Audit committee

Date: Tuesday, 15 October 2019
Time: 16:30
Venue: Mancroft room, City Hall, St Peters Street, Norwich, NR2 1NH

Committee members:
Councillors:
Price (chair)
Driver (vice chair)
Giles
McCartney-Gray
Peek
Stutely
Wright
Youssef

For further information please contact:

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Agenda

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1	**Apologies**	
	To receive apologies for absence	
2	**Public questions/petitions**	
	To receive questions / petitions from the public Please note that all questions must be received by the committee officer detailed on the front of the agenda by **10am on 10 October 2019.** Petitions must be received must be received by the committee officer detailed on the front of the agenda by **10am on 13 October 2019.** For guidance on submitting public questions or petitions please see appendix 1 of the council's constutition.	
3	**Declarations of interest**	
	(Please note that it is the responsibility of individual members to declare an interest prior to the item if they arrive late for the meeting)	
4	**Minutes**	**5 - 10**
	To approve the accuracy of the minutes of the meeting held on 23 July 2019	
5	**Audit Annual Audit Letter 2018-19**	**11 - 40**
	Purpose - This report presents the annual audit letter	
6	**Internal Audit Update Q2 19-20 - July to September Update**	**41 - 52**

Purpose - To advise members of the work of internal audit, completed between July to September 2019, and the progress against the internal audit plan.

The role of internal audit is to provide the audit committee and management with independent assurance, on the effectiveness of the internal control environment. Internal audit coverage is planned so that the focus is upon those areas and risks which will most impact upon the council's ability to achieve its objectives.

The 2019-20 Audit Plan was approved by the audit committee on 12 March 2019.

7 Working party to consider a response to the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England **53 - 98**

Purpose - To consider the appointment of members to a working group to compile a response to the questions posed in the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England, also known as the Redmond review.

Date of publication**: Monday, 07 October 2019**

NORWICH City Council

Minutes

Audit committee

16:30 to 17:30 **23 July 2019**

Present: Councillor Price (chair), Maxwell (substitute for Councillor Driver), McCartney-Gray, Peek (from item 5), Ryan (substitute for Councillor Giles), Stutely , Wright[1] and Youssef

Also present: Councillor Kendrick, cabinet member for resources

Apologies: Councillors Driver (vice chair) and Giles

1. Public questions/petitions

There were no public questions or petitions received.

2. Declarations of interest

There were no declarations of interest.

3. Minutes

RESOLVED to approve the accuracy of the minutes of the meeting held on 11 June 2019, subject to amending item 5, Statement of Accounts 2018-19, fifth paragraph, fourth sentence, inserting the word “not” between “was” and “delivering” so that the sentence reads as follows:

“Members also were concerned about the under-spend in the Housing Revenue Account (HRA) and sought reassurance that the council was not delivering less in terms of repairs and maintenance.”

4. Annual Governance Statement 2018-19

The principal internal auditor (LGSS) presented the report. The committee had approved the draft Annual Governance Statement (AGS) at its last meeting. The AGS had been reviewed and there were no material changes in the final AGS, which would be signed off by the leader of the council and the chief executive officer.

RESOLVED to approve the Annual Governance Statement for 2018-19.

[1] Appointed to the committee as a member (replacing Councillor Lubbock)

6. Statement of Accounts and Audit Results Report 2018-19

(The external auditor (associate partner, Ernst & Young LLP) and the external audit manager attended the meeting for this item.)

The strategic finance business partner introduced the report. There were two material changes to the audited statement of accounts from the draft accounts relating to net pension liability and an additional capital accrual for work carried out on a housing revenue account project. Members were also advised that there was one unadjusted audit difference in the accounts which the chief finance officer had chosen not to adjust relating to data inputs for valuation calculations resulting in an understatement of asset values of £0.236m because the error was immaterial in its size and made no impact on the council's usable reserves and would require a disproportionate amount of work for the amount of work involved.

The external auditor presented the Norwich City Council and Group Audit Results Report dated 22 July 2019. During his presentation he drew member's attention to the Significant Risk section of the report and his conclusions. He confirmed that work had been completed on the movement in reserves statement and no issues had been identified or any adjustments required.

The external auditor commented on the section on the unadjusted error and referred members to Section 4, Audit Differences of the audit results report where the external auditors requested that the misstatement be either corrected or a rationale as to why it was not corrected be considered or approved by the audit committee. The strategic finance business partner and the chief finance officer explained that the misstatement of property assets related to the council's independent property valuer using the incorrect inputs for two aspects of two valuation calculations. The chief finance officer had taken the view to close the accounts with the unadjusted error so that the finance team could move on to other work. The external auditor explained how the errors had been identified in the sample testing of a selection of the council's assets. Only two errors had been identified in the sample and were immaterial in size and therefore it had not been deemed necessary to extrapolate further data against the whole list. The strategic finance business partner confirmed that the error had been an undervaluation of two assets. The chair said that the issue of the data being input incorrectly had been highlighted and that it was not expected to reoccur.

During his presentation of the audit results report, the external auditor explained that the impact of the McCloud judgement on discrimination arising from public sector pension schemes and transitional arrangements meant that pension liability was a big issue for councils this year. The financial statements had been reviewed to incorporate the council's increased pension liability following the outcome of this ruling and advice from Norfolk Pension Fund's actuaries. In reply to a question from the chair, the external auditor explained that the council had provision for its liability. The contingent liability is based on the hypothetical situation of all pensions being paid out at one time. The actual value of the fund, made up of contributions from employees and employers, could see an increase in contributions as it was important in the medium term budget provision going forward. The value of the pension fund varied due to investments on the stock market. Officers said that further information would be available in the autumn.

