weeks)
Minimal (1)	No significant service impact Service disruption up to 1 day	Unlikely to cause adverse publicity	First aid level injuries		Financial loss or overspend under £10k	Environmental incident with no lasting detrimental effect

RISK LIKELIHOOD

Type	Probability	Detail description
Almost certain (5)	90%+	Without action is likely to occur; frequent similar occurrences in local government/Council history
Probable (4)	60%-90%	Strong possibility; similar occurrences known often in local government/Council history
Possible (3)	40%-60%	Might occur; similar occurrences experienced in local government/Council history
Unlikely (2)	10%-40%	Not expected; rare but not unheard of occurrence in local government/Council history
Rare (1)	0%-10%	Very unlikely to occur; no recent similar instances in local government/Council history

Audit, Governance and Standards Committee

18 November 2019

Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England (the "Redmond Review")

Final Decision-Maker	Audit, Governance and Standards Committee
Lead Head of Service/Lead Director	Mark Green, Director of Finance and Business Improvement
Lead Officer and Report Author	Chris Hartgrove, Interim Head of Finance
Classification	Public
Wards affected	All

Executive Summary

The "*Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England*" (the "Redmond Review") is calling for views and information on the quality and effectiveness of the audit of local authorities in England.

The Review is specifically seeking views, supported by evidence where possible, on the extent to which local authority accounts and the local authority audit process allows users of those accounts to hold local authorities to account for their use of resources. The Review is also seeking views on how local authority accounts and the audit process might be developed to better meet users' needs and serve the interests of other stakeholders and the wider public interest.

Members of the Committee should note that MBC were one of 209 authorities in England to receive a late audit opinion on the 2018/19 financial statements, which is a vivid example of why the local authority financial reporting and audit process is now coming under the spotlight as a priority area for potential reform.

The full details of the issues raised in the Review are discussed in Sections 4 to Section 11 of the report. This includes a number of observations on how individual issues are relevant to, or are impacting on, the MBC financial statements and audit. In addition, a suggested response has been outlined for each section of the consultation for the consideration of members of the Committee, to assist in guiding the discussion.

The (extended) deadline for responses is 20th December 2019.

Timetable	
<i>Meeting</i>	<i>Date</i>
Audit, Governance and Standards Committee	18 November 2019
Response Deadline (extended)	20 December 2019

This report makes the following recommendations:

1. That the Committee considers and comments upon the contents of the report, including the suggested responses outlined in Sections 4 to 11.
2. That the Committee delegates authority to the Chairman of the Audit, Governance & Standards Committee to approve the draft consultation response prepared by officers (following this meeting), prior to submission in accordance with the 20th December 2019 deadline.

Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England (the "Redmond Review")

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	There are no direct impacts on corporate priorities, although the Council is committed to the highest standards in financial reporting and the delivery of Value for Money.	Director of Finance & Business Improvement
Cross Cutting Objectives	No implications identified.	Director of Finance & Business Improvement
Risk Management	Detailed within Section 5.	Director of Finance & Business Improvement
Financial	The reform of local authority financial reporting and audit could have a number of both positive and negative financial implications. These are currently not quantifiable but are explained in the report where appropriate.	Director of Finance & Business Improvement
Staffing	No implications identified.	Director of Finance & Business Improvement
Legal	Local authority financial reporting and external audit exist within a clear legal framework, which is explained throughout out the report.	Director of Finance & Business Improvement
Privacy and Data Protection	No implications identified.	Director of Finance & Business Improvement
Equalities	No implications identified.	Director of Finance & Business Improvement

Issue	Implications	Sign-off
Public Health	No implications identified.	Director of Finance & Business Improvement
Crime and Disorder	No implications identified.	Director of Finance & Business Improvement
Procurement	No implications identified.	Director of Finance & Business Improvement

2. INTRODUCTION AND BACKGROUND

2.1 The *"Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England"* (the "Redmond Review") is calling for views and information on the quality and effectiveness of the audit of local authorities in England.

2.2 The Review is specifically seeking views, supported by evidence where possible, on the extent to which local authority accounts and the local authority audit process allows users of those accounts to hold local authorities to account for their use of resources. The Review is also seeking views on how local authority accounts and the audit process might be developed to better meet users' needs and serve the interests of other stakeholders and the wider public interest.

2.3 The scope of the Review is in two parts as follows:

- A *"Strategic Call for Views"* – focusing on what the users of accounts expect from the local authority accounts production and audit process; and
- A *"Technical Call for Views"* – which asks for views on the detailed statutory and professional frameworks underpinning the audit and financial reporting framework.

3. SCOPE OF REVIEW

3.1 The consultation document is a comprehensive piece of work with a wide-ranging scope, covering nine chapters.

3.2 Part 1: The "Strategic Call for Views" (Chapters 1 - 2) – covers the following:

- Definitions of audit and its users; and
- The "expectation gap".

3.3 Part 2: The "Technical Call for Views" (Chapters 3 - 9) – covers the following:

- Audit and wider assurance
- The governance framework
- Audit product and quality
- Auditor reporting
- How local authorities respond to audit findings
- The financial reporting framework; and
- Other issues (e.g. inspection and objection powers).

3.4 The consultation document covers 44 pages and there are 43 questions on which a response is invited. However, the document also states that "it is not necessary for respondents to answer every question, should they wish to focus on a specific area of interest to them".

3.5 It is therefore suggested that the MBC response might wish to focus on a range of key areas of specific local interest or concern. Potential key areas of focus include:

- The "expectation gap" – a perceived difference between what users of the financial statements and other stakeholders expect from an audit and what an audit is actually required to deliver
- The current size and complexity of local authority financial statements
- The scope of the VFM opinion; and
- The balance between the reduction in audit fees and quality of outputs.

3.6 The (extended) deadline for consultation responses is 20th December 2019.

PART1: STRATEGIC CALL FOR VIEWS

4. The Expectation Gap (Chapter 2)

- 4.1 The term “expectation gap” is generally used to describe a perceived difference between what users of the financial statements and other stakeholders expect from an audit and what an audit is actually required to deliver under the statutory framework and appropriate professional standards.
- 4.2 The consultation argues that (in a local authority context) there are a range of audit expectations that are not matched (either partly or fully) by the corresponding statutory and regulatory framework. Examples cited include expectations such as (an audit provides):
- An opinion on the value for money of service delivery
 - Assurance over the effectiveness of service delivery
 - Assurance over performance information
 - Assurance over financial resilience (an audit is backwards looking); and
 - The auditor will have actively sought out any evidence of fraud.
- 4.3 When financial or service failure occurs, it is the responsibility of elected representatives and statutory officers (e.g. Chief Finance Officer on a financial matter). An unmodified audit report and Value for Money (VFM) opinion is not a guarantee that the Council is in good financial health or that it is delivering effective and efficient services. Nor does the scope of the VFM opinion require an auditor to form a view on financial resilience.
- 4.4 However, the consultation argues that an effective audit may help avert a failure through providing an early and public warning of significant risks and, where senior external audit staff have an ongoing informal relationship with statutory officers and elected representatives that enables them to provide real-time constructive challenge, this may support more efficient and effective outcomes e.g. auditors of local authorities have:
- Statutory powers that provide mechanisms that allow them to sound an early warning; and
 - A duty to investigate objections raised by electors.
- 4.5 In addition, new developments in local government (e.g. commercial property purchases and wholly-owned commercial subsidiaries) contribute to the lack of clarity about what auditors do and what they should be doing.
- 4.6 The consultation also flags a “variant” on the expectation gap, whereby some argue that there is an audit quality gap (e.g. that auditors of local authorities have inadequate sector knowledge and/or inadequate skills, inadequate resources etc. to fulfil their statutory responsibilities).

Local Observations

4.7 The consultation questions on the expectation gap focus on the coverage of external audit of the financial statements and the scope of the VFM opinion. The following observations are made:

- The current coverage and scope is arguably no longer relevant given the current issues faced by local authorities
- The audit coverage of the Statement of Accounts is too broad ranging with insufficient focus of scarce resources given to the core financial statements and key risks (relevant to local authorities). This is partly driven by the excessive disclosure requirements in local authority financial statements
- The summary financial and performance information contained in the Narrative Report is not audited (the audit opinion restricted to the information 'not being inconsistent'); and
- The scope of the external auditor's VFM opinion restricts the value it adds. In particular, the information contained in the financial statements, (including the supporting records), informed by inter-related financial strategies and plans, provides an opportunity for external auditors to form a meaningful judgement on an authority's financial resilience, but this is not currently part of the auditor's mandate.

4.8 Addressing some or all of the points raised in Paragraph 4.7 would help to reduce/close the Expectation Gap and assist users of the financial statements and other stakeholders in achieving the assurance they reasonably expect from an audit.

Suggested Response

4.9 A suggested response on behalf of MBC would therefore argue for re-focusing the coverage and scope of the audit engagement in a way that would add genuine value and provide greater assurance to users of the financial statements and other stakeholders (i.e. helping close the expectation gap). It is recognised that this might come at the price of some additional audit fees, although increased costs could be at least partially offset by the audit of a more concise set of financial statements.

PART2: TECHNICAL CALL FOR VIEWS

5. Audit and Wider Assurance (Chapter 3)

- 5.1 This chapter looks at the role of audit within the wider context of the assurance that local authorities are expected to provide to elected representatives, central government and other stakeholders regarding the use of resources and key risks.
- 5.2 In considering whether such assurance should be delivered through a statutory audit or through some other assurance mechanism, the consultation notes a number of complexities for local authorities. Thus specific requirements include:
- Producing a number of reports that set out key financial strategies and plans, that must be approved by full council, but which do not form part of the annual report and accounts document (e.g. Budget Report, "Section 25 Report", Medium-Term Financial Strategy, Capital Strategy etc.). A number of these are prescribed in statute
 - Providing a number of detailed statistical returns to central government covering both capital and revenue income and cost data, at least annually (with a statutory code "SERCOP" setting out how to allocate costs); and
 - Making publicly available a wide range of financial information under the transparency code e.g. expenditure items of more than £500. The consultation states....."it is unclear how or whether this information is quality assured or whether the transparency data should be reconciled to the information presented in the financial statements"
- 5.3 Many local authorities deliver a range of complex services, some of which are looked at by specialist inspectorates.
- 5.4 In addition, many authorities are delivering these services through increasingly complex business models. This means that those providing audit and wider assurance services need to have access to a range of specialist skills and experience beyond audit and accounting. They also need to have sufficient understanding of the wider regulatory framework.

Local Observations

- 5.5 The consultation questions in this area seek views on whether external auditors should make greater use of the work of internal auditors and whether there should be a role for auditors in assessing other statutory reports that local authorities are required to produce.
- 5.6 The following observations are made:
- It would appear that there is currently a gap in the assurance framework in local authorities, with no over-arching assurance given that statutory (and other) reports, statistical returns and public disclosures are robust and holistically integrated into a system of governance that delivers VFM; and
 - External auditors should be required to engage with relevant inspectorates

when considering service delivery.

Suggested Response

- 5.6 A suggested response on behalf of MBC would therefore argue that the scope of the VFM opinion could be expanded to assess the systems in place to support the preparation of some of the reports that statute requires to be presented to full Council. There might be a role for internal audit in this process.

6. The Governance Framework (Chapter 4)

- 6.1 This chapter looks at the governance framework for local authority audit. It explores whether the fragmented nature of the framework is detrimental to the quality of the audit process and potentially the behaviour of auditors.
- 6.2 The consultation sets out the current framework following the demise of the Audit Commission (AC) in March 2015. Thus the Local Audit and Accountability Act 2014 transferred the AC's audit functions to a range of successor bodies:
- *Public Sector Audit Appointments Ltd (PSAA)* – an independent company created by the LGA responsible for the management of audit contracts, housing benefit subsidy calculations and publishing summary reports on the results of audits and auditor compliance and audit quality (although responsibility for publishing the summary report lapsed in 2018/19)
 - *National Audit Office (NAO)* – responsible for the Code of Audit Practice and supporting guidance, the guide to the electorate's rights with regard to the audit of their local authority and a prescribed person for whistleblowing disclosures those working in local government
 - Audit Firms – responsible for quality assurance for audit engagements (monitored and assessed by the FRC) and a prescribed person to which whistleblowing disclosures can be made; and
 - Government (MHCLG) – responsibility limited to deciding when to conduct a best value inspection.
- 6.3 The "most visible aspect of the new regime" highlighted in the consultation, and one of the key objectives of the Local Audit and Accountability Act 2014, is the dramatic reduction in audit fees (nationally, fees reduced by circa 25% in 2015/16, and a further 23% in 2018/19).

6.4 Whilst some have argued that it is too early to assess the effectiveness of the current framework, others have raised concerns. Most notably Sir John Kingman in his review of the FRC published in December 2018. The “Kingman Review” was especially critical, noting for example:

- “Since the Audit Commission’s abolition in 2015, the new local audit framework enables bodies to procure and appoint their own auditors from an open and competitive market of qualified providers. However, 98% of relevant authorities have opted into a central procurement body. The Review has serious concern that those arrangements, in practice, are prioritising a reduction in cost of audit at the expense of audit quality”
- “These arrangements, if allowed to persist, run a very clear risk of allowing weak and limited audit disciplines to prevail in local government. This is particularly concerning given the vital role played historically by district auditors for instance, in detecting and seeking out corruption”; and
- “Particularly at a time when local authorities are under acute financial pressure, and some local authorities are engaging in risky speculative ventures, high-quality and robust scrutiny of local authorities’ finances and financial management in the public interest is a critical part of local democracy. The Review is very concerned that the quality of this scrutiny is being pared back at the worst possible time”.

