

## **AUDIT AND GOVERNANCE COMMITTEE**

### **2 OCTOBER 2020**

## **LOCAL AUDIT REVIEWS AND GUIDANCE NOTE**

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### **Recommendation**

- 1. The Committee is asked to note the report and appendices, and views are sought around the initial review of the Sir Tony Redmond Independent Review of Local Audit, in particular Section 5 (summarised in paragraphs 10 to 14 of this report) and the suggestions for consideration on the future role and reporting of the Audit and Governance Committee.**

### **Background**

2. In June 2019 Sir Tony Redmond was asked by the then Secretary of State for Ministry of Housing, Communities and Local Government (MHCLG) (Rt Hon. James Brokenshire MP) to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting – The Redmond Review. In April 2020 a new Code of Audit Practice came into force and consultation started shortly afterwards on its application and guidance for 2020/21 external audits. The Redmond Review was published early September 2020 and includes reference to the Audit Code, the consultation on which also closed early September 2020. This report to Committee flags up the key findings and recommendations of both the Redmond Review and the Code of Audit Practice consultation, including the potential matters for this Committee to consider in its future ways of working.

### **Key issues arising**

3. The Redmond Review is attached at Appendix 1 in full. The report is broken down in to 8 sections, with an Executive Summary and recommendations. The Review is broken down into 4 key component areas:

- The regulation, procurement and performance of external audit: **Sections 2-4**
- The role of the Audit Committee and governance arrangements in place locally around audit: **Section 5**
- Audit coverage of financial resilience of local authorities: **Section 6**. This section links heavily to the Audit Guidance Note (AGN) 3 which sets out how local auditors are expected to approach and report on their VFM work under the new Code of Audit Practice. AGN 03 is attached at Appendix 2.
- The transparency of local government financial statements: **Section 7**

Section 8 covers issues related to smaller audits, including parish / town councils that councillors may be interested to note.

4. The following paragraphs summarise the key points raised in each section and notes the potential impact for this Council.

- ***The regulation, procurement and performance of external audit: Sections 2-4***

5. The report raises concerns at various points regarding the balance of price and quality, as well as the way external audit has been governed since the demise of the Audit Commission. Sections 2.2 to 2.5 noting the role of the various bodies in regulating the quality, price and effectiveness of external audit. It concludes that “the structure is fragmented and piecemeal”.

6. Section 3 also highlights concerns regarding the levels of fees and the quality of Key Audit Providers (KAPs). Paragraph 3.2.11 and Figure 3.3. note that the overall levels of audit fees have dropped significantly from 2014/15 to 2018/19. Whilst noting at Section 3.4 that fee variations have increased. This is the experience of Worcestershire whereby we have seen year on year very little net change due to additional fees. Whilst this has always been justified by our external auditors and agreed locally it is interesting to note that this is a consistent national picture.

7. Section 4 identifies a number of national concerns regarding audit provider performance, including questioning the current value of the VFM opinion and paragraphs 4.1.11 to 4.1.13 how it views AGN3 as a potential way to address these concerns. Sections 4.2 to 4.5 consider how we can define and assess the quality of audit. This draws attention to the knowledge and focus of the local audit team, as well as fees and the risks raised by audit. Concern is raised regarding the timeliness of audit reports and the fact, as noted at Figure 4.5 that there has been a significant increase in the number of opinions issued being delayed, with only 70% of opinions issued by 30 September in relation to the 2018/19 audits. Members will recall this was an issue for Worcestershire some years ago for one year due to our working papers but has not been in the last few years.

8. In addition it is worth noting section 4.3.5 - *There is a question as to whether external audit could make more use of the knowledge and expertise of internal audit in developing sufficient understanding of the local authority. It is usual for the external audit team to meet the Head of Internal Audit as part of the audit planning process, but it is unclear if liaison extends much beyond that. Internal auditors are likely to be much closer to the business than external audit and, in many authorities, a proportion of their work focuses on governance and service delivery matters. This could make internal audit a rich source of knowledge, should the external audit team wish to use it.*

9. As such the report recognises changes are required and makes a number of recommendations that this Committee should note:

- **Recommendations 1 and 2** – A new body, the Office of Local Audit Regulation (OLAR), be created to manage, oversee and regulate local audit... with the current roles and responsibilities relating to local audits discharged by... *various bodies being...* transferred to the OLAR. **This is welcomed by officers as it brings together quality, fee and direction.**

- **Recommendation 5** – All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority. **This is welcomed by officers but we note that this has not been an issue we have flagged locally before and is just thus common sense.**
  - **Recommendation 6** – The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of the local audit requirements. **This is supported, we would advocate strong external audit and note have reduced significantly since the abolishment of the Audit Commission and best value audits. The increased focus on VFM discussed in the Review and the Code should provide further assurance from audit and recognises the additional fees.**
  - **Recommendation 7** – That quality be consistent with the highest standards of audit within the revised fee structure... **We accept this recommendation but note we have had no local matters to raise and instead welcome the common sense approach of using one regulator to oversee this consistency between audit providers.**
  - **Recommendation 9** – External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice. **This is completely accepted and supported, in recent years the shift away from reliance on IA by external audit has had an impact on perceived duplication of resource and standing of the internal team. This move is thus welcomed. It should be noted though that in Worcestershire the new Chief Internal Auditor (CIA) has maintained a good working relationship and engagement with our external auditors and thus implementing this recommendation we feel will be easier for this Council.**
- **The role of the Audit Committee and governance arrangements in place locally around audit: *Section 5***

10. Section 5.1 outlines the differences across this and other sectors in terms of the membership and knowledge of Audit Committees, as well as engagement with external audit.