The external auditor referred to the section on the Group Accounts and confirmed that the process had been completed and no issues had arisen which needed to be brought to the attention of the committee. He also confirmed that the New Accounting Standards had been applied and there was nothing significant to report to the committee. In conclusion, the external auditor brought to members' attention the Executive Summary and referring to the status of the audit said that the external audit work had been completed for all of the items listed except the last four bullet points: review of the final version of the financial statements; completion of subsequent events review; receipt of the signed management representation letter, and final manager and engagement partner reviews. He confirmed that he expected to issue an unqualified audit opinion on the financial statements by 31 July 2019, the accounts publication date.

Discussion ensued on the tight timescales for the submission and completion of the audit by the accounts publication date. The chair acknowledged the outstanding achievement of the finance team in closing down the accounts and the pressures of the external auditors to meet the 31 July 2019 deadline. He suggested that the council might consider moving the date of the audit committee back a week in future years but pointed out that this would fall within the school summer holidays. The external auditor said that the outstanding issues list was not indicative of a badly organised close down of the accounts but rather a reflexion of the timescale permitted from the start to completion of the external audit. He was confident that the audit would be completed by 31 July 2019. The chair said that the council could consider moving the audit committee back a week in future.

The external auditor confirmed that as set out in Section 3 of the audit results report, an unqualified audit opinion was expected to be issued. He said that the unadjusted error was not above the threshold of materiality and that he considered that the financial team had presented a very robust set of financial statements. He referred to Section 5, Value for Money section of the report and the financial resilience of the council and said that external audit plan (approved, February 2019) had identified a risk to the council from its increasing commercialisation to meet the funding gap between funding and expenditure which in years 2019-20 and 2021-22 would be £7 million. A member pointed out that the council needed to find £7m over three years.

Discussion ensued in which the chair referred to the concerns raised by the committee relating to the governance arrangements for the council's commercial activity during the year. The business plan for Norwich Regeneration Limited (NRL) had been updated and the investment strategy had been approved strategy. The external auditor referred to the conclusions in the report and confirmed that proper arrangements were in place. He said that it was getting more difficult to deliver the savings and that he was satisfied that the council could make up a shortfall in its future savings plan delivery from the General Fund balance and still remain within the council's approved minimum reserves. The chief finance officer referred members to the introduction to the council's budget report (February 2019) and in reply to a member's question confirmed that in the last three years, no core services had been cut and that the savings had been made through income generation and efficiencies.

In conclusion members commented in appreciation of the finance team and corporate leadership team in ensuring that the financial statements were submitted on time and would receive an unqualified opinion from the external auditor. A member commented on this achievement and the progress made over the council had made in this respect over the last 9 years. The external auditor confirmed that the information received from the council and the audit opinion was appropriate for a council of this size.

The committee considered the letter of management representation.

RESOLVED to:

(1) approve the statement of accounts presented in Appendix 1 of the report, subject to the completion of any outstanding audit work; and, if any outstanding audit work gives rise to a material adjustment to the accounts, to delegate approval of the statement of accounts, as amended/adjusted in line with audit findings, to the chief finance officer, in consultation with the chair (or vice chair) of the committee;

(2) delegate to the chief finance officer, in consultation with the chair, the signing of the accounts by 31 July 2019.

(3) review and note the Audit Results Report, Appendix 2, from the council's external auditor;

(4) approve the draft letter of management representation presented in Appendix 3 of the report, including the chief finance officer's rational for not correcting an audit difference within the financial statements.

7. Internal Audit 2019-20 – April to June Update (Quarter 1)

The principal auditor (LGSS) presented the report and answered members' questions.

During discussion, the principal auditor confirmed that the committee would be advised if management did not adopt the recommendations of internal audit. A table had been introduced into the monitoring report which summarised the progress of implementation of recommendations following previous internal audits. This was in response to a request from the chair. She confirmed that two actions in relation to the NRL audit had been completed within the timescale requested.

The chair commented that the full refresh of the corporate risk register was an important piece of work and that it was expected that the report would be considered at the next meeting of the audit committee.

In reply to questions, the principal auditor explained that internal audit had been asked to provide advice and guidance on the controls within the process and procedure notes for sending out mail in response to a data breach. The recommendations had been accepted by management. Officers reviewed data breaches to identify where a control had failed and where deemed necessary reported the breach to the Information Commissioner's Office.

The principal auditor confirmed that progress against the internal audit work programme was on target for this first quarter.

RESOLVED to note the contents of the report.

CHAIR

Report to	Audit committee	**Item**
	15 October 2019	5
Report of	Chief finance officer	
Subject	Annual Audit Letter 2018-19	

Purpose

This report presents the annual audit letter.

Recommendation

The committee is asked to review and note the attached report from the council's external auditor.

Corporate and service priorities

The report helps to meet the corporate priority people living well.

Financial implications

There are no direct financial implications arising from this report.

Ward/s: All wards

Cabinet member: Councillor Kendrick – Resources

Contact officer

Karen Watling, chief finance officer 01603 212440

Background

1. The annual audit letter communicates to the members of Norwich City Council the key issues arising from the audit work carried out for the year ended 31 March 2019 by our external auditors. The letter is brought to the attention of all members and is also made available to external stakeholders, including members of the public, by publication on the council's website alongside the statement of accounts.

Key Findings, control themes and observations

2. The detailed findings of the audit work were reported to this committee on 23 July 2019 in the *2018-19 Audit Results Report*. The key findings, control themes and observations contained in the letter are based on the findings in the audit results report.

Looking Ahead

3. The "Focused on your future" section of the letter draws attention to new accounting standards and summarises the potential implications for local authority accounts. We will work closely with the auditors assess the implications of the standards on the Council accounts ahead of the year end.

