

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.