6.5 The core recommendation from the Kingman Review included the following:

- “The Review recommends that the arrangements for local audit need to be fundamentally rethought. This should include robust assessment and scrutiny of the quality of local audit work, with individual reports shared with audit committees and published; a more appropriate threshold for enforcement action; and, bringing together in one place all the relevant responsibilities, so a single regulatory body can take an overview”
- “Such a role (regarding local audit) could be taken on by the FRC or its successor body, but the Review recommends that it would be much better undertaken by a separate body that has (or could develop) a deeper expertise in the local audit world. That body should have a different and much more focused remit than the former Audit Commission. It should have a clear objective to secure quality, and should set the relevant standards, inspect the quality of relevant audit work and oversee the relevant professional bodies. It should also take on responsibility for appointing auditors for local bodies and agreeing fees”.

Local Observations

6.6 The consultation asks for views on the current procurement process for local authority audit, the regulation of external auditors and the core recommendation made by the Kingman Review that the regulator for local authority audit should ideally be a separate body that has (or could develop) a deeper expertise in the local audit world.

6.7 The following observations can be made:

- The current procurement process for local authority audit has been highly successful in driving down audit fees. However, recent experience (in Maidstone, Kent and nationally) appears to demonstrate that external audit professional capacity (and potentially quality too) is suffering, and the position is getting worse. For example, Maidstone was one of the 42% of authorities nationally, that received a late audit opinion in 2018/19 (up from 13% in 2017/18); and
- There is considerable anecdotal evidence to suggest that recruiting and retaining audit staff with the right skills, experience and knowledge is increasingly becoming a major 'headache' for audit firms.

Suggested Response

6.8 A suggested response on behalf of MBC would therefore argue that there is currently an imbalance between cost reduction, quality, external audit hours and staff mix.

6.9 The core recommendation in the Kingman Review is also supported; a single regulatory body should improve the currently fragmented regulatory system.

7. Audit Product and Quality (Chapter 5)

7.1 This part of the consultation begins with highlighting growing concerns regarding the coverage and quality of local government audit from stakeholders such as the NAO and CIPFA. CIPFA attribute the decline in external audit to the reduction in audit fees and also highlight sector feedback such as the increasing number of finance directors calling for more value for money work, particularly in relation to financial sustainability.

7.2 Two key aspects of audit quality are noted (which are "not necessarily complementary"):

- The quality of the auditor's performance against agreed standards or principles; and
- The quality of the audit output in meeting the legitimate expectations of the users of the accounts (the Review is primarily interested in this aspect).

7.3 The consultation notes the "binary nature of audit opinions", with local authority auditors issuing two audit opinions (the financial audit opinion and the VFM opinion), which are both largely pass or fail tests.

7.4 The pass or fail nature of audit opinions means that they are seen as a "nuclear" option. Auditors have to pass a number of internal professional and legal tests before issuing a modified opinion, which could make them very reluctant to do so.

Financial Audit

- 7.5 Current work by audit regulators and inspectors is thought to focus on the first aspect (in Paragraph 7.2 above), of how well audits deliver on the standards, which poses a particular issue for public sector audit, where some financial reporting and auditing standards have to be adapted or interpreted to be relevant.
- 7.6 The FRC's performance reports on audit firms raise concerns about a lack of professional scepticism and challenge rather than failures of audit process. The FRC has also indicated that the quality of those audits tends to be lower than private sector audits conducted by the same firms.
- 7.7 There is also a widely expressed concern that the reduction in fees has led to a change in the mix of staff undertaking local authority audits (i.e. teams are less experienced and have less sector specific knowledge).
- 7.8 The FRC has fewer powers when it identifies poor quality local authority audits than it does when it identifies poor quality Companies Act audits (because the threat of enforcement notices and financial penalties only exist for private sector audits).
- 7.9 The counter-argument from local authority auditors is that they are forced (by the FRC's regulatory regime) to focus time and effort on areas that would be high risk in the private sector but are not for the public sector.
- 7.10 The way that auditing standards define materiality drives quality outcomes in the local government sector e.g. auditors are allowed to set a lower materiality for sensitive balances, but cannot set a higher materiality (which can force a focus on relatively low risk Balance Sheet items such as Property, Plant and Equipment).
- 7.11 Other concerns raised in the consultation paper include:
- Do auditors have sufficient understanding of the business to be able to focus on the right areas? (can be problematic as audit firms draw upon a wider pool of staff); and
 - Consistency of accounting judgements made by auditors. Local authorities all undertake the same broad range of services and engage in similar transactions. In the past two audit cycles different audit firms have made different judgements in relation to a number of matters (e.g. pension deficit valuation following the McCloud judgement).

VFM Audit

- 7.12 The NAO's Code of Audit Practice sets out the procedures that auditors must have regard to when undertaking work to support a VFM opinion.
- 7.13 The current Code is a high-level principles-based document. Other than referring to the need to comply with relevant professional standards, there is no mention of audit quality (and not in the supporting Auditor Guidance Notes either). The currently proposed updates to the Code indicate no proposals to provide any more detail on quality.

7.14 It therefore seems that other than auditing standards, which are not designed for ensuring that enough work has been done to form a VFM opinion, there is no definition of what a quality VFM audit looks like.

Reliance on Internal Audit

7.15 All local authorities should have an Internal Audit (IA) function that complies with Public Sector Internal Audit Standards.

7.16 Whilst being mindful of the prohibition in UK Auditing Standards of external auditors placing direct reliance on the work of IA, the Review is interested exploring the relationship between internal and external audit, particularly if a closer or more codified relationship could lead to higher quality outcomes.

Resourcing Audit Engagements

7.17 Delivering high quality audit products is dependent on auditors having sufficient staff with the expertise and sector knowledge to audit local authority accounts. But in August 2019, the PSAA reported that - for 2018/19 accounts - 42% of audited accounts produced by local government bodies were not delivered on time (compared to 13% in 2017/18).

Local Observations

7.18 The consultation therefore asks for views on a range of matters on audit product and quality, including whether the auditors have sufficient understanding of the business to focus on the right risks.

7.19 The consultation is also interested in views on the impact that the failure to meet statutory deadlines has had on the quality and usefulness of the audit process, on the real world impact for local authorities of this delay, and in suggestions for changes that could be made to the framework to mitigate the risk that this situation reoccurs in future years.

7.20 The following observations are made:

- There does appear to have been a recent decline in audit quality, at least in terms of visible outputs
- Auditing standards do not always have a positive impact on the quality of the financial audit (e.g. sometimes there is an over-emphasis in relatively low risk disclosure notes)
- Audit firms do not (or are not able to) allocate sufficient resources to deliver high quality and timely audits; and
- Insufficient consideration is given to financial resilience. This should be a key part of the VFM work programme.

7.21 The MBC Internal Audit function is delivered by the MKS shared services partnership and is widely acknowledged as being highly independent as a consequence (as well as having substantial professional capacity). Whilst the local relationship between external and internal audit has always been positive, the separate domains have moved apart in recent years as their separate Standards have developed; the last remaining area of 'overlap' is a shared interest in good governance. The effective prohibition by UK auditing standards from external audit placing direct reliance on IA work can be an impediment to the most cost effective delivery of external audit.

Suggested Response

7.22 A suggested response on behalf of MBC would therefore argue that the impact of auditing standards on the quality of local authority financial audits should be reviewed, to ensure that 'unintended consequences' are removed.

7.23 Also that financial resilience should form an integral part of the VFM work programme.

7.24 The audit process would be further enhanced if external auditors were not prohibited by UK auditing standards from placing direct reliance on IA work

7.25 In a redesigned system external auditors should be 'sufficiently incentivised' to ensure they are able to allocate sufficient resources.

8 Auditor Reporting (Chapter 6)

8.1 The auditors of local authorities have a wider range of reporting powers and duties than the auditors of companies. This part of the consultation paper therefore looks at the statutory and non-statutory audit reports as well as the audit certificate and audit completion report.

8.2 However, the consultation emphasises that the work of the "Brydon Review" is not replicated. There have been no qualified financial audit opinions in the local authority sector since the new audit arrangements were introduced in 2015/16 and the Brydon Review is looking at financial audit opinions and reports in detail.

VFM Certificates and Reports (format)

8.3 The Audit Code requires auditors to form an opinion on whether "In all significant respects, the audited body had proper arrangements".....

8.4 The consultation paper notes two things on the VFM opinion:

- It is backwards looking – it provides no assurance on whether those arrangements will remain in place going forward; and secondly
- It provides no assurance that value for money outcomes have actually been achieved.

8.5 In addition, it is a single opinion covering the financial management, financial resilience and service delivery aspects of value for money (most common reason for a qualified VFM opinion is an Ofsted "inadequate" judgement).

VFM Certificates and Reports (timeliness)

- 8.6 The consultation paper notes that often modified VFM opinions are delivered well after the event that led to the qualification (years later in some cases). It therefore argues that the late opinion is an impediment to the enhancement of transparency and accountability.
- 8.7 However, given that the VFM audit looks at arrangements in place to secure value for money outcomes, it does not necessarily need to be linked to the statutory deadlines for preparing and auditing financial statements.

VFM Certificates and Reports (format)

- 8.8 The consultation paper notes that local authority auditors have statutory powers that provide them with a number of mechanisms that allow them to sound an early warning as follows:
- *Statutory Recommendations* – the power to make written recommendations (copied to the Secretary of State) to the audited body, which need to be considered by full council in public and responded to publicly
 - *Public Interest Report* – the power to report (copied to the Secretary of State) publicly on any matter that comes to their notice that may be of interest to the authority or the general public
 - *Advisory Notice on the Budget* – if the auditor considers that a budget presented to and approved by full council or equivalent is unlawful they can issue a public advisory notice stating that fact and/or make an application for a judicial review
 - *Application to the courts* – if an auditor considers that an item of account is contrary to law, they can make an application to the courts to disallow it.
- 8.9 The consultation paper further notes that these powers have not been used to a large extent. Although the number of modified VFM conclusions significantly increased from 2013-14 to 2014-15 (and has remained fairly constant since), this has been primarily due to inadequate Ofsted reports. In addition:
- The use of statutory recommendations has remained consistently low; and
 - Public Interest Reports have always been uncommon but seem to be no longer be used (despite “the increasingly high profile of commercial and other new arrangements entered into by some local authorities”).
- 8.10 An advisory notice on the budget and an application to the courts are rightly seen as “nuclear” options (the only council to receive an advisory notice is Northamptonshire County Council).

Publishing the results of Local Authority Audits

- 8.11 The PSAA responsibility for producing a report summarising the results of local government (including police and fire) and NHS audits has now lapsed.

Local Observations

8.12 The Review is interested in views on:

- The VFM opinion, including its format, timing whether it should be qualified on the grounds of an inadequate opinion from an inspectorate
- Public Interest Reports and Statutory Recommendations; and
- Publishing (in summary format) the results of local authority audits.

8.13 The following observations are made:

- Although local records are not maintained, it appears that external auditors have never had cause to exercise their reporting powers and duties at MBC, although districts generally are lower risk, given that they do not discharge services such as education and social care.
- Similarly there is no indication that MBC has ever received a qualified opinion on either the financial or VFM audit; and
- There is no reason why the VFM opinion could not be separated from the statutory audit.

Suggested Response

8.14 A suggested response on behalf of MBC could include a preference for separating the VFM opinion from the statutory audit. This could potentially open up an opportunity to allow a 'forward focus' (e.g. on financial resilience).

8.15 The publication of summarised audit information is potentially useful in providing context for members (of audit committees especially).

9. How local authorities respond to audit findings (Chapter 7)

9.1 This part of the Review looks at whether the governance framework for responding to audit findings and qualified audit reports adequately incentivises local authorities to take recommendations seriously.

9.2 The consultation notes that when auditors raise concerns with large companies, there tends to be an immediate and significant impact on the share price, which provides a powerful incentive to management, to respond to (or to look like they are responding to) audit recommendations.

9.3 However, the same incentive does not exist in local authorities, which have no share price and are funded largely based on relative need. There is no evidence that a modified opinion is publicised by local authorities or the auditor and such opinions are rarely reported in the sector press.

9.4 Most local authorities (including district councils) are not required to have Audit Committees (but many do). There is no statutory guidance or freely available sector specific good practice guidance on either the membership or scope of Audit Committees.

- 9.5 A CIPFA survey published in November 2016 found that 92% of Audit Committees or equivalent were chaired by an elected member, normally one appointed from the majority group and 61% had no independent members.
- 9.6 Further comment is made in the consultation paper on there not being an explicit requirement for auditors to follow-up on the implementation of non-statutory recommendations, particularly those relating to VFM arrangements.
- 9.7 The consultation paper also expresses concern regarding a lack of clarity on the use to which audit reports are put by stakeholders (e.g. Public Interest Reports and Statutory Recommendations must be copied to the Secretary of State. But MHCLG has no responsibility for taking action when it receives such a report). Similarly the PSAA must be notified when a qualified opinion is issued, but has no responsibility for taking any action.