Fees Update

4. EY will verbally update the audit committee on any scale fee variations relating to the 2018-19 audit. The final fee for the certification of claims and returns will be confirmed upon completion of the work on housing benefits.

Norwich City Council

Annual Audit Letter for the year ended 31 March 2019

12 August 2019

EY
Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a ‘Statement of responsibilities of auditors and audited bodies’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk).

This Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment (updated April 2018)’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to Norwich City Council (the Council) following completion of our audit procedures for the year ended 31 March 2019. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council (and Group) as at 31 March 2019 and of its expenditure and income for the year then ended.
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception: ► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 22 July 2019.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 31 July 2019.

In January 2020 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

MARK HODGSON

Mark Hodgson

Associate Partner

For and on behalf of Ernst & Young LLP

02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this Annual Audit Letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2018/19 Audit Results Report to the 23 July 2019 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Plan that we issued on 11 January 2019 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2018/19 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

03 Financial Statement Audit

Financial Statement Audit

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2019.

Our detailed findings were reported to the 25 July 2019 Governance and Audit Committee.

Misstatements due to fraud or error

Significant Risk

What was the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

One area susceptible to manipulation is the capitalisation of revenue expenditure on Property, Plant and Equipment given the extent of the Council's capital programme. The specific procedures undertaken to address this are set out on the next page. This page details the standard procedures we undertake to respond to the risk of fraud and error on every engagement.

What did we do and what judgements were we focused on?

In order to address this risk we undertook the following audit procedures:

- Identified fraud risks during the planning stages;
- Inquired of management about risks of fraud and the controls put in place to address those risks;
- Documented our understanding of the oversight given by those charged with governance of management's processes over fraud;
- Considered the effectiveness of management's controls designed to address the risk of fraud;
- Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;
- Reviewed the accounting estimates for evidence of management bias; and
- Evaluated the business rationale for significant unusual transactions.

ISA 240 mandates we perform procedures on: accounting estimates, significant unusual transactions and journal entries to ensure they are appropriate and in line with expectations of the business

What are our conclusions?

We did not identify any material weaknesses in controls or evidence of material management override.
We did not identify any instances of inappropriate judgements being applied or any management bias in accounting estimates.
We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.

Significant risk

Misstatements due to fraud or error * Capitalisation of revenue spend

Significant Risk

What was the risk?

The Council is under financial pressure to achieve budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way to achieve these targets.

We consider the risk applies to capitalisation of revenue expenditure. Management could manipulate revenue expenditure by incorrectly capitalising expenditure which is revenue in nature and should be charge to the comprehensive income and expenditure account.

What did we do and what judgements were we focused on?

We performed the following procedures:

- Sample tested additions to Property, Plant and Equipment (PPE) to ensure that they have been correctly classified as capital and included at the correct value in order to identify any revenue items that have been inappropriately capitalised; and
- Used our data analytics tool to identify and test journal entries that move expenditure into capital codes.

We consider the risk applies to capitalisation of revenue expenditure and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement.

What are our conclusions?

Testing of additions did not identify any incorrectly capitalised items of expenditure.

The use of our data analytics tool did not identify any unusual journal entries.

Our testing did not identify any inappropriate capitalisation of revenue expenditure.

Significant risk

Misstatements due to fraud or error – accounting adjustments made in the 'Movement in Reserves Statement' *

What was the risk?

The Council is under financial pressure to achieve its revenue budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way of achieving these targets.

We consider the risk applies to accounting adjustments made in the movement in reserves statement.

The adjustments between accounting basis and funding basis under Regulation changes the amounts charged to General Fund balances. Regulations are varied and complex, resulting in a risk that management misstatement accounting adjustments to manipulate the General Fund balance. We have identified the risk to be highest for adjustments concerning:

- Revenue Expenditure Funded from Capital Under Statute (REFCUS)
- Minimum revenue provision (MRP)

Significant Risk

What did we do and What judgements are we focused on?

We performed the following procedures:

- Sample tested REFCUS to ensure the expenditure meets the definition of allowable expenditure, or is incurred under direction from the Secretary of State; and
- Reviewed the Council's policy and application of the 'Minimum Revenue Provision'.

We consider the risk applies to accounting adjustments made in the movement in reserves statement and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement.

What are our conclusions?

Our work on REFCUS testing did not identify any issues.

Our testing on MRP did not identify any issues.

Other Areas of Audit Focus

Valuation of land and buildings – inherent risk

What was the risk?

The fair value of property, plant and equipment (PPE) and investment properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

What did we do and what judgements were we focused on?

We performed the following procedures:

- We have considered the work performed by the Council's valuers (Norfolk Property Services), including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- We have undertaken sample testing of key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre);
- We have considered the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. We will also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;
- Reviewed assets not subject to valuation in 2018/19 and confirmed that the remaining asset base is not materially misstated;
- We have considered circumstances that require the use of EY valuation specialists to review any material specialist assets and the underlying assumptions used;
- Considered changes to useful economic lives as a result of the most recent valuation; and
- Tested accounting entries have been correctly processed in the financial statements.

What are our conclusions?

Following full consideration of their work, we placed reliance on the Council's valuation expert. The Council's expert valuer possesses the relevant qualifications and experience, and undertook a review of a selection of assets as instructed. We considered the underlying assumptions made by the expert valuer and concluded that they were reasonable so far.

Our testing has not identified any material misstatements from inappropriate judgements being applied to the property valuation estimates so far. We identified two errors that in total (0.236 million) were significantly below our performance materiality of £2.514 million. As these amount to below our performance materiality level we considered the overall valuation estimate to not be unreasonable. These errors were not adjusted for within the financial statements.