11. Paragraph 5.1.6 notes that on average Audit Committees consist of 7 members most commonly. Paragraph 5.1.7 makes a number of unsupported statements regarding the skills and training of members of the Committee. It is noted that a number of Finance professionals and business owners sit on this Committee and that regular training with good attendance has been in place for two years.

12. Paragraphs 5.1.9 to 5.1.11 raise the option of an independent member of the Committee. This is followed up with Recommendation 4, second bullet, that *consideration be given to the appointment of at least one independent member, suitably qualified, to the Audit Committee. The Committee is asked therefore to consider this recommendation.*

13. Paragraphs 5.1.12 to 5.1.15 raises the question around how frequently the Head of Paid Service (Chief Executive), Monitoring Officer (Assistant Director of Legal and Democratic Services), and the s151 Officer (Chief Financial Officer) meet with external audit and Committee. With recommendation 4, third bullet suggesting formalising the facility of the CEO, Monitoring Officer and CFO to meet with the key audit partner at least annually. We are please to note this practice is already in place at Worcestershire. Also our external auditors have access to meet independently with the CIA, the Leader and the CEO. As such we feel we are already compliant with this recommendation but welcome the strength of weight reflected in the report to the importance of this relationship. The same is true of paragraph 5.1.15, in that there is good attendance at Committee by our external audit team. **Committee's view on senior officer attendance at this Committee as per paragraph 5.1.14 is welcomed.**

14. Section 5.3 raises questions about the relationship of external audit and Audit Committee with Full Council. Paragraph 5.3.5 in particular notes with some examples that some serious matters have not been referred. We note that in Worcestershire the delay in the accounts was a matter referred and raised to Council. As such the report raises **Recommendation 12 - the external auditor be required to present an Annual Audit Report to the first Full Council after 30 September each year... OLAR to decide the framework.** This is perhaps a matter of culture by organisation and appear as a sledgehammer to crack a nut where there is perceived non-compliance. For Worcestershire that would typically be November Council, some seven months after the year end. It is unclear of any right to reply. It also raises question as to what debate and purpose of the Audit Committee will be if the report goes to Council. There is no submission the Committee can represent on this recommendation and we await any enactment or further clarification on the matter.

- **Audit coverage of financial resilience of local authorities:** *Section 6.*

15. Section 6 of the report attempts to draw a definition of financial resilience, including drawing reference to potential risks to that, such as commercialisation agendas. Figure 6.1 draws reference to CIPFA's Financial Resilience index which Worcestershire County Council do openly report through the budget setting report, and a separate report was then brought to this Committee. Section 6.3 reviews the audit assessment of this resilience through judgement of going concern and value for money (vfm) work. Section 6.5 notes the need for a new model for England and makes reference to the AGN03 (Appendix 2 of this report). This focus and the processes set out in AGN03 are welcomed by the CFO as adding additional review and support, and whilst there will inevitably be additional costs this will strengthen the standing of the sector and draw out failings where this risk often sits heavily on the shoulders of s151 Officers alone. AGN03 is also welcomed and paragraph 12 of that note and subsequent paragraphs could be helpfully seen as key lines of enquiry that enable self-appraisal and challenge to form the review of this Committee. As such this is welcomed.

## - **Financial reporting: Section 7**

16. Section 7 raises valid questions and concerns regarding the format and usefulness of local authority statement of accounts. That is not disputed by officers of this council, and we agree with the statement that local authority accounts are arguably more complex and more challenging for a service user to understand. For Worcestershire County Council the inclusion of the Pension Fund accounts in those statements adds to the complexity and the decoupling, which would require changes to primary legislation, is noted. The focus of audit on areas of technical not cash or budget nature, such as Property, Plant and Equipment and depreciation is considered over complex. Section 7.5 therefore identifies three options to address this concern:

- Review International Financial Reporting Standards (IFRS) as a basis for preparation of the accounts and move to cash accounting – not favoured due to concerns regarding lack of consistency.
- Expansion and standardisation of the current narrative statement – again this is not favoured due to the expansion of potential audit coverage and no guarantee it would address the visibility or clarity of the statements.
- Introduce a new summary statement – this is the favoured option and a number of examples are given for certain types of councils at Appendix 4 of the Redmond Review, although noting county councils are not an example used. These statements would still be subject to audit for consistency with the main statements (**Redmond Review Recommendation 20**).

17. The review has asked as part of **Recommendation 22 CIPFA and LASAAC to review the statement of accounts**. This is welcomed but it is not the first time such a review has occurred, and it is hoped this time there is a significant simplification.

## - **Other sections**

18. Section 8 makes reference to specific matters relating to parish / town councils as well as public interest reports. Section 9 draws conclusions and paragraph 9.3 as then reflected in **Recommendation 10 suggests that the deadline for publishing local authority accounts be revisited with a view to extending it to 30 September from 31 July**. This is not supported by officers as it draws time away from the added value accountancy adds to an organisation by looking backwards and also risks budget setting being delayed.

## **Conclusion**

19. Overall the report is welcomed however it is noted there are some areas of concern that the Committee will want to give consideration to, and actions will still need primary or secondary legislative changes.

## **Contact Points**

Specific Contact Points for this report  
Michael Hudson, Chief Financial Officer  
Tel: 01905 845560

Email: [mhudson@worcestershire.gov.uk](mailto:mhudson@worcestershire.gov.uk)

### **Supporting Information**

- **Appendix 1** – Independent Review into the Oversight of Local Audit and Transparency of Local Authority Financial Reporting – This can be found at the link below:  
<https://worcestershire.moderngov.co.uk/ecSDDisplay.aspx?NAME=SD1247&ID=1247&RPID=791968>
- **Appendix 2** – Auditor Guidance Note 3 (AGN 03) – Auditors' Work on Value for Money (VFM) arrangements

### **Background Papers**

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.