Local Observations

- 9.8 The Review is interested in respondents' views on the reporting of audit reports and findings, including currently existing local arrangements. In addition, views are sought on tracking the implementation of recommendations.
- 9.9 MBC has an established committee – the "Audit, Governance and Standards Committee" (AGS) – that discharges the audit committee function. The AGS has a number of good practice features, including political balance and 'wider membership' (in the form of parish council representation).
- 9.10 The AGS agenda includes regular follow-up reports from Internal Audit on the implementation of Internal Audit recommendations.

Suggested Response

- 9.11 A suggested response on behalf of MBC would perhaps endorse the current role of the AGS Committee at MBC whilst welcoming – perhaps as a development opportunity – any further clarity or rigour that might result from changes to the existing framework.

10. The financial reporting framework (Chapter 8)

The Purpose of Local Authority Financial Reporting

- 10.1 The consultation paper argues that "to be relevant" the information produced in local authority financial statements must meet the accountability and/or decision-making needs of users and be sufficiently transparent and understandable to be interpretable by a reasonably well-informed person".
- 10.2 When producing financial reports, local authorities are required to have regard to the CIPFA's (statutory) "Accounting Code"), which is based on private sector accounting standards other than where adapted for the specific circumstances of local authorities or where these conflict with specific statutory requirements.

10.3 The consultation paper draws attention to some notable contrasts between local authority accounts and accounts produced in other sectors. In particular, local authority accounts:

- Are often lengthy documents (usually significantly longer than many large and complex private sector corporations); and
- Look different to central government and private sector accounts e.g. all local authority accounts have two sector specific primary statements.

10.4 In addition, local authority statements are supported by Accounting Policies and Notes to the Accounts. Many of the notes are those required by accounting standards. However, the local authority specific primary statements (e.g. the Collection Fund) have local authority specific notes.

The Balanced Budget Requirement

10.5 Local authorities are required to set a balanced budget before the start of the financial year. They are also required to maintain a (self-assessed) level of general fund reserves commensurate with sound financial risk management. However, the consultation papers flags a couple of issues:

- The system was designed in 1992 (prior to the introduction of accruals accounting in the local authority sector); and
- As the specific calculation is set out in primary legislation, changing it would require including amending clauses in an Act of Parliament.

10.6 Following the adoption of accruals accounting, and as International Financial Reporting Standards ("IFRS") have continued to develop, Council Tax payers have been protected from certain accruals movements through means of statutory overrides (e.g. depreciation is reversed and replaced by a "Minimum Revenue Provision"). The consultation paper notes that this further increases the length of the accounts (with some transactions now shown on both an accruals and a funding basis; and reconciled).

10.7 The consultation paper also highlights that:

- The length and difficulty in understanding local authority financial information is now a subject of discussion (e.g. CIPFA has produced a discussion paper on whether the current Accounting Code supports the production of useful information in a cost-effective manner); and
- There has also been a push to put more useful summary information in the narrative section appended to the front of the financial statements. However, this information is not subject to audit.

Local Observations

10.8 The Review is interested in respondents' views on local authority accounts, including whether they allow users to understand performance and financial resilience and how to resolve the mismatch between the accruals and funding basis.

10.9 Views on the reporting of summary financial and performance information are also sought.

10.10 The MBC Statement of Accounts 2018/19 (including the Narrative Report) was 97 pages in length. This is not uncommon (and it actually follows on from a local rationalization process in 2017/18). A strongly held view held locally (and nationally within the sector and profession) is that the Accounts do not allow users to understand an authority's financial performance and financial resilience.

10.11 Summary financial and performance information is included in the Narrative Report and is (in the opinion of the external auditors) 'not inconsistent' with the Statement of Accounts, which arguably falls short of the degree of assurance that users of the Accounts and other stakeholders can reasonably expect.

Suggested Response

10.12 A suggested response on behalf of MBC would argue that a more concise and modified form of local authority accounts would better allow users to understand an authority's financial performance and financial resilience. It is an approach that would be complemented by a detailed annual report covering summary and financial information that would be covered by the financial audit opinion. A more concise set of accounts would also reduce the time and expense devoted to accounts preparation.

11. Other issues (Chapter 9)

11.1 This chapter looks briefly at a number of other matters related to the quality and effectiveness of local authority audit. These include group accounts, outsourcing, and inspection and objection powers.

Inspection and Objection

11.2 Unaudited accounts have to be published on a council's website for a continuous 30 day period, including the first 10 days in June. Local residents, interested persons and journalists can inspect the accounts and related documents. Local electors can also ask questions about the accounts and raise an objection with the external auditor to a transaction therein.

11.3 The auditor is required to consider all objections and if they have merit, to launch an investigation. Investigations can lead to a Public Interest Report or to an application to the courts to declare a transaction unlawful.

11.4 The consultation paper notes that there has not been any objection on accounts has led to a Public Interest Report or an application to the courts since the introduction of the current audit regime.

11.5 There is no central record of objections raised (e.g. covering the percentage leading to investigations and/or recommendations to management, or what the process costs have been).

Local Authority Business Models

- 11.6 Business models adopted by local authorities have seen significant change since the current audit regime was introduced. There has been a sharp rise in:
- *Subsidiary companies* – covering a large range of business activities.
 - *Wider partnership working* – often non-statutory arrangements in which local auditors can only report on the arrangements in place within the individual bodies they audit; and
 - *Commercialisation* – borrowing to fund commercial property acquisitions.
- 11.7 The consultation paper highlights the fact that the proliferation of these changing business models presents a whole range of challenges to auditors in their financial and VFM audits.

Local Observations

- 11.8 The Review is interested in respondents' views on the effectiveness of the inspection and objection regime.
- 11.9 The use of inspection and objection powers has been extremely limited at MBC. No records are kept, although anecdotally there has only been one inspection request (from the local press) in the last decade. Again anecdotally, there have been no objections.
- 11.10 In recent years, MBC has reacted to the challenges presented by reduced government funding streams through developing different business models. Notably:
- Maidstone Property Holdings (MPH) - a 'vehicle' for residential lettings, and a wholly owned subsidiary of the Council. The level of transactions so far has meant that MPH has not been deemed material for the purposes of group accounts (although that is likely to change soon as the company grows); and
 - Mid-Kent Services (MKS) – a major shared services partnership (with Maidstone, Swale and Tunbridge Wells), delivery functions such as Legal, Internal Audit, Payroll, ICT, Revenues and Benefits.

Suggested Response

- 11.11 A suggested response on behalf of MBC would potentially state that the inspection and objection regime does provide local residents with another avenue to hold the Council to account and is therefore supported in principle. However – locally – the mechanism has been little used (meaning the actual public benefit has been negligible). This is perhaps partly attributable to a lack of awareness amongst the general public. However, anecdotal evidence from elsewhere (where the powers are regularly used) suggests that in extreme cases, can lead to significant disruption to normal Council business, due to local residents with 'vexatious intent'. A suitable alternative (modified system) might be some form of publicized annual event or forum allowing members of the public to inspect and (local electors to) ask questions.

11.12 In addition, more guidance would help assist auditors assess the impact of significant changes in common business models.

12. AVAILABLE OPTIONS

12.1 **Option 1** – The Committee could consider and comment upon the contents of the report, including the suggested responses to the consultation document. This will help to guide officers in drafting the Council’s formal submission and ensure that it accurately reflects the views of Members. **Recommended**

12.2 **Option 2** – the Committee could choose not to consider and comment upon the contents of the report. However, this could potentially result in officers developing a formal submission that does not fully reflect the views of Members. **Not Recommended**

13. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

13.1 **Option 1** - This will help to guide officers in drafting the Council’s formal submission (to the “Redmond Review” consultation) and ensure that it accurately reflects the views of members of the Audit, Governance and Standards Committee.

14. RISK

14.1 An MBC response to the consultation document is optional. However, failure to respond would mean that the views of the Council will not be taken into account in the potential reform of the financial reporting and audit regime for local authorities in England (therefore risking an outcome that is adverse to the interests of MBC).

15. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

15.1 The primary purpose of the report is to consult with Members of the Committee on the Council’s response to the Redmond Review consultation document.

16. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

16.1 Officers will note the comments of the Committee and develop a draft response to the consultation document for the consideration and approval of the Chairman of the Audit, Governance and Standards Committee prior to submission in accordance with the deadline of 20th December 2019.

17. REPORT APPENDICES

17.1 The following document is published with this report and forms part of the report:

- Appendix 1: “Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England” (“Call for Views”) (17th September 2019)
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18. BACKGROUND PAPERS

18.1 None.

APPENDIX 1

Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England

Call for Views

Launch Date: 17 September 2019

Respond By: 22 November 2019

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Foreword

I am pleased to have been asked to undertake this review of the effectiveness of audit in local authorities together with an assessment of the transparency of financial reporting delivered to users of annual reports and accounts.

This call for evidence is a key part of the review in determining whether the requirements of the Local Audit and Accountability Act 2014 are being fulfilled. I will look to test the assurance processes in place with regard to the value for money arrangements together with financial resilience in local councils.

I will talk to practitioners who work in this sector alongside the audit community and it would be beneficial to the review for this call for evidence to include as much factual analysis and hard data as is possible to illustrate the outcomes of current audit and financial reporting arrangements.

All information supplied to the Review will be considered carefully before formulating the final report for submission to the Secretary of State. Your contributions will be much valued and thank you for taking the time to participate in this exercise.

Tony Redmond

A handwritten signature in cursive script that reads "Tony Redmond". The signature is written in black ink on a white background.

Review Objectives

1. The Review will examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework in order to determine:
 - Whether the audit and related regulatory framework for local authorities in England is operating in line with the policy intent set out in the Act and the related impact assessment;
 - Whether the reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
 - Whether the current statutory framework for local authority financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold local authorities to account; and
 - To make recommendations on how far the process, products and framework may need to improve and evolve to meet the needs of local residents and local taxpayers, and the wider public interest.

Executive Summary

Introduction

1. The Review is calling for views and information on the quality and effectiveness of the audit of local authorities in England. The definition of local authority comprises councils, including parish councils, Police and Crime Commissioners, Fire and Rescue Authorities, Independent Drainage Boards and Parks Authorities. It does not include Clinical Commissioning Groups or NHS Trusts. The Review would like your views, supported by evidence where possible, on the extent to which local authority accounts and the local authority audit process allows users of those accounts to hold local authorities to account for their use of resources. The Review would also like your views on how local authority accounts and audit process might be developed to better meet users' needs and serve the interests of other stakeholders and the wider public interest.
2. In providing responses, consideration should be given to both the accounts production and audit *processes*, to the accounts and audit *product* and to the *governance framework* for local authority audit. The Review is mindful that whilst all these elements are linked, there are distinct issues of quality and effectiveness. These are explored in the main body of this document.
3. **By audit, the Review means the external audit of the statutory accounts and the related work that supports the opinions provided in the external audit report published with a set of financial statements.** It does not include internal audit work or other forms of assurance, other than where these interact with the external audit process. These interactions are discussed in the technical Call for Views.
4. **By financial reporting, the Review means the statutory accounts, produced after each year end, that are subject to external audit.** It does not include the financial statistics that all local authorities are required to prepare for central government or any other financial reports or data that a local authority uses as part of its financial planning and budget monitoring processes.
5. Views are particularly sought on how the accounts and audit of local authorities could be improved to provide greater assurance to locally elected members along with local taxpayers and service users.
6. This call for evidence forms two parts, which respondents can complete as they see fit. These are:
 - a. **Strategic Call for Views** focussing on what the users of the accounts expect from the local authority accounts production and audit process.
 - b. **Technical Call for Views** which, in addition to the matters covered in the Strategic Call for Evidence, asks for views on the detailed statutory and professional frameworks underpinning the audit and financial reporting framework.

Relevance to other areas of reform

7. This Review is primarily interested in the local authority financial reporting and audit product, along with the governance and regulatory framework for the audits of local authorities. Other areas that the Government is looking at include competition in the audit market for FTSE250 companies, the quality of Companies Act audits and the role of the regulator for those auditing listed companies. These areas are being addressed through respectively, the CMA Audit Markets Study¹, the independent review of the Financial Reporting Council² and Sir Donald Brydon's review of audit quality³.
8. Nevertheless, this Review recognises that the findings from these separate areas of reform and enquiry have considerable relevance to the quality of the local authority audit and financial reporting processes and product along with the governance framework for local authority audit. In particular the independent review of the FRC has made specific recommendations to address issues with the governance framework for local authority audit. This Call for Views specifically invites input on some of the matters that these Reviews and investigations have highlighted.

Scope of this Call for Views

Part 1: Strategic Call for Views

9. Chapter 1 (*Definitions of audit and its users*) provides an overview of local authority audit in the local government sector and what it is supposed to deliver. It considers developments over time that have shaped the local authority audit processes and product and explores potential users of the accounts.
10. Chapter 2 (*The expectation gap*) compares the requirements of local authority audit, including the opinion on the systems in place for economy, effectiveness and efficiency of service delivery in statute and in international standards with what is currently expected of audit by elected representatives and other stakeholders.

Part 2: Technical Call for Views

11. Chapter 3 (*Audit and wider assurance*) looks at the role of audit within the wider context of the assurance that local authorities are expected to provide to elected representatives, central government and other stakeholders regarding the use of resources and key risks. It seeks views on whether external auditors should make greater use of the work of internal auditors and whether there should be a role for auditors in assessing other statutory reports that local authorities are required to produce.
12. Chapter 4 (*The governance framework*) looks at the governance framework for local authority audit. It explores whether the fragmented nature of the framework is detrimental to the quality of the audit process and product and whether the current regulatory framework drives particular and possibly sub-optimal behaviours by auditors. It asks for views on the Recommendation made by the Independent Review of the Financial Reporting Council that the regulator for local authority audit should ideally be a separate body that has (or could develop) a deeper expertise in the local audit world.