Our consideration of the annual cycle of valuations did not identify any issues with the implemented plan or with the movement on assets not revalued in year.

Other Areas of Audit Focus

Pension Liability Valuation – inherent risk

What was the risk?

The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Norfolk County Council.
The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £177.8 million.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.
For 18/19 it is possible these entries will be subject to further volatility as a consequence of Brexit.

What did we do and what judgements were we focused on?

We performed the following procedures:

- Liaised with the auditors of Norfolk Pension Fund, and obtain assurances over the information supplied to the actuary in relation to the Norwich City Council;
- Assessed the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by National Audit Office for all Local Government sector auditors, and considered any relevant reviews by the EY actuarial team;
- Reviewed and tested the accounting entries and disclosures made within the Norwich City Council's financial statements in relation to IAS19; and
- Reviewed the impact of Brexit on the value of Pension Fund assets and considered whether there are any risks of material misstatement arising from this.

What are our conclusions?

We assessed and were satisfied with the competency and objectivity of the Council's actuary. EY pensions team and PwC (Consulting Actuary to the NAO) reviewed the work of the actuaries and have deemed the assumptions used to be reasonable.

A national issue resulted in a relatively late change to the pension fund accounts and IAS 19 fund liability disclosure. This related to legal rulings regarding age discrimination arising from public sector pension scheme transitional arrangements, commonly described as the McCloud ruling. Revised actuarial reports provided by the actuaries showed an increase in the liability of £5.36 million to the Council's Pension Liabilities as a result of the adjustments, with further associated disclosure added to recognise this as a source of estimation uncertainty and an adjusted post balance sheet event. The impact of the Guaranteed Minimum Pension ruling was also taken into account in these adjustments.

Other Areas of Audit Focus

Group Accounts

What was the risk?

In 2015 the Council incorporated Norwich Regeneration Limited (NRL), a company, with the Council as the sole owner. Activity is at a level considered material, which requires the Council to prepare group accounts.

We identify this as an inherent risk as the Council this can be a complex area of accounting.

What did we do and What judgements are we focused on?

We have performed the following procedures:

- Reviewed the group assessment prepared by the Council, ensuring that the accounting framework and accounting policies are aligned to the Norwich City Council group;
- Scoped the audit requirements for NRL based on their significance to the group accounts. Liaising with the external auditor of NRL and issuing group instructions that detail the required audit procedures they are to undertake in order to provide us with assurance for the opinion we will issue on the group accounts;
- Ensured the appropriate consolidation procedures are applied when preparing the Council group accounts and appropriate disclosures are made within the group accounts.

What are our conclusions?

We have reviewed the Council's group assessment and agree with the conclusion reached.

We have undertaken a review of the subsidiary auditors work following our scoping and issuing of group instructions. We have not identified any issues.

We were satisfied with the consolidation and had no matters to report.

Other Areas of Audit Focus

New Accounting Standards – inherent risk

What was the risk?

IFRS 9 financial instruments

This new accounting standard changes:

- How financial assets are classified and measured;
- How the impairment of financial assets are calculated; and
- The disclosure requirements for financial assets.

There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of Practice on local authority accounting provides guidance on the application of IFRS 9.

IFRS 15 Revenue from contracts with customers

This new accounting standard covers the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.

What did we do and what judgements were we focused on?

We performed the following procedures:

- Assessed the Authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standards, transitional adjustments and planned accounting for 2018/19;
- Considered the classification and valuation of financial instrument assets such as Norwich Airport investment and Norwich Regeneration Limited for IFRS 9;
- Reviewed the new expected credit loss model impairment calculations for assets for IFRS 9;
- Considered application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation for IFRS 15; and
- Checked additional disclosure requirements.

What are our conclusions?

We did not identify any issues with the implementation of the new accounting standards.

Financial Statement Audit (cont'd)