¹ <https://www.gov.uk/cma-cases/statutory-audit-market-study>

² [Independent Review of the FRC](#)

³ [Brydon Review - Audit](#)

13. Chapter 5 (*Audit product and quality*) looks at the local authority specific elements of audit quality. It asks for views on whether the auditors of local authorities have sufficient understanding of the business to focus on the right risks for both the financial audit and value for money opinions. It questions whether the definition of the 'going concern' assumption used for private sector audits is appropriate for local authorities.
14. Chapter 6 (*Auditor Reporting*) looks at statutory and non-statutory audit reports. For local authorities this includes Public Interest Reports, Statutory Recommendations and Advisory Notices, as well as the audit certificate and audit completion report that are common to the public and private sector. It explores whether auditor reporting is timely and whether the structure and format of reports is conducive to communicating useful information to stakeholders.
15. Chapter 7 (*How local authorities respond to audit findings*) looks at the steps that local authorities take to respond to audit qualifications, statutory recommendations and other audit findings. It explores whether local authorities are taking action to address audit findings and whether changes to the governance framework would enable elected members to hold the executive to account for doing so in a more effective manner.
16. Chapter 8 (*The financial reporting framework*) looks at the specific characteristics of the local authority financial reporting framework. It explores the impact that the difference between the basis on which the balanced budget is calculated and the basis on which financial results are reported has on the transparency of local authority financial reporting; on whether the statutory adjustments to get from one basis to the other drives peculiar and possibly sub-optimal behaviours by local authorities. It asks what statutory and non-statutory measures could be taken to improve the transparency and usefulness of local authority accounts.
17. Chapter 9 (*Other issues*) looks briefly at a number of other matters related to the quality and effectiveness of local authority audit. These include group accounts, outsourcing, and inspection and objection powers. It also covers matters relevant to smaller authorities.
18. A list of questions is provided at the end of each chapter. It is not necessary for respondents to answer every question, should they wish to focus on a specific area of interest to them. Equally respondents are free to comment on any other issues arising from this document and provide supplementary evidence if they wish to. Supplementary information submitted that is not directly relevant to any of the questions will be considered, provided that it is relevant.
19. This call for views closes on 22 November at 5pm. Responses should be submitted to Redmond.Review@communities.gov.uk

Part 1: Strategic Call for Views

Chapter 1: Definitions of audit and users of the accounts

Audit

1. The audit framework for the annual financial statements produced by local authorities is based on and to a large extent is consistent with the framework for the audit of financial statements produced by listed companies.
2. The audit of financial statements in the UK has been shaped by developments in company law and in the auditing standards set in the UK by the accountancy professional bodies, the Auditing Practices Board established in 1991 and (since 2004) the Financial Reporting Council (“FRC”). The standards that UK auditors are required to follow are adapted from those set by the International Auditing and Assurance Standards Board and comprise a mixture of guiding principles and specific processes and procedures that an audit must include.
3. The interpretation of this statutory and standards-based regime has also been influenced by a number of landmark legal cases over time. Company law does not explicitly define the meaning or purpose of audit, nor for whose benefit it is undertaken. The absence of clear statutory objectives has left scope for the courts to play a significant role in determining auditors’ responsibility, the manner in which they are discharged and to who they owe a duty of care. This is as true for local authority audit as it is for the audit of companies.
4. Local authority audit differs from the audit of companies in two main ways:
 - a. There is an additional audit opinion. Commonly known as the **Value for Money opinion (“vfm opinion”)**, auditors are actually required to provide an **opinion on the adequacy of systems in place to support the economy, effectiveness and efficiency in its use of resources**. Whilst auditing standards provide a framework within which an audit of financial statements must be conducted, they do not apply to the audit work supporting the ‘vfm opinion’. Instead, the Statutory Code of Audit Practice (“the Audit Code”) produced by the National Audit Office (“NAO”) on behalf of the Comptroller and Auditor General, provides limited guidance on the work auditors need to undertake on these systems.
 - b. **The financial audit opinion will always report that all local authorities are a going concern**. Auditors are required to test and report on the ‘going concern assumption – i.e. whether an entity will continue to exist for the following twelve months. If an entity is not a going concern assets and liabilities are valued on a different basis and the auditor modifies their financial audit opinion. As local authorities have a continuing responsibility to deliver statutory services, irrespective of whether there is sufficient money to do so, the accounts will always meet the going concern test. This means that the assurance that an auditor gives on going concern is meaningless when assessing a local authority’s financial resilience.

Users of the accounts

5. Defining the users of local authority accounts is difficult. Auditing standards define the users of the accounts for a private sector entity as: “– existing and potential investors, lenders and other creditors”⁴. Other stakeholders who will have an interest in private

⁴International Accounting Standards Board *Conceptual Framework for Financial Reporting* – para. 1.5

sector accounts are suppliers, customers, regulators and ratings agencies. All of these stakeholders can be expected to have a reasonable level of financial literacy and familiarity with the format and content of financial statements and annual reports. In addition, they are largely interested in similar information.

6. This does not necessarily hold true in the local authority sector. Auditing standards suggest: “In the case of a public sector entity, legislators and regulators are often the primary users of its financial statements.”⁵ The Chartered Institute of Public Finance and Accountancy (“CIPFA”) currently defines the primary users of local authority financial statements as “service recipients and their representatives and resource providers and their representatives”.⁶
7. This definition in and of itself is open to considerable interpretation. Service recipients and their representatives is presumably intended to mean local residents and their locally elected representatives, but could also include Members of Parliament, the media, financial advisors, and lobby and special interest groups. Resource providers and their representatives is presumably intended to mean central Government but could also include tax payers (both Council Tax and non-Domestic Rates) and their representative groups and other funding organisations.
8. There also needs to be an acknowledgement that other user groups exist. These include but are not limited to existing and potential lenders, credit ratings agencies, trade unions, statisticians, analysts, academics and think tanks with an interest in local government. Local authorities are increasingly delivering core services through more complicated and innovative organisational structures, so it would be reasonable to expect the range of users of accounts to increase.
9. This policy poses a particular challenge in ensuring that audited financial information presented by local authorities is focussed on the needs of the key users of accounts. Different stakeholder groups will be interested in different information, have differing expectations of whether a particular transaction is material, will have differing expectations of the audit process and will have differing levels of financial literacy.
10. What is also different between local authority accounts and company accounts is the absence of an analyst community. In the private sector, market analysts review the annual accounts and other financial information published by listed companies and provide a summarised view of what this means for the financial health and future prospects of that company. No such community exists in the local authority sector, which means that users of accounts have less help in interpreting what the financial information means.

Q1. Who, in your opinion, are the primary users of/main audience for local authority accounts?

Q2. Who are the other users of local authority accounts? Are any of these other users of accounts particularly important?

Q3. What level of financial literacy/familiarity with accounts and audit is it reasonable to expect the primary users of accounts to have and what implications does this have

⁵ <https://www.ifac.org/system/files/downloads/a018-2010-iaasb-handbook-isa-320.pdf> – para. A2

⁶ CIPFA *Statutory Code of LA Accounting Practice 2019-20* – para. 2.1.2.6

for the information presented in accounts and/or the information that should be subject to external audit?

Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it?

Chapter 2: The Expectation Gap

1. The term 'expectation gap' has generally been used to characterise a perceived difference between what users of the financial statements and other stakeholders expect from an audit and what an audit is required to deliver under the statutory framework and appropriate professional standards.
2. In the local authority sector examples of audit expectations that are not matched (or not matched fully) by the corresponding statutory and regulatory framework include:
 - a. An expectation that the audit will provide an opinion on the value for money of service delivery;
 - b. An expectation that the audit will provide assurance over the effectiveness of service delivery;
 - c. An expectation that the audit will provide assurance over the financial resilience of the authority;
 - d. An expectation that the auditor will have actively sought out any evidence of fraud;
 - e. An expectation that the auditor will have confirmed that specific grant income has been spent solely on the purposes for which it was intended; and
 - f. An expectation that the audit opinion covers all of the financial and non-financial information included in the annual report and accounts.
3. The key decisions in relation to the future prospects of a local authority are taken by elected members and statutory officers (rather than by auditors). Responsibility for establishing an appropriate and effective system of control is split between three officers, each of whom have a specific area of responsibility set out in statute, as follows:
 - a. **Head of Paid Service** (typically the Chief Executive or Managing Director): overall responsibility for the management and co-ordination of employees of the authority to enable efficient and effective discharge of statutory responsibilities.
 - b. **Chief Finance Officer** (typically the Finance Director or Borough Treasurer): proper administration of financial affairs, including ensuring the authority has sufficient reserves to manage financial risks. The Chief Finance Officer also has personal responsibility for issuing a statutory warning notice to full council or equivalent if it looks like there is insufficient resource to meet future expenditure. This is known as a "Section 114 Notice".
 - c. **Monitoring Officer** (typically the Borough Solicitor or Head of Law and Democracy): maintaining the constitution and ensuring the lawfulness and fairness of decision making.
4. In some authorities, responsibility for service delivery is further diffused. In upper and single tier authorities, the **Director of Adult Services** and **Director of Childrens' Services** have responsibility for the efficiency and effectiveness of service delivery in their areas of responsibility. In Police and Crime Commissioners and Fire and Rescue Authorities, the elected representatives oversee service delivery which is the responsibility of the **Chief Constable** and **Chief Fire Officer** respectively.
5. Where a local authority suffers financial or service failure, this is the responsibility of elected representatives and statutory officers. An unmodified audit report and vfm opinion is not a guarantee that a local authority is in robust financial health or that it is delivering effective and efficient services. Nor does the scope of the vfm opinion

specifically require an auditor to form a view on the financial resilience of a local authority. However, an effective audit may help avert a failure through providing an early and public warning that highlights significant risks.

6. In addition, where senior external audit staff have an ongoing informal relationship with statutory officers and elected representatives that enables them to provide real-time constructive challenge, this may support local authorities in delivering more efficient and effective outcomes.
7. Auditors of local authorities have statutory powers that provide them with a number of mechanisms that allow them to sound an early warning. Some of these can be used outside the normal financial audit cycle. Details of these powers and their use is discussed in **Chapter 6**.
8. Auditors of local authorities also have a duty to investigate objections raised by electors. Electors have the right to inspect accounts and underlying records for a 30 day period that must include the first ten working days in June and if they have concerns to raise an objection with the auditor. The auditor is required to consider whether to investigate and formally respond to objections after due consideration of the significance of the subject matter vis a vis the time and resource required to investigate. This could give rise to a further expectation gap, where electors expect that an auditor will investigate any matter they choose to raise at any time.
9. Perceptions of audit coverage or lack of audit coverage of new activities that are growing in popularity in the sector, for example, commercial property purchases, joint arrangements and wholly owned commercial subsidiaries also contribute to the lack of clarity about what auditors do and what they should be doing.
10. Finally, there are a number of factors common to all local authority external audit engagements that could add to the expectation gap. Key amongst these are:
 - a. **Fraud** – external auditors are required to consider the risk of material fraud when conducting a financial audit but are not required or expected to develop procedures to identify all instances of fraud or irregularity.
 - b. **Performance information** – external audit does not give any assurance over performance information. If performance information is reported in the same document as the audited financial statements, the auditor is required to read that information to ensure that it is not inconsistent with the financial statements (if relevant) and what they know about the local authority, but not to do any additional work to test its accuracy or reasonableness.
 - c. **Future prospects** – an audit is backwards looking and an external auditor is not currently required to assess forward financial plans or strategies.
11. A variant on the expectation gap argument is that it is actually an audit quality gap, that auditors of local authorities have some or all of inadequate sector knowledge, inadequate skills, inadequate resources or inadequate systems to fulfil their statutory responsibilities. Audit quality is discussed in more detail in **Chapter 5**.
12. These various potential gaps can be categorised into three main areas:
 - a. **Knowledge gap** – do users of accounts understand what the statutory framework requires auditors of local authorities to do?

- b. **Evolution gap** - is there a difference between what users of accounts expect auditors to do and what they are responsible for doing?
- c. **Quality gap** – do external auditors do the things that they are supposed to do to with and appropriate degree of knowledge, skill and rigour?

Q6. In your opinion, what should an external audit of a set of local authority financial statements cover?

Q7. In your opinion, what should the scope of the external auditor's value for money opinion be?

Q8. What is your view on the scope of an external audit engagement as described in Chapters 1 and 2 of this Cal for Views? If it is different from your expectations, does this have implications for the reliance you place on external audit work?

Q9. Should the external audit engagement be extended? If so, which additional areas/matters are most important for external auditors to look at? What would be the cost implications of extending the engagement to the areas/matters you consider to be most important be?

Part 2: Technical Call for Views

Chapter 3: Audit and Wider Assurance

1. Assurance is commonly defined as a process leading to a statement which provides stakeholders with confidence that outcomes will be achieved.
2. Most taxpayers, residents and other stakeholders expect elected representatives and statutory officers to be truthful in their communications regarding service delivery outcomes and the financial resilience of their local authority. They are also likely to want assurance that funds have been spent appropriately and effectively to support delivery of statutory outcomes and local policy priorities. In the local government sector this seems to mean different things to different stakeholders.
3. The MHCLG Accounting Officer's System Statement for Local Government includes external audit as part of the governance framework but does not use the external audit process to gain assurance over its effectiveness. Instead it lists a wide range of financial and non-financial data that "is considered and analysed in the Department to provide indications of which local authorities or groups of authorities are at highest risk of financial distress, service failure or other inability to meet statutory duties."⁷
4. It is an interesting question whether such assurance should be delivered through a statutory audit or through some other assurance mechanism. This question is more complicated for local authorities than for other types of entities for a number of reasons.
5. Firstly, local authorities are required to produce a number of statutory reports that set out key financial strategies and plans, that must be approved by full council, but which do not form part of the annual report and accounts document. These include but are not limited to the Balanced Budget Report, the Chief Finance Officer's Report accompanying the budget (also known as a "Section 25 Report"), the Mid-Term Financial Strategy, the Capital Strategy, the Investments Strategy and the Minimum Revenue Provision Strategy. The balanced budget calculation is set by primary legislation. The content of many other statutory reports is set by legislation or through statutory codes.
6. Secondly, local authorities are required to provide a number of detailed statistical returns to central government covering both capital and revenue income and cost data, at least annually. There is a statutory code, the Service Reporting Code of Practice ("SeRCoP"), that sets out how to allocate costs between service areas in these returns. However, spend on service areas in accounts is no longer required to be presented on a SeRCoP basis.
7. Finally, all local authorities are required to make publicly available a wide range of financial information under the transparency code, including every item of expenditure of more than £500. It is unclear how or whether this information is quality assured or whether the transparency data should be reconciled to the information presented in the financial statements.
8. Many local authorities deliver a range of complex services, some of which are looked at by specialist inspectorates but most of which are not. Key amongst these are the DHSC and DfE inspectorates, respectively the Care Quality Commission and OFSTED, which monitor and inspect and therefore could be said to provide wider assurance over the

⁷ [MHCLG Accounting Officer System Statement](#) – Annex A

quality of adults and childrens' social care; and the police and fire inspectorate, HMICFRS, whose inspections cover service resilience in addition to the effectiveness of service delivery.

9. In addition, many authorities are delivering these services through increasingly complex business models. This means that those providing audit and wider assurance services need to have access to a range of specialist skills and experience beyond audit and accounting. They also need to have sufficient understanding of the wider regulatory framework.
10. The final piece of the assurance jigsaw is internal audit. The relationship between internal and external audit is discussed in **Chapter 5**.

Q10. Should the scope of the vfm opinion be expanded to explicitly require assessment of the systems in place to support the preparation of some or all of the reports that statute requires to be presented to full Council? If you do, which reports should be within scope of the external audit vfm engagement? If not, should these be assessed through another form of external engagement? If you believe that the vfm opinion should be extended to cover these reports will there be implications for the timing of audit work or auditor reporting?

Q11. Should external auditors be required to engage with Inspectorates looking at aspects of a local authority's service delivery? If you believe that this engagement should happen, how frequent should such engagement be and what would be the end purpose of doing so?

Chapter 4: The Governance Framework for the Audit System

Responsibilities following the abolition of the Audit Commission

1. Before it closed on 31 March 2015, the Audit Commission was responsible for appointing auditors for local government, NHS trusts, health housing and other local bodies in England. Approximately 70% of these audits were carried out by District Audit, the Commission's in-house audit practice, the rest being contracted out to private sector auditors.
2. A number of reasons were given for the abolition of the Audit Commission. It was perceived as being unaccountable to ministers and Parliament, as the both the regulator and largest provider of audit services to the sector, it was considered to have an inherent conflict of interest and there was a perception that the CPA/CAA regime had turned it into more of an inspectorate than a regulator or external audit provider.
3. The Local Audit and Accountability Act 2014 transferred the audit functions previously carried out by the Audit Commission to a range of successor bodies as follows:
 - a. Management of audit contracts – transferred to Public Sector Audit Appointments Ltd ("PSAA"), an independent company created by the Local Government Association. This company has also taken on statutory responsibility for bulk procurement of audit contracts, for all councils that have not opted-out. An equivalent body, Smaller Authorities Audit Appointments Ltd performs the same functions for parish councils, independent drainage boards and other smaller authorities.
 - b. Registration and professional conduct of auditors – transferred to the professional accountancy bodies. Currently all firms qualified to conduct local government audit are registered by the ICAEW.
 - c. Quality assurance for audit engagements – firm's internal procedures; which in turn are monitored and assessed by the Financial Reporting Council ("FRC").
 - d. Grant certification – the role of making arrangements for housing benefit subsidy calculations transferred to PSAA until the audit contracts ended. Other grant certification work was not transferred to a successor body.
 - e. Code of Audit Practice and supporting guidance – transferred to the Comptroller and Auditor General ("C&AG"), the Head of the National Audit Office ("NAO")
 - f. Provision of information about audit – the C&AG was given responsibility for the guide to the electorate's rights with regard to the audit of their local authority. PSAA was given responsibility for publishing summary reports on the results of audits and auditor compliance and audit quality. PSAA's responsibility for publishing the summary report lapsed in 2018-19.
 - g. Whistleblowing – external auditors became prescribed persons to which whistleblowing disclosures could be made. The C&AG's responsibility as a prescribed person for whistleblowing disclosures was extended to include disclosures from those working in local government.

Current position

4. The new arrangements have been gradually introduced since 2015-16. 2018-19 is the first year for which all the arrangements have been in operation. However, the key characteristics of the framework, with the split of responsibilities between the C&AG, the FRC, audit firms and PSAA have remained constant since 2015-16.
5. The most visible aspect of the new regime, and one of the key objectives of the Local Audit and Accountability Act 2014, is the reduction in audit fees. PSAA's website states "scale audit fees and indicative certification fees for most audited bodies [for 2015/16] have been reduced by 25 per cent based on the fees applicable for 2014/15"⁸, and fee scales reduced by a further 23 percent⁹ on the retendering of audit lots for the 2018-19 audit cycle.
6. A key characteristic of the governance framework set up to replace the Audit Commission is the fact that, other than deciding when to conduct a best value inspection, there is no role for MHCLG. This was a deliberate consequence of the policy intent when the Commission was abolished. Recently, MHCLG has set up a discussion forum, the Local Audit Delivery Board, that brings all parties with responsibility for the governance framework together. However, this Board has no statutory basis and does not have a clear remit.
7. Whilst some have argued that it is too early to assess the effectiveness of the current framework, others have raised concerns that the fragmented nature of responsibilities for assuring quality means that no-one has oversight of the state of audit in the sector, there has been a loss of sector specific knowledge and it is too easy for those with responsibility to claim that a particular area of concern is outside their remit. Most recently these concerns have been raised in Sir John Kingman's review of the FRC. The summary findings and recommendations are reproduced below.

⁸<https://www.psa.co.uk/201516-work-programme-and-scales-of-fees/>

⁹<https://www.psa.co.uk/201819-work-programme-and-scales-of-fees/>

Independent Review of the Financial Reporting Council: Executive summary of findings on local audit

There are important differences between local authority audit and private sector audit:

Auditors of local public bodies report not only on the financial statements, but also on arrangements for securing value for money, and financial sustainability;

Auditors of those bodies carry out their work on behalf of the public, yet in comparison to the lines of accountability in companies between the directors, audit committee and shareholders, there is substantially lower awareness and challenge of the auditors' work in the public sector;

The FRC's enforcement powers in relation to local audit are meaningfully different in comparison to its powers in relation to private sector statutory audit. The former are not within scope of the Audit Enforcement Procedure.

Instead of the question as to whether an auditor has 'breached a relevant requirement', a far narrower test applies in relation to local audit – that there are reasonable grounds to suspect misconduct, and that the matter appears to raise 'important issues affecting the public interest'; and

Unless the local body is also a Public Interest Entity, there are no requirements regarding the rotation of auditors.

Historically, the AC also appointed auditors to a range of local bodies in England and Wales, as well as setting and overseeing relevant standards, and conducting UK-wide antifraud work. Since the AC's abolition in 2015, the new local audit framework enables bodies to procure and appoint their own auditors from an open and competitive market of qualified providers. However, 98% of relevant authorities have opted into a central procurement body. The Review has serious concern that those arrangements, in practice, are prioritising a reduction in cost of audit at the expense of audit quality.

These arrangements, if allowed to persist, run a very clear risk of allowing weak and limited audit disciplines to prevail in local government. This is particularly concerning given the vital role played historically by district auditors for instance, in detecting and seeking out corruption.

Particularly at a time when local authorities are under acute financial pressure, and some local authorities are engaging in risky speculative ventures, high-quality and robust scrutiny of local authorities' finances and financial management in the public interest is a critical part of local democracy. The Review is very concerned that the quality of this scrutiny is being pared back at the worst possible time.

Recommendations

The Review recommends that the arrangements for local audit need to be fundamentally rethought. This should include robust assessment and scrutiny of the quality of local audit work, with individual reports shared with audit committees and published; a more appropriate threshold for enforcement action; and, bringing together in one place all the relevant responsibilities, so a single regulatory body can take an overview.

Such a role (regarding local audit) could be taken on by the FRC or its successor body, but the Review recommends that it would be much better undertaken by a separate body that

has (or could develop) a deeper expertise in the local audit world. That body should have a different and much more focused remit than the former Audit Commission. It should have a clear objective to secure quality, and should set the relevant standards, inspect the quality of relevant audit work and oversee the relevant professional bodies. It should also take on responsibility for appointing auditors for local bodies and agreeing fees.

Q12. Does the current procurement process for local authority audit drive the right balance between cost reduction, quality of work, volume of external audit hours and mix of staff undertaking audit engagements?

Q13. How should regulators ensure that audit firms and responsible individuals have the skills, experience and knowledge to deliver high quality financial and vfm audits, whilst ensuring the barriers to entry do not get too high?

Q14. What metrics should regulators use when assessing whether financial and vfm audits are delivered to an appropriate level of quality?

Q15. Do you agree with the Independent Review of the Financial Reporting Council's findings and recommendations; and why do you agree/not agree? If you agree with the recommendations do you think the 'single regulatory body' should be the "successor body to the FRC" or a sector specific entity? If you do not agree with the recommendations are there any other changes you would make to the regulatory framework for local authority audit?

Chapter 5: Audit Product and Quality

1. The Public Accounts Committee has raised significant concerns about the quality of local government audit coverage and quality, reporting: “There are a number of issues with external audit. Some council chief executives, finance directors and heads of internal audit raised concerns with the National Audit Office that the contribution of external audit to local governance has reduced recently. CIPFA told us that it shared this concern, which it linked to the change to reduction in audit fees. 25% of finance directors at single tier and county councils felt that their audit fees in 2017–18 were too low relative to the risk that their authorities face. Over half of finance directors at single tier and county councils (which have responsibility for social care services for vulnerable people) wanted some change to their external audit. The most common change, wanted by 26% of these finance directors, was more value for money work, particularly in relation to financial sustainability.”¹⁰
2. There are two key aspects of audit quality, which are not necessarily complementary. These are:
 - a. The quality of the auditor’s performance against whichever standards or principles have been agreed; and
 - b. The quality of the audit output in meeting the legitimate expectations of the users of the accounts.
3. This review is primarily interested in the second of these two aspects. However, this chapter along with **Chapter 6 – Auditor Reporting** includes coverage of the quality of the auditor’s performance. It is also important to note that the two aspects of audit quality are interlinked.

Quality in local authority external audit

Binary nature of audit opinions

4. Under the current framework, auditors of local authorities issue two audit opinions: the financial audit opinion; and the vfm opinion. These two opinions are largely pass or fail tests.
5. Vfm audit opinions are discussed in **Chapter 6**. The financial audit opinion is either **clean** also known as **unmodified** or it is **modified** in one of three ways:
 - a. An **‘except for’** opinion – means the financial statements are true and fair except for the treatment or presentation of one or more specific items.
 - b. An **‘adverse’** opinion – means the financial statements are not true and fair.
 - c. A **‘disclaimer’** of the opinion – means that the auditor is unable to obtain enough evidence to assess whether the financial statements are true and fair.
6. Auditors can also present a clean opinion with an emphasis of matter, where they want to highlight an issue. However, local authority auditors have additional reporting options (see **Chapter 6**), which means there is no incentive to issue an emphasis of matter.

¹⁰ [PAC report - Local Government Governance and Accountability \(15 May 2019\)](#)

7. The pass or fail nature of audit opinions means that they are seen as a nuclear option. Auditors have to pass a number of internal professional and legal tests before issuing a modified opinion, which could make them very reluctant to do so.