Our application of materiality

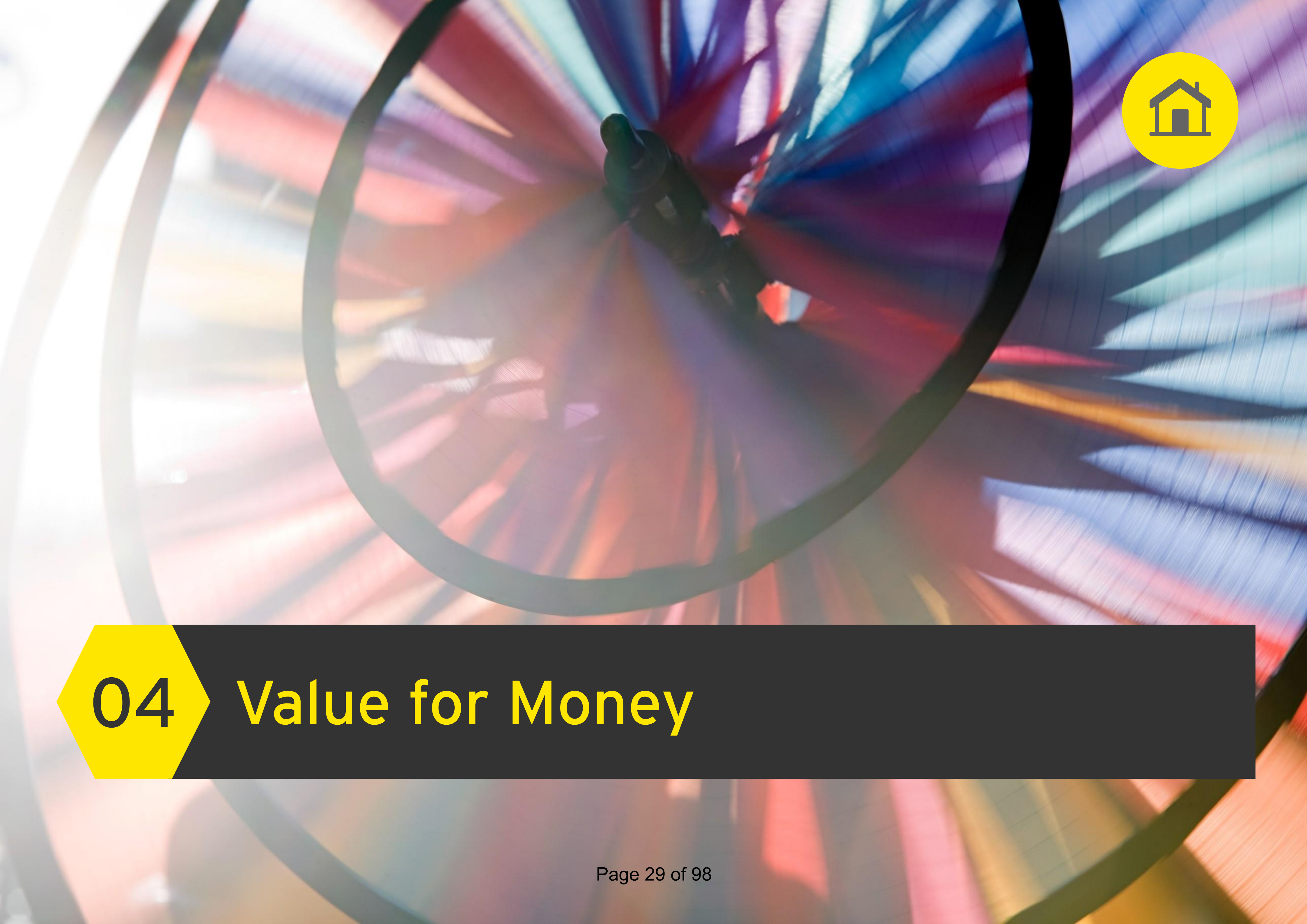
When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £3.35 million (2017/18: £2.6 million), which is 2% of gross expenditure on provision of services reported in the accounts of £167.5 million adjusted for the surplus on trading undertakings and non domestic rates tariff and levy payment. We consider gross expenditure on provision of services to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £167,000 (2017/18: £130,000)

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits: reduced materiality level of £5,000 applied in line with bandings disclosed.
- Related party transactions and members allowances: reduced materiality level applied equal to the reporting threshold.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.



04 Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

We identified significant risks in relation to these criteria.

We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 31 July 2019.

Value for Money Risks – Risks

What was the significant value for money risk?	What did we do?
Taking Informed Decisions - Commercialisation The Council continues to identify new ways to generate income in the current constrained financial environment. In 2018/19 the Council has increased investments in commercial property and the investment in the Council's own company, Norwich Regeneration Limited. This has included diversifying the investment portfolio and purchasing assets out of area. Entering into commercial activity on an increased scale requires the Council to continue to have appropriate governance and corporate arrangements in place to appropriately plan and deliver these schemes. We have identified a risk due to the increasing activity by the Council in this area.	We undertook the following procedures: - Considered the Council's commercialisation strategy against current guidance provided by CiPFA; - Reviewed purchases in year to ensure they are in line with the updated strategy; - Reviewed the updated NRL business plan; and - Reviewed the returns included within the medium term financial plan from commercial activity. The Council has a Capital Strategy which clearly aligns the commercial property strategy and Norwich Regeneration Limited (NRL) to the Council's objectives. The Council has a robust gateway methodology for all potential acquisitions. We have concluded proper arrangements were in place during 2018/19 for informed decision making.
Deploy resources in a sustainable manner – Medium Term Finances The latest Medium Term Financial Plan (MTFP) shows there is a gap between funding and expenditure in years 2019/20 to 2021/22 of £7 million. Savings plans had yet to be fully developed to address the gap at planning, with the commercialisation agenda above one approach to mitigating the risk. Given the level of the savings required this presents a risk to the Council's financial position.	We undertook the following procedures: - Monitored the financial position for 2018/19. This saw the Council recognise an underspend of £1.5 million and delivered 96% of it's savings targets. The Council has a track record of recording underspends and achieving it's savings targets. The Council has contributed £1.1 million to reserves in year. - We have reviewed the arrangements the Council has for identifying their medium savings requirements through review of the medium term financial strategy. They have modelled savings across different service lines. The Council has already identified £1.9 million of gross savings, with £1 million of this coming from additional income. £0.7 million of the additional income is to come from the commercialisation agenda. - The bridging graph on the next page provides a sensitivity analysis of the past and current activity on future reserves. Overall the Council appears to have a strong track record in identifying and achieving savings targets. It's medium term financial strategy appears sound. The Council does envisage using reserves to support the revenue budget over the next three years, at it's current pace these reserves would remain above the approved minimum level.

05 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts
The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement
We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading. We completed this work and did not identify any areas of concern.

Report in the Public Interest
We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public. We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations
We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response. We did not identify any issues which required us to issue a written recommendation.

Objections Received
We did not receive any objections to the 2018/19 financial statements from members of the public.

Other Powers and Duties
We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Other Reporting Issues (cont'd)

Independence

We communicated our assessment of independence in our Audit Results Report to Audit Committee on 23 July 2019. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

We did not identify any significant deficiencies in internal control during our audit.