Financial Audit

8. Current work by audit regulators and inspectors is thought to focus on the first issue, of how well audits deliver on the standards. This poses a particular issue for public sector audit, where some financial reporting and auditing standards have to be adapted or interpreted to be relevant.
9. The FRC's reports on the performance of audit firms raise concerns about the lack of professional scepticism and challenge rather than failures of audit process. Whilst the FRC does not publish local government specific audit quality data, it has indicated in Audit Delivery Board meetings that the quality of those audits tends to be lower than private sector audits conducted by the same firms. There is also a widely expressed concern that the reduction in fees has led to a change in the mix of staff undertaking local authority audits – i.e. teams are less experienced and have less sector specific knowledge, which has a detrimental impact on quality.
10. The FRC has fewer powers when it identifies poor quality local authority audits than it does when it identifies poor quality Companies Act audits. Specifically, it does not have the same powers to serve enforcement orders or impose financial penalties on local authority auditors who fail to meet their statutory responsibilities. Although these powers have rarely been used, the fact that the threat of use exists for private sector audits but not for local authority audits could influence resourcing decisions made by Audit firms.
11. Some auditors have countered that the FRC's regulatory regime is actively detrimental to the quality of local authority audits. To get a clean bill of health from the FRC, auditors are forced to focus time and effort on areas that would be high risk in the private sector but are not for the public sector. If true, this could be a sector specific example of 'auditing to complete the audit file', rather than to reach the correct opinion.
12. Some auditors have countered that the FRC's regulatory regime is actively detrimental to the quality of local authority audits. To get a clean bill of health from the FRC, auditors are forced to focus time and effort on areas that would be high risk in the private sector but are not for the public sector. If true, this could be a sector specific example of 'auditing to complete the audit file', rather than to reach the correct opinion.
13. There is also a question about whether the way auditing standards define materiality drive quality outcomes in the local government sector. Auditing standards require external auditors to determine the quantum and nature of errors that would be material to users of the account. They are then required to determine "performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures."¹¹ The standard further suggests that for public sector entities, total or net expenditure is the most appropriate basis for setting materiality.
14. There is a question as to whether total or net expenditure is the most appropriate basis for setting materiality for all LAs. Materiality for LA Pension Fund audits is already set

¹¹ [International Standard on Auditing 320 - Materiality](#) - para. 11

based on net liabilities. There is a question as to whether the same approach should be adopted for those LAs with a disproportionately large balance sheet relative to their net expenditure.

15. Auditors are allowed to set a lower performance materiality where balances are particularly sensitive but cannot set a higher performance materiality. This poses a particular problem for the audits of many smaller local authorities, where the balance sheet is disproportionately large relative to gross or net expenditure. To comply with auditing standards, the auditor is required to focus more time and audit effort on balance sheet items, even where these may be less risky or of less interest to users of the accounts. Whilst amending auditing standards is outside the scope of this Review, views on the extent to which this and other professional standards have a positive or negative effect on audit quality would be welcomed.
16. Finally there is a question about whether auditors have sufficient understanding of the business to be able to focus on the right areas. Understanding the business is a key part of any audit. Together with the assessment of balances against performance materiality it drives how much effort is focussed on any specific area. The local authority regulatory framework is different to that of other sectors, and the incentives and risks are different. As audit firms draw upon a wider pool of staff to undertake LA audits, there is a question of the extent to which their audit teams are able to maintain and demonstrate appropriate skills and knowledge to meet the legitimate expectations of users.
17. Another aspect of understanding of the business is consistency of accounting judgements made by auditors. Unlike companies, local authorities all undertake the same broad range of services and engage in similar transactions. In the past two audit cycles different audit firms have made different judgements in relation to matters such as Inverse Floater ‘Lender Option Borrower Option’ loans, pension deficit valuation following the McCloud judgement, and acceptable treatments for Minimum Revenue Provision. It is arguable that these differences have increased uncertainty and cost for both local and central government, without improving audit quality or adding any transparency that would help users of the accounts.

VfM Audit

18. The NAO’s Code of Audit Practice sets out the procedures that auditors must have regard to when undertaking work to support a vfm opinion.¹² The NAO is currently consulting on updating this code.
19. The current Audit Code is a high-level principles-based document. What is noticeable is that other than referring to the need to comply with **relevant** professional standards, there is no mention of audit quality. The proposed updates to the Audit Code indicate that the NAO is not proposing to provide any more detail on quality. This is a particular issue for vfm audits where Auditing Standards are neither relevant nor applicable. The current Audit Code is supplemented by a number of Auditor Guidance Notes (AGNs), which have the same status as the Audit Code. AGN03 covers vfm audit. It takes the form of a principles-based note, with a supplementary document for each sector. AGN03 provides information about sector developments, inspectorates whose work auditors may want to have regard to and about the key documents auditors may want to

¹² [NAO Code of Audit Practice](#) – chapter 3

look at when forming their audit opinion. There is no mention of audit quality or the work auditors need to undertake before forming their vfm opinion.

20. It therefore seems that other than auditing standards, which are not designed for ensuring that enough work has been done to form a vfm opinion, there is no definition of what a quality vfm audit looks like. Nor does there seem to be any basis for a regulator to form a view on whether an audit firm's procedures are adequate to deliver quality outcomes.

Reliance on Internal Audit

21. All local authorities should have an internal audit function that complies with Public Sector Internal Audit Standards. These standards define the role of internal audit as providing "independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."¹³ In practice internal auditors of local authorities cover a range of areas including but not limited to financial resilience, aspects of service delivery, fraud investigations and the operating effectiveness of control frameworks.
22. Whilst being mindful of the prohibition in UK Auditing Standards of external auditors placing direct reliance on the work of internal audit the Review is interested exploring the relationship between internal and external audit, particularly if a closer or more codified relationship could lead to higher quality outcomes.

Resourcing Audit Engagements

23. Delivering high quality audit products is dependent on auditors having sufficient staff with the expertise and sector knowledge to audit local authority accounts. Events during 2018-19 have called into question whether there is enough expertise or resource in the sector. In August 2019, PSAA reported that for 2018-19 accounts, 209 out of 497 audited accounts produced by local government bodies were not delivered on time (2017-18: 64 out of 495 missed the deadline). Whereas in 2017-18, technical accounting issues, client issues and outstanding objections were the main reasons for missing the statutory deadline, in 2018-19 we have been informed that roughly a third of the audited accounts that that were not delivered on time, were late due to issues at audit firms.
24. The Review is interested in views on the impact that the failure to meet statutory deadlines has had on the quality and usefulness of the audit process, on the real world impact for local authorities of this delay, and in suggestions for changes that could be made to the framework to mitigate the risk that this situation reoccurs in future years.

Q16. Do external audit firms have enough understanding of the local authority regulatory framework to focus audit work on the right areas? How do they/should they demonstrate this? Who should regulate this work?

Q17. Do auditing standards have a positive impact on the quality of local authority financial audits?

¹³ <https://www.cipfa.org/policy-and-guidance/standards/public-sector-internal-audit-standards>

Q18. Do audit firms allocate sufficient resources to deliver high quality and timely audits? How is consistency and quality maintained in external audit work? To what extent is there consistency in audit teams year on year? What more can be done to ensure consistency between firms?

Q19. To what extent are senior audit staff, particularly the responsible individual signing the audit certificate, visibly involved in audit work? Who do senior audit staff meet with?

Q20. Should external auditors consider financial resilience as a key factor when designing their vfm work programme? If so, what factors do they/should they consider as indicative of a lack of financial resilience?

Q21. Does the Code of Audit Practice provide enough guidance on how much work needs to be done to support the vfm opinion? If not, what should it cover?

Q22. Do auditing standards provide appropriate guidance on quality standards for vfm audits? If not, is guidance needed and should it be included in the Code of Audit Practice or elsewhere?

Q23. What is the current relationship between external and internal audit? How should that relationship be developed to add most value to local authorities and local residents?

Q24. What should happen when a regulator finds that a local authority audit has not met quality standards? Where should the balance between ensuring effective enforcement action against auditors and maintaining participants in the audit market lie?

Chapter 6: Auditor Reporting

1. Auditors of local authorities have a wider range of reporting powers and duties than the auditors of companies. These are:
 - a. The audit certificate and report, which differs from private sector audit certificates in that it has two opinions, the financial audit opinion and an opinion on the adequacy of systems in place to support the economy, effectiveness and efficiency of service delivery, commonly known as the “vfm opinion”; and
 - b. Sector specific statutory reporting powers.
2. The Brydon Review is looking at financial audit opinions and reports in some detail. The arguments made to and conclusions reached by Sir Donald Brydon are likely to be relevant at least in part to the financial audit opinion. In addition, there have been no qualified financial audit opinions in the LA sector since the new arrangements were introduced in 2015-16.
3. Therefore that discussion is not repeated in this Call for Views, which focuses on the format and timing of the vfm opinion; and secondly the use, format and timing of the sector specific reporting powers.

VfM certificates and reports - format

1. It is arguable that users of local authority accounts are more interested in the vfm opinion than in the financial audit opinion. Currently vfm audit is largely a pass or fail test. The Audit Code requires auditors to form an opinion on whether “In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.”
2. The vfm audit opinion is either **clean** also known as **unmodified**, or is **modified** in one of two ways:
 - a. An ‘**except for**’ opinion means that the LA has proper arrangements in place except for in one or more significant areas.
 - b. An ‘**adverse**’ opinion means that a LA does not have proper arrangements in place.
3. There are two things to note about this opinion: firstly it is backwards looking – it provides no assurance on whether those arrangements will remain in place going forward; and secondly it provides no assurance that value for money outcomes have been achieved. This is reflected in the Audit Code which requires auditors to consider outcomes to the extent they provide evidence to support the arrangements that the LA says it has.
4. In addition, it is a single opinion covering all of the financial management, financial resilience and service delivery aspects of value for money. This had led to a situation where the most common reason for a qualified vfm opinion is an Ofsted judgement that childrens’ services were “inadequate”. When PSAA published its summary report on the results of 2017-18 audit work it listed 32 qualified vfm opinions. Half of these were due

to an “inadequate” Ofsted rating.¹⁴ The circumstances supporting an “inadequate” Ofsted rating are fully explained in a detailed and publicly available report. Given this, it is not clear how qualifying the vfm opinion adds to transparency.

5. The NAO consultation on the new Audit Code recognises that there may be room to improve the format of the vfm opinion and asks a number of questions about how changes to the Audit Code can make auditor reporting more impactful. This Review is also interested in ideas about how the vfm opinion could be enhanced to provide more transparency to users.

Vfm certificates and reports - timeliness

6. Questions have been raised both about how long it takes before an auditor feels comfortable in issuing a qualified vfm opinion and about when the vfm opinion would be most useful to members.
7. Often modified opinions are delivered well after the event that led to a qualification, in extreme cases some years later. For example, during 2016-17 Spelthorne Borough Council, which had net service expenditure of about £10m p.a. purchased the BP Campus for £385m. The auditors issued an adverse vfm opinion in March 2019, by which time Spelthorne had substantially revised its approach to commercial property acquisitions and had built its portfolio through about £600m of additional purchases.
8. The purpose of presenting this example is not to criticise or challenge why the auditors took so long to come to an opinion in this case, but rather to ask whether an opinion formed so long after the event that led to concerns can ever be said to enhance transparency and accountability of members.
9. The timing of the vfm opinion, whether modified or not is also of interest to the Review. Given that the vfm audit looks at the arrangements in place to secure value for money outcomes, it does not necessarily need to be linked to the statutory deadlines for preparing and auditing financial statements. This differs from central government, where the vfm opinion on the ‘regularity’¹⁵ of transactions is directly linked to the annual accounting cycle. The Review is interested in when in the annual cycle an opinion on arrangements in place to secure value for money would be of most use and the resource implications of decoupling the timing of the financial audit and vfm opinions.

Statutory Reporting Powers – use and timeliness

10. Auditors of local authorities have statutory powers that provide them with a number of mechanisms that allow them to sound an early warning. Some of these can be used outside the normal financial audit cycle. These are:
 - a. **Statutory Recommendations** – the auditor has the power to make written recommendations to the audited body, which need to be considered by full council or equivalent in public and responded to publicly. Recommendations can be made during or at the end of the audit and must be copied to the Secretary of State.

¹⁴ [Report on the results of auditor's work \(Oct 2018\)](#) – list of qualified opinions will not include LAs where the 2017-18 audit was concluded after the PSAA report was published.

¹⁵ Regularity is defined in [Managing Public Money](#) as public funds being spent in a way that is “compliant with the relevant legislation (including EU legislation), delegated authorities and following the guidance in this document.” (Section 2.4)

- b. **Public Interest Report** – the auditor has the power to report publicly on any matter that comes to their notice that may be of interest to the authority or the general public. Public Interest Reports can be made at any time and must be copied to the Secretary of State.
- c. **Advisory Notice on the Budget** – if the auditor considers that a budget presented to and approved by full Council or equivalent is unlawful they can issue a public advisory notice stating that fact and/or make an application for judicial review.
- d. **Application to the courts** – if an auditor considers that an item of account is contrary to law, they can make an application to the courts to disallow it.

11. These powers have not been used to a large extent. Table 1 details the number of times each power has been used for principal councils¹⁶ in the final two years of the Audit Commission regime and the first three years of the current audit framework as reported in the summary publications “Report on the results of auditors’ work” published by PSAA.

Table 1: Modified auditor reporting 2013-14 to 2018-19¹⁷					
Columns in grey indicate last two years of Audit Commission regime 2015-18 - Local Audit and Accountability Act 2014 implementation period					
Power	2013-14	2014-15	2015-16	2016-17	2017-18
Modified vfm opinion	18	26	40	43	48
Modified financial statement opinion	0	0	0	1	1
Statutory recommendations	1	1	0	3	1
Public Interest Report	1	2	2	1	0
Advisory Notice	0	0	0	0	1
Application to Courts	0	0	0	0	0

12. The number of modified vfm conclusions significantly increased from 2013-14 to 2014-15, but has remained fairly constant since. Given the increase financial pressure local authorities have been under in recent years an increase in modified vfm conclusions is not that surprising. However, as mentioned elsewhere, the most common reason for a modified vfm conclusion is an inadequate Ofsted report. Since Ofsted does not inspect every local authority’s Childrens’ Services provision every year qualifications for this reason are somewhat ‘sticky’. Once a local authority’s vfm opinion has been qualified on these grounds it will be continue to be qualified in every year until an Ofsted inspection changes the assessment of Childrens’ Services.
13. The use of statutory recommendations has remained at a fairly consistent low-level. This may not be an issue if significant control issues are being reported to elected representatives through other methods.
14. Public Interest Reports have always been very uncommon but seem to no longer be used. This is surprising given the increasingly high profile of commercial and other new arrangements entered into by some local authorities.