06 Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.
IASB Conceptual Framework	The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year. This introduces; – new definitions of assets, liabilities, income and expenses – updates for the inclusion of the recognition process and criteria and new provisions on derecognition – enhanced guidance on accounting measurement bases - enhanced objectives for financial reporting and the qualitative aspects of financial information. The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards. However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.	It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements. However, Authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.

07 Audit Fees

Audit Fees

Our final fee for 2018/19 as expected, at the scale fee set by the PSAA and reported in our 17 July 2019 Annual Results Report.

Description	Final Fee 2018/19 £'s	Planned Fee 2018/19 £'s	Scale Fee 2018/19 £'s	Final Fee 2017/18 £'s
Total Audit Fee – Code work	TBC – Note 2	61,534	61,534	96,219
Total Audit Fee – Certification of claims and returns	TBC - Note 1	29,260 – Note 1	N/A	39,280

Note 1 – From 2018/19, the Council is responsible for appointing their own reporting accountant to undertake the work on their claims in accordance with the instructions determined by the relevant grant paying body.

As your appointed auditor for the financial statements audit, we are pleased that for 2018/19 the Council has appointed us to act as reporting accountants in relation to the housing benefit subsidy claim. There is therefore no scale fee prescribed by PSAA as it is now no longer within their remit.

The Grant Claims line includes the fee agreed for Housing Benefits £25,760 and the estimated fee for the pooling of housing capital receipts claim of £3,500. We will confirm our final fees following the completion of our work and report this to the Audit Committee within our Annual Grant Certification report in January 2020.

Note 2 - The planned fees for 2018/19 may be subject to a scale fee variation due to increases in the scope of the audit as summarised below:

- Audit of the group accounts. This is likely to be between £3,000 to £5,000 due to the scale and complexity of the work.
- Significant risk identified in relation to the value the value for money conclusion.

This additional fee will be discussed with management and is then subject to approval by the PSAA. Once agreed we will report this fee to the Audit Committee.

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ED None

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Report to	Audit Committee 15 October 2019	**Item**
Report of	Chief Internal Auditor, LGSS	6
Subject	Internal audit 2019-20 – July to September update (Quarter 2)	

Purpose

To advise members of the work of internal audit, completed between July to September 2019, and the progress against the internal audit plan.

The role of internal audit is to provide the audit committee and management with independent assurance, on the effectiveness of the internal control environment. Internal audit coverage is planned so that the focus is upon those areas and risks which will most impact upon the council's ability to achieve its objectives.

The 2019-20 Audit Plan was approved by the audit committee on 12 March 2019.

Recommendations

The committee is requested to consider the contents of this report.

Corporate and service priorities

The report helps to meet the corporate priority for value for money services.

Financial implications

None

Ward/s: All wards

Cabinet member: Councillor Kendrick – Resources

Contact officers:

Duncan Wilkinson, Chief Internal Auditor, LGSS	01908 252089
Neil Hunter, Head of Internal Audit, LGSS	01223 715317
Magen Powell, Principal Auditor, LGSS	01603 212575

Background documents

None

LGSS Internal Audit & Risk Management

Norwich City Council

Quarterly update report

Q2

As at 4h October 2019

Resources

As outlined to Audit Committee at the beginning of the financial year, it is good practice to keep audit plans under review and update them to reflect emerging risks, revisions to corporate priorities, and resourcing factors which may affect the delivery of the audit plan.

Additional work is considered where it will help to improve the internal control environment and governance arrangements at the Council. Consequently it is appropriate to review the internal audit plan and re-profile accordingly.

The original plan was agreed as 450 days, there have been no further changes to the plan for 2019-20. As at 4th October 2019, 268 productive days are projected to have been delivered against the plan which reflects the profiling with the majority of testing completed in quarter's two to four.

CLT has delegated the responsibility for agreeing changes to the Plan midyear to the Director of Business Services. In line with changing risks and priorities facing the council the Director of Business Services has approved the following changes as recommended by internal audit.

Plan changes

System	Original profile	New profile	Change	Comment
Payroll	15	20	5	Additional work required.
AGS	10	12	2	Additional work required.
Committee Reporting	15	20	5	Increase time required to support and respond to queries.
Contract Extensions	5	10	5	Additional work required.
Contract Management	20	30	10	Increased scope of review
HR & Finance System Project	5	9	4	Delay of system implementation.
Annual Review of Key Policies	6	9	3	Additional work required.
Scheme of Delegation	5	10	5	Additional work required.
Commercial Property Investment Strategy	20	25	5	Additional work required.
Ad Hoc Queries	15	25	10	Increase in queries.

System	Original profile	New profile	Change	Comment
LGSS Withdrawal Meetings	0	10	10	Additional pressure.
NFI	20	10	-10	Reduce
NRL	15	0	-15	Remove
Financial Regulations	2	0	-2	Remove
Contract Procedure Rules	2	0	-2	Remove
Fees and Charges	5	0	-5	Remove
Risk Management Review	5	0	-5	Remove
IT Audits	25	0	-25	Remove
Overall change to the plan			**0**	

Progress against the plan

Finalised Assignments

The following audit assignments have reached completion as set out below:

Directorate	Assignment	Control Assurance	Compliance Assurance	Organisational Impact
2018/19 Audit Plan				
Cross cutting	Information Security and GDPR	Satisfactory	Limited	Moderate
Cross cutting	E5 Finance System IT Controls	Satisfactory	Satisfactory	Moderate
2019/20 Audit Plan				
Cross cutting	Commercial Property Investment Strategy	Good	Good	Minor

At the conclusion of an audit assignment an assurance opinion of the system is reported and these are explained further in Appendix B – Audit Definitions.

Key points from the completed 2018/19 reviews include:

Information Security and GDPR

The key weaknesses are:

- The Information Asset Register has not been updated since 2016, therefore the Council may be unaware of assets at the Council and whether adequate data protection and privacy controls are in place to secure the data held within such assets;
- Records are not managed in accordance with the Council's 'Schedule of Processing' document;
- There is inadequate training and awareness of GDPR;
- GDPR considerations for existing contracts are not in place;
- Current documentation has not been updated to reflect the specific requirements of GDPR.

E5 Finance System IT Controls

The key weaknesses are:

- End to End testing for the new E5 Finance System has not been planned. Considering the system is due to go-live in July 2019, this is now a critical activity which should be performed as a priority;
- The lack of a comprehensive password policy to govern user access to major systems could result in systems not being adequately set up to align with baseline security standards which are considered good practice for the Council, thus putting the data held within such systems at risk;
- User roles from the current Finance System will be mirrored on the new E5 Finance System. This is not considered good practice and could result in users maintaining inappropriate access on the new E5 Finance System simply as a result of having inappropriate access on the current system. The implementation of the new E5 Finance System should instead be considered an opportunity to improve and strengthen user access;
- Threshold auditing of the Finance System is not conducted, therefore suspicious activity would not be identified through proactive deployment of detective controls;
- A Change Management Policy and Change Advisory Board are not in place.

Key points from the completed 2019/20 reviews include:

Commercial Property Investment Strategy

The key weaknesses are:

- The strategy document requires some amendments to update minor errors / omissions;
- The financial model for a block of properties sample tested does not include costs relating to the agents management of the property;
- There has been heavy reliance on the council's advisors/managing agents in many aspects of the processes. However at the time of the audit no service contract had been completed although this has now been finalised and signed.

Draft / Interim reports / Work in progress

At the time of producing this report, the following audit assignments are at draft report stage or work in progress:

Directorate	Assignment
Cross cutting	Payroll
Cross cutting	Scheme of Delegation
Cross cutting	Key Policies and Procedures
Cross cutting	Council Tax
Cross cutting	National Non-Domestic Rates (NNDR)
Cross cutting	Contract Management

Further information on work planned, and in progress, may be found in the Audit Plan, attached as Appendix A.

Implementation of management actions

Throughout the year we have sought assurances from teams that their actions from previous audits have been implemented to schedule. Summary of follow up recommendations due as at quarter two of 2019-20:

	Essential Recommendations		Important Recommendations	
Audit	**Agreed**	**Status as at end of Q2**	**Agreed**	**Status as at end of Q2**
Audits completed in 2018/19				
Commercial Rents			6	5 completed, 1 revised target date to end Oct 2019.
Corporate Key Performance Measures			3	2 completed, 1 revised target date to end Oct 2019.
Norwich Regeneration Limited	5	3 were due to date, all completed	3	Not yet due
Project Management			3	3 revised target date to end April 2020.
Housing Benefits			1	Completed
Audits completed in 2019/20				

Commercial Property Investment Strategy			1	Revised target date to end Oct 202019
Review of Mailings Using the Insertion Machine			5	All completed

There are currently no outstanding essential actions, and this provides positive assurance of the Councils commitment to maintain the internal control environment.

Summaries of completed audits with limited or no assurance

At the conclusion of an audit an assurance opinion of the system is reported. This reflects the effectiveness of control, compliance and organisational impact. These are explained further in Appendix B – Audit Definitions

Individual reviews which highlight there is only limited or no assurance, in the final report, are communicated to the Audit Committee for awareness. A review of Information Security and GDPR resulted in limited assurance within compliance, consequently 14 recommendations were made of which 3 were classified as essential and 7 were classified as important. All recommendations were agreed with implementation dates which will be followed up accordingly.

Other audit activity

In addition to completing ongoing audit reviews, the Internal Audit team has been conducting work in the following areas:

Whistleblowing Policy

The councils whistleblowing policy has been updated to reflect changes to staff contact details when raising a concern, these are cosmetic to the policy.

Since the last report to Audit Committee there have been three instances where concerns have been raised through the council's whistleblowing policy, these are currently under investigation. One is being progressed by Nplaw, Internal Audit is undertaking work on another allegation however it has been determined that one significant whistle blowing allegation will not be referred to the LGSS Internal Audit team for investigation but will be offered to another external organisation.

National Fraud Initiative

The Council participates in a national data matching service known as the National Fraud Initiative (NFI), which is run by the Cabinet Office. Data is extracted from Council systems for processing and matching. It flags up inconsistencies in data that may indicate fraud and error, helping councils to complete proactive investigation. Nationally it is estimated that this work has identified £1.17 billion of local authority fraud, errors and overpayments since 1996. Historically this process has not identified significant fraud and error at Norwich, which provides assurance that internal controls continue to operate effectively.

The Council has carried out the current exercise to the deadlines set by the Cabinet Office. From the 2018 exercise a total of 8257 matches were identified of which 329 matches met the NFI's recommended filter as being of higher importance based on previous NFI exercises. Work has commenced on reviewing these matches and will continue throughout the year. Any significant matters arising in terms of fraud and error identified will be reported.

Development

Continuous improvement

The LGSS Internal Audit team follows good professional practice such as the Public Sector Internal Audit Standards, and the supporting Local Government Application Note.

The Internal Audit team has reviewed the audit definitions which are issued on conclusion of audit work. The methodology and approach continues to be relevant, and some minor revisions have been made to the terminology which should add clarity to the reporting process. The audit definitions are listed in Appendix B.