¹⁶ Principal councils are defined as upper and single tier authorities, shire districts, fire and rescue authorities, local police bodies, combined authorities and passenger transport authorities.

¹⁷ Source: PSAA. Stats correct as of September 2019. Does not include outstanding audits.

15. An advisory notice on the budget and an application to the courts are rightly seen as nuclear options. Given this, it is not surprising that the only council to receive an advisory notice has been Northamptonshire CC and no application to the courts has been made under the current regime.
16. The Review is interested in views on whether sufficient use has been made of each of modified vfm opinions, statutory recommendations and public interest reports, where these powers have been used whether this has been done in a timely fashion, and in the barriers (if any) for using statutory reporting powers.

Publishing a summary of the results of local authority audits

17. Between 2015-16 and 2017-18 PSAA took over responsibility for producing a report summarising the results of local government (including police and fire) and NHS audits. Now that the new audit regime has been fully implemented, this responsibility has lapsed. The Review is interested in views on whether a summary publication of audit results adds value, if so what it should cover and in which entity is best placed to produce it.

Q25. Do you think that the format of the vfm audit opinion provides useful information? If not what would you like it to cover?

Q26. Do you think the vfm opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate?

Q27. Do you think that the vfm opinion is presented at the right point in a local authority's annual financial management and budgeting cycle? If not when do you think it would be most useful?

Q28. Where auditors have identified significant issues, audit certificates and reports have often been delayed? Why do you think this is and can changes be made to the framework to encourage earlier reporting of significant issues?

Q29. In your view, what sorts of issues should Public Interest Reports be used to highlight?

Q30. Statistics demonstrate that very few Public Interest Reports and Statutory Recommendations have been issued. Why do you think this is? Does it indicate an issue with the framework or common behaviours? If you think this is an issue, what can be done to incentivise more frequent and timely reporting of significant issues?

Q31. Does a publication summarising the results of local authority audits add value? If so who should publish it and what information would they need to have access to to perform this function effectively?

Chapter 7: The Framework for Responding to Audit Findings

Introduction

1. This chapter looks at whether the governance framework for responding to audit findings and qualified audit reports incentivises LAs to take recommendations seriously. It also considers the profile of modified audit opinions.
2. Whilst some have argued that the auditors of large companies are too slow to highlight issues, when they do raise concerns, there tends to be an immediate and significant impact on the share price of that company. Auditors do not necessarily have to report to have an impact on the value of shares. An auditor announcing that it is going to resign from a listed company audit can have the same impact. This provides a powerful incentive to management, to respond to or to look like they are responding to audit recommendations provided in the annual Audit Completion Report.
3. The same incentive does not exist in local authorities, which have no share price and which are funded largely based on an assessment of relative need. When a local authority receives a modified audit opinion, there is no evidence that this is publicised by the LA or the auditor and such opinions are rarely reported in the sector press.
4. The Best Value Inspection of Northamptonshire County Council (“NCC”) noted that the auditors recorded an adverse vfm opinion in both 2015-16 and 2016-17, but that “neither of these reports seemed to trouble NCC” and that “there is no evidence that the second adverse best value judgement ... was escalated to full council.”¹⁸ Whilst, as the Best Value Inspector highlights, NCC is an extreme case and their lack of reaction to the audit report is unusual, there does not seem to be any consistent practice for much of the sector in the way that auditor reports are received and responded to.

Who do external auditors report to

5. PCCs and Chief Constables are required to have Joint Audit Committees (“JAC”), with independent members. These are normally chaired by the PCC. JACs are responsible for receiving audit reports and provide independent assurance on the adequacy of the corporate governance and risk management arrangements in place and the associated control environment, advising according to good governance principles and proper practices. There is an expectation that the Chief Finance Officer and Chief Executive will attend all JAC meetings and the Chief Constable will attend the meeting where the audit certificate and report is presented.
6. Mayoral Combined Authorities are required to have an Audit Committee with an independent chair. The other members of the Committee can be independent or as seems to be common practice can be elected members from the constituent authorities. Other types of councils are not required to have Audit Committees although in practice many do. Where a local authority does not have an Audit Committee auditor reports are received by another appropriate committee. There is no statutory guidance or freely available sector specific good practice guidance on either the membership or scope of Audit Committees or their equivalents.

¹⁸ [NCC Best Value Inspection](#) - paras. 3.85 & 3.86.

7. A CIPFA survey¹⁹ published in November 2016 found that 92% of Audit Committees or equivalent were Chaired by an elected member, normally one appointed from the majority group and 61% had no independent members. Virtually all of these committees considered both external and internal audit reports along with the annual governance statement. Heads of Internal Audit and Chief Finance Officers attended 97% and 95% of meetings respectively. Strategic Directors attended 37% of meetings and Chief Executives 24% of meetings. The survey did not collect data on skills and training of members or on when issues were escalated to full council.
8. There does not seem to be any more recent sector-wide information on which committees receive audit reports, on their membership, attendees, terms of reference or on what gets escalated to full council or other bodies. Nor does there seem to be any explicit requirement for auditors to follow-up on the implementation of non-statutory recommendations, particularly where these relate to vfm arrangements.
9. The use to which audit reports are put by stakeholders is also unclear. Public Interest Reports and Statutory Recommendations must be copied to the Secretary of State. However, MHCLG has no responsibility for taking action when it receives such a report and, other than the best value inspection powers, which are rightly seen as a nuclear option to be used only as a last resort, no authority to take any action. PSAA must be notified when a qualified opinion is issued, but has no responsibility for taking any action.
10. The Review is interested in respondent's views on whether the governance framework for considering internal and external audit findings encourages local authorities to take prompt action in response to issues raised and whether it supports continuous improvement.

Q32. To whom should external auditors present audit reports and findings; is it the audit committee, to full council or equivalent or another committee? If findings are not presented to full council or equivalent what information (if any) should full council or equivalent receive?

Q33. In your authority, what is the membership of the audit committee (number of members, how many are independent etc) and which officers typically attend?

Q34. How should local authorities track implementation of recommendations made by internal audit, external audit and relevant statutory inspectorates? What should the external auditors do if recommendations are not being implemented?

Q35. Should there be a role for an external body in tracking action taken in response to modified audit opinions and/or statutory recommendations and public interest reports? If so should that responsibility sit with MHCLG, the sector specific oversight body recommended by the Independent Review of the Financial Reporting Council or another body?

¹⁹ <https://www.cipfa.org/services/networks/better-governance-forum/corporate-governance-documentation/cipfa-survey-of-audit-committees-in-local-authorities-and-police>

Chapter 8: The Financial Reporting Framework

The purpose of financial reporting in the local authority sector

1. Financial reports provide basic information to people interested in the performance of an entity. Most of the money that local authorities receive is provided from general or local taxation. Given this, it is reasonable to expect people outside the body who are interested in a local authority's financial performance to want to know how the money being managed is being spent. This includes knowing whether the local authority is performing effectively to achieve what was intended with the money.
2. Other than through use of inspection and objection rights (**see chapter 6**), many of the individuals with an interest in the performance of a local authority do not have the power to require the authority to produce customised financial or performance information. Instead they rely on the financial statements. This means that to be relevant the information produced in local authority financial statements must meet the accountability and/or decision-making needs of users and be sufficiently transparent and understandable to be interpretable by a reasonably well-informed person.

Introduction to the framework

3. When producing financial reports, local authorities are required to have regard to the Statutory Code of Local Authority Accounting Practice ("the Accounting Code"), issued by the CIPFA. The Accounting Code is based on private sector accounting standards other than where they have been adapted for the specific circumstances of local authorities or where these conflict with specific statutory requirements. When implementing, adapting or interpreting accounting standards, the Code seeks to maintain consistency, with other parts of the UK public sector. Preparation of the Code is overseen by the CIPFA/LASAAC Accounting Code Board, which comprises representatives of types of local authorities and supreme audit institutions in all four jurisdictions of the UK, the Financial Reporting Council, auditors and independents. MHCLG has observer status on this Board.
4. The Code applies to principal councils, police and crime commissioners, chief constables, fire and rescue authorities, the Greater London Authority, mayoral combined authorities, passenger transport executives and national parks authorities in England. It also applies to similar authorities in Wales, Scotland and Northern Ireland, although the legislative framework for these authorities is different and they are outside the scope of this Review. The Code does not normally apply to subsidiary companies consolidated into local authority accounts. Such companies use the applicable private sector accounting framework.
5. The Code is updated annually and a new edition is published each financial year. It is not a free document. Purchasing the 2019-20 Code from CIPFA costs £340 (hard copy) or £710 (online copy). CIPFA's sales numbers demonstrate that not every local authority purchases a new Code for every financial year.
6. The Code does not apply to parish councils, ports authorities or independent drainage authorities with gross income and expenditure of less than £6.5m per annum (which is currently all of them). The accounting and governance framework for these authorities is set by an organisation called the Joint Panel on Accountability and Governance (JPAG),

which comprises representatives of the associations for each type of smaller authority, auditors active in the sector, the National Audit Office, the Smaller Audits Appointments Authority Ltd and MHCLG. Smaller parish councils fill in a simplified financial return on a receipts and payments basis. Further discussion of smaller authorities is included in **Chapter 9**.

Format of local authority accounts

7. The first thing that is noticeable when looking at local authority accounts is their length. Table 2 compares the length financial statements section from the 2018-19 annual reports of five local authorities selected at random to the financial statements section from the 2018 annual reports of two large and complex private sector corporations.

Entity	Net General Fund Service Expenditure	Financial Statements Length (pages) ²⁰
Bristol City Council	£351.5m	124
Fenland District Council	£12.7m	79
Leeds City Council	£755.8m	77
Richmondshire District Council	£6.3m	72
Merseyside PCC	£460.1m	66
Royal Bank of Scotland PLC		77
CAPITA PLC		84

8. The second key aspect of local authority accounts is that they look different to central government and private sector accounts. All local authority accounts have two sector specific primary statements. In addition to this, some authorities are required to produce supplementary accounts.
9. Table 3 shows the primary statements and supplementary accounts that the user can expect to find in a set of local authority accounts.

Statement	Purpose
Comprehensive Income and Expenditure Statement (CIES)	Summary of the resources generated and consumed by the council on an accruals basis. Shows gross and net expenditure by service area and other income and expenditure incurred by the council.
Movement in Reserves Statement (MIRS)	Shows how the movement in reserves in the Balance Sheet is reconciled to the CIES deficit and what adjustments are required to be charged to the General Fund balance for Council Tax setting purposes.
Balance Sheet	Sets out the Council's financial position at the year end.
Expenditure and Funding Analysis (EFA)	Summarises the annual expenditure used and funded by the Council together with the adjustments between the funding and accounting basis to reconcile with the CIES.
Cashflow Statement	Summarises the inflows and outflows of cash for revenue and capital transactions during the year.

²⁰ Number of pages counted does not include annual report, governance statement or audit report

Collection Fund Account ²¹ - Billing authorities	Agent's statement that reflects the statutory obligation for billing authorities to maintain an account showing collection of Council Tax and National Non-Domestic Rates (NNDR) and the distribution of these taxes to precepting authorities.
Housing Revenue Account (HRA) - LAs with social housing stock	Local authorities are not allowed to cross subsidise provision of social housing from general taxation or vice versa. The HRA shows the major elements of expenditure on social housing and how these costs are met.

10. The statements referred to above are supported by Accounting Policies and Notes to the Accounts. Many of the notes are those required by accounting standards. However, the local authority specific primary statements have local authority specific notes.

The balanced budget requirement and statutory adjustments

11. The key financial control in local government is the balanced budget requirement. Every local authority is required to approve a balanced budget by either 1 or 8 March before the start of the financial year to which it relates. The calculation that local authorities are required to make is set out in primary legislation. It can be summarised as:

	£'
Net service expenditure	(x)
NNDR & grant income	x
Other income/expenditure	x/(x)
Appropriations from/to reserves	<u>x/(x)</u>
Council tax requirement	x

12. The balanced budget calculation has a lot to recommend it. The fact that full council or equivalent passing the balanced budget makes the council tax charge for the coming year lawful provides a strong incentive to set and approve a balanced budget every year. Local authorities are also required to maintain a self-assessed level of general fund reserves commensurate with sound financial risk management. When a local authority overspends it will need to generate additional income or will need to utilise reserves, which will mean that there is less resource available to support the following year's budget.

13. There are a couple of issues with the calculation. Firstly, it was designed in 1992, prior to the introduction of accruals accounting in the local authority sector; and secondly, as the specific calculation is set out in primary legislation, changing it would require including amending clauses in an Act of Parliament covering an appropriate topic.

14. Following the adoption of accruals accounting by the local authority sector and as International Financial Reporting Standards ("IFRS") have continued to develop, successive government have sought to protect council tax payers from accruals movements that do not have an immediate impact on the costs of service delivery through means of statutory overrides.

²¹ Districts and Unitary Authorities including London Boroughs collect Council Tax and NNDR. They are known as 'billing authorities'. Taxes collected are shared between billing authorities and other authorities with a right to a share of those taxes (known as 'precepting authorities') in proportions set out in statute.

15. The most significant of these adjustments relates to depreciation. Local authorities are required to charge depreciation on assets in the same way as any other entity. They then reverse out the depreciation charge in the EFA and replace it with a prudent provision for the debt taken out to acquire assets (Minimum Revenue Provision).
16. The adjustments process has two consequences. Firstly it greatly increases the length of local authority accounts as in addition to having between two and four additional primary statements (all with their own notes), the accounts report some transactions on both an accruals and a funding basis and include notes reconciling the two; and secondly, neither the CIES or the Balance Sheet show the true financial position of an authority. To understand that position it is necessary to understand how the outturn reported in these statements reconciles to the basis on which the balanced budget calculation is made.

Recent developments in the sector

17. The length and difficulty in understanding local authority financial information has been a subject of discussion for some time within the sector. For example, CIPFA has produced a strategy discussion paper on whether the current Accounting Code supports the production of useful information in a cost-effective manner.
18. There has also been a push to put more useful summary information in the narrative section appended to the front of the financial statements. However, as highlighted in **Chapter 2**, this information is not subject to audit. All the auditor is required to do is to read this narrative information to ensure it is not inconsistent with the accounts or their understanding of the business.

Q36. Do local authority accounts allow the user to understand an authority's financial performance and its financial resilience? If not, how could they be revised to be more understandable? What information could be presented to enable users of the accounts to understand whether the financial position of a specific LA is getting better or worse?

Q37. The UK Government is committed to maintaining IFRS based accounting for the UK public sector. Given this, how would you recommend resolving the mismatch between the accruals and funding basis to improve the understandability of local authority accounts?

Q38. Do you think that summary financial information should be reported in the annual report section of the accounts? If so, on what basis and should this information be covered by the financial audit opinion?

Q39. If you think that summary financial information should be reported in the annual report section of the accounts, should it be presented with performance information? If so, what performance information would be of most interest to stakeholders?

Chapter 9: Other Issues

Inspection of and objections to items in the accounts

1. Inspection and objection rights are intended to allow local residents to hold their councils to account. Local authorities are required to publish their unaudited accounts on the council website for a continuous 30 day period that must include the first ten days in June. Local residents, interested persons and journalists can inspect the accounts and related documents. Those on the electoral register can also ask questions about the accounts produced by their local LA and raise an objection with the external auditor to a transaction therein.
2. The auditor is required to consider all objections and if they have merit, to launch an investigation. Investigations can lead to a Public Interest Report or to an application to the courts to declare a transaction unlawful. If the matter does not warrant either of these outcomes, it may still be a matter that the auditor may wish to raise with the authority or to consider as part of their routine planned audit work. Where an auditor investigates they will write to the person who raised the objection setting out the results of their investigation. They do not copy this letter to the LA, MHCLG or any other party.
3. There has not been any objection on accounts has led to a Public Interest Report or an application to the courts since the introduction of the current regime. Anecdotal evidence suggests that there are two types of objections. Some local residents have specific issues with their local authority's expenditure on one or more items and raise objections on the same matter every year. The second type of objection is where special interest campaigns have tried to get local residents to object to the same item in accounts across a number of local authorities. This type of objection has been made in relation to PFIs and Lender Option Borrower Option loans (LOBOs).
4. There is no central record of how many objections have been raised by authority, what percentage of these have led to investigations and/or recommendations to management, or what the costs of this process have been both for auditors and local authorities. Where objections have been raised about a sector-wide, for example LOBOs, they have taken a long time to resolve and in for some LAs this has held up completion of the audit process.

Changes in local authority business models

5. As alluded to elsewhere in this call for views, the business models adopted by local authorities have seen significant change since the current audit regime was introduced.
6. The first significant change is the general power of competence introduced in the Localism Act 2011. This allows local authorities to set up wholly-owned subsidiaries, which are allowed to do anything a legal person can do. Before 2014-15, the general power of competence was not widely used. However, in recent years local authorities have increasingly used this power to set up subsidiaries covering a large range of business activities. Thinking about the impact general power of competence companies have on the financial and vfm audit opinions poses a challenge for auditors, as irrespective of whether they are material enough to require group accounts, they can expose local authorities to financial and reputational risk or divert management attention away from core service delivery.

7. The second significant change relates to wider partnership working – how local auditors can cooperate effectively with each other when reporting on partnership working. Partnerships are often non-statutory arrangements in which local auditors can only report on the arrangements in place within the individual bodies they audit. Some of these are set up by agreement between local authorities. Others such as Clinical Commissioning Groups and some Local Enterprise Partnerships have been set up as a result of government policy.
8. The final significant change is the increase in borrowing to fund commercial property acquisition (“commercialisation”). In some cases local authorities have designed commercial property strategies purely to generate a return. However, many of these strategies will also be focused on regeneration and increasing local economic activity. Commercialisation provides a challenge for the financial audit partly due to the materiality considerations discussed in **Chapter 5** and partly due to the auditor’s need to consider and understand appropriate laws and regulations. It poses a challenge for the vfm audit opinion partly because the auditor will need to check whether an authority has appropriate systems in place to manage this activity and partly because of the risk of diverting management attention.

Smaller Authorities

9. As noted earlier in this call for views, the local authority financial reporting and audit framework includes smaller authorities. Smaller authorities, also known as “Category 2 authorities”, are parish councils, drainage authorities and similar with gross annual income and expenditure not exceeding £6.5m. Smaller authorities with gross income or expenditure of more than £200k are required to prepare a simplified accruals Annual Governance and Accounts Return. Those with income and expenditure of less than £200k can prepare a receipts and payments Annual Governance and Accounts Return. Those with no income and expenditure are allowed to send a statement to their auditor declaring themselves to be exempt from preparing accounts.
10. Smaller authority Annual Governance and Accounts Returns are subject to a limited assurance review. Undertaking a limited assurance review primarily involves performing inquiry and analytical procedures, thereby enabling the auditor to reach a conclusion on whether anything has come to their attention that indicates that the accounts are not true and fair. The conclusion provides some assurance to users of the accounts but less than a full audit certificate.
11. The first issue the Review wants to explore is the adequacy of this opinion for all smaller authorities. As services and assets are transferred to them a small number of parish councils are approaching the £6.5m threshold. Given the sums of money they have stewardship for, questions have been asked about whether they should be subject to a level of external review greater than a limited assurance engagement. One of the issues with this suggestion is that the next level of assurance recognised by professional standards bodies is a full external audit, and legislation already allows Category 2 authorities to ‘opt up’ if they so wish.
12. The second issue the Review wants to explore is the inspection and objection regime for smaller authorities. A few smaller authorities receive a large number of objections on each set of accounts. As auditors are allowed to charge additional fees to recoup their

costs in responding to objections, the financial burden on smaller authorities whose accounts are objected to can be disproportionate, potentially leading to an increase in Council Tax bills for local residents. The Review is interested in suggestions in the way this burden can be reduced, whilst retaining the right for all local residents to inspect and object to items of account.

Q40. For larger authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner? If not, how should the regime be modified?

Q41. Is more guidance needed to help auditors assess the impact of significant changes to common business models? If so is this guidance needed to support the financial audit, the vfm audit or both?

Q42. Is the financial reporting and audit framework for larger category 2 authorities appropriate? If not, what additional information should be subject to audit/assurance and what would be the cost implications of this?

Q43. For smaller authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner and is the cost of processing and responding to objections proportionate? If not, how should the regime be modified?

Appendix 1: About this Call for Views

Who is this for?

1. The Review would welcome views from any respondents with an interest (direct or indirect) in local authority audit and financial reporting.

How to respond

2. This call for views closes on 22 November 2019.
3. Please send any response to Redmond.Review@communities.gov.uk
4. If you do not have access to email, you can write to Redmond Review Secretariat
2nd Floor Fry Building, 2 Marsham Street, London, SW1P 4DF.

Disclosure of the information you provide

5. Because information provided in response to this call for views will be received by the Review Secretariat which is hosted by the Ministry of Housing, Communities and Local Government, that information may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004).
6. If you want information you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
7. In view of this it would be helpful if you could explain to us why you may regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances.
8. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.

Personal data

9. The following is to explain your rights and give you the information you are entitled to under the Data Protection Act 2018.
10. Please note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

The identity of the data controller and contact details of our Data Protection Officer

11. MHCLG is the data controller. The Data Protection Officer can be contacted at dataprotection@communities.gov.uk.

Why we are collecting your personal data

12. Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

Our legal basis for processing your personal data

13. The Data Protection Act 2018 states that, as a government department, MHCLG may process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

With whom we will be sharing your personal data

14. Your data will be shared with the Independent Reviewer.

Your rights, e.g. access, rectification, erasure

15. The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right:
 - to see what data we have about you
 - to ask us to stop using your data, but keep it on record
 - to have all or some of your data deleted or corrected
 - to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law.
16. You can contact the ICO at <https://ico.org.uk>, or telephone 0303 123 1113.
17. Your personal data will not be sent overseas.
18. Your personal data will not be used for any automated decision making.
19. Your personal data will be stored in a secure government IT system.

Appendix 2: Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England

A. Purpose

The Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) invites Sir Tony Redmond to conduct a Review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014 (the Act). The Review will not look at broader issues of local authority finances and sustainability.

B. Review objectives

The Review will examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework to in order to determine:

- Whether the audit and related regulatory framework for local authorities in England is operating in line with the policy intent set out in the Act and the related impact assessment
- Whether the reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
- Whether the current statutory framework for local authority financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold local authorities to account; and
- To make recommendations on how far the process, products and framework may need to improve and evolve to meet the needs of local residents and local taxpayers, and the wider public interest.

C. Scope

The review's scope is taken to include the objectives and context included in these terms of reference.

In practice, this means the review is likely to focus on the following questions;

- Have the financial savings from local audit reforms been realised?
- Is there a more accessible audit market and has there been an increase in audit providers?
- Have audit standards been maintained or improved, and not been compromised?
- Is there an 'expectation gap' in what external audit provides? What is the nature of the gap and how can it be filled?
- Are auditors properly responding to questions or objections by local taxpayers?
- Are auditors using their reporting powers in an appropriate way?
- Are audit recommendations effective in helping local authorities to improve their financial management?

- Are councils responding to auditor recommendations in an appropriate manner?
- Whether local authority accounts report financial performance including use of resources against budget in a manner that is transparent and comprehensible to council tax payers and the general public?
- Does the financial information provided in local authority accounts facilitate scrutiny by local taxpayers and by the local press?

The financial reporting and audit framework for Clinical Commissioning Groups, NHS Trusts and Foundation Trust and special trustees for hospitals is outside the scope of this Review. This is because these bodies have significantly different statutory bases and governance frameworks to other bodies covered by the Act.

D. Context

Local Government in England is responsible for 22% of total UK public sector expenditure. It is essential that local authority financial reporting is of the highest level of transparency to allow taxpayers to understand how their money is being spent.

The responsibilities for the framework within which local authority audits are conducted is the Local Audit and Accountability Act 2014. It gave effect to manifesto commitments to abolish the Audit Commission and its centralised performance and inspection regimes and put in place a new localised audit regime, refocussing local accountability on improved transparency.

Now the Act has been fully implemented, the Government is required to review its effectiveness. This review will meet MHCLG's commitment to undertake a post implementation review of the audit framework and financial reporting elements of the Act. The Government wants to use this opportunity to step back and review the effectiveness of the local authority financial reporting and audit regime. Developments in the sector such as the growth of commercial investment activity have led to a perceived widening of the 'expectation gap'; that is, the difference between what users expect from an audit and the reality of what an audit is and what auditors' responsibilities entail. There may also be an expectation gap between the information that users of local authority accounts believe is needed and what is available to them through audited financial statements or other publicly available information.

Other elements of the Act, including openness transparency of council meetings, the local authority publicity code and intervention powers are outside the scope of this Review. MHCLG will undertake a post implementation review of those elements of the Act in house.

This Review has assumed greater significance due to developments elsewhere. BEIS commissioned Sir John Kingman in April 2018 to carry out a review into the role of the Financial Reporting Council and, in February 2019, Sir Donald Brydon to carry out a review into the quality and effectiveness of statutory audit (reporting in December 2019). In addition, the Competition and Markets Authorities' 18 April 2019 report recommends changes to the statutory audit market that will impact on local audit. Alongside this, there have been three recent PAC hearings on: the Financial Sustainability of Local Authorities (Nov 2018) Local Audit in England (Jan 2019) and Local Authority Governance (Mar 2019). Finally, as part of its legal duties, the National Audit Office is required to review and replace the current Code of Audit Practice by April 2020.

E. Governance

The review will be led by Sir Tony Redmond and report to the Secretary of State for Communities and Local Government

The Independent Reviewer will be supported by an Advisory Group that will advise on the direction of the review and sources of evidence and will help to scrutinise and challenge emerging findings and recommendations.

F. The Review Secretariat

There will be a small dedicated Review Secretariat acting in support of the Independent Reviewer.

G. Stakeholder Engagement

The Review will undertake engagement with a wide range of stakeholder groups, including those representing the interests of local authorities, the accountancy profession, and local residents and taxpayers in order to fully understand the range of issues and to ensure constructive challenge.