Appendix A – Internal audit plan

Norwich 2019/20

Audit	Status	Qtr opened / planned	Qtr closed	Profiled days
National Fraud Initiative	Ongoing	All year	N/a	10
Fraud Investigations	Ongoing	All year	N/a	10
Total Anti-Fraud and Corruption:				**20**
Accounts Receivable	Not started	Q4		25
Purchase to Pay	Not started	Q4		25
Payroll	In progress	Q1		20
Housing Rents/Arrears	Not started	Q3		20
Housing Benefits	Not started	Q4		20
Council Tax	In progress	Q2		15
NNDR	In progress	Q2		15
Bank Reconciliations	Not started	Q3		10
Treasury Management	Not started	Q3		15
Total Key Financial Systems:				**165**
Strategic Risk Management	Ongoing	All year	N/a	15
Total Risk Management:				**15**
Contract Management	In progress	Q1		30
Joint Ventures	Ongoing	All year	N/A	30
Total Contracts:				**60**
Annual Key Policies & Procedures Review	In progress	Q1		9
Total Policies & Procedures:				**9**
Key Performance Indicators	Not started	Q3		5
Scheme of Delegation Compliance	In progress	Q1		10
Commercial Property Investment Strategy	Complete	Q1	Q2	25
Contract Extensions	Complete	Q1	Q1	10
Total Compliance:				**50**
Attend HR & Finance Project Meetings	Ongoing	All year	N/a	9
Attend Information Governance Group	Ongoing	All year	N/a	5
Attend Data Breach Response	Ongoing	All year	N/a	5
Attend/facilitate Corporate Governance and RM Group	Ongoing	All year	N/a	5
Annual Governance Statement	Complete	Q1	Q1	12
Total Governance:				**36**
Disabled Facility Grant	Complete	Q1	Q1	10
Total Grant assurance:				**10**
Ad -Hoc Advice & Guidance	Ongoing	All year	N/a	25
Follow-Ups of Agreed Actions	Ongoing	All year	N/a	10
Total Advice & Guidance:				**35**
LGSS Withdrawal Meetings	Ongoing	All year	N/a	10
Committee Reporting	Ongoing	All year	N/a	20
Management Reporting	Ongoing	All year	N/a	10
Audit Plan	Ongoing	All year	N/a	10
Total Reporting:				**50**
Operational Plan Total - 2019/20				**450**

Appendix B – Audit Definitions

There are three elements to each internal audit review, and an assurance opinion is provided against each element at the conclusion of the audit. The following definitions are used by Internal Audit in assessing the level of assurance which may be provided against each key element, and in assessing the impact of individual findings:

Control Environment / System Assurance

The adequacy of the control environment / system is perhaps the most important as this establishes the key controls and frequently systems 'police/ enforce' good control operated by individuals.

Assessed Level	Definitions
Substantial	Substantial governance measures are in place that give confidence the control environment operates effectively.
Good	Governance measures are in place with only minor control weaknesses that present low risk to the control environment.
Satisfactory	Systems operate to a moderate level with some control weaknesses that present a medium risk to the control environment.
Limited	There are significant control weaknesses that present a high risk to the control environment.
No Assurance	There are fundamental control weaknesses that present an unacceptable level of risk to the control environment.

Compliance Assurance

Strong systems of control should enforce compliance whilst ensuring 'ease of use'. Strong systems can be abused / bypassed and therefore testing ascertains the extent to which the controls are being complied with in practice. Operational reality within testing accepts a level of variation from agreed controls where circumstances require.

Assessed Level	Definitions
Substantial	Testing has proven that the control environment has operated as intended without exception.
Good	Testing has identified good compliance. Although some errors have been detected these were exceptional and acceptable.
Satisfactory	The control environment has mainly operated as intended although errors have been detected that should have been prevented / mitigated.
Limited	The control environment has not operated as intended. Significant errors have been detected and/or compliance levels unacceptable.

No Assurance	The control environment has fundamentally broken down and is open to significant error or abuse. The system of control is essentially absent.

Organisational Impact

The overall organisational impact of the findings of the audit will be reported as major, moderate or minor. All reports with major organisational impact will be reported to the Corporate Management Team along with the relevant Directorate's agreed action plan.

Organisational Impact	
Level	Definitions
Major	The weaknesses identified during the review have left the Council open to significant risk. If the risk materialises it would have a major impact upon the organisation as a whole.
Moderate	The weaknesses identified during the review have left the Council open to medium risk. If the risk materialises it would have a moderate impact upon the organisation as a whole.
Minor	The weaknesses identified during the review have left the Council open to low risk. This could have a minor impact on the organisation as a whole.

Findings prioritisation key

When assessing findings, reference is made to the Risk Management matrix which scores the impact and likelihood of identified risks arising from the control weakness found, as set out in the Management Action Plan.

For ease of reference, we have used a system to prioritise our recommendations, as follows:

Essential	**Important**	**Standard**
Failure to address the weakness has a high probability of leading to the occurrence or recurrence of an identified high-risk event that would have a serious impact on the achievement of service or organisational objectives, or may lead to significant financial/ reputational loss.	Failure to respond to the finding may lead to the occurrence or recurrence of an identified risk event that would have a significant impact on achievement of service or organisational objectives, or may lead to material financial/ reputational loss.	The finding is important to maintain good control, provide better value for money or improve efficiency. Failure to take action may diminish the ability to achieve service objectives effectively and efficiently.
The improvement is critical to the system of internal control and action should be implemented as quickly as possible.	The improvement will have a significant effect on the system of internal control and action should be prioritised appropriately.	Management should implement promptly or formally agree to accept the risks.

Report to	Audit Committee	**Item**
	15 October 2019	
Report of	Chief finance officer	7
Subject	Working party to consider a response to the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England	

Purpose

To consider the appointment of members to a working group to compile a response to the questions posed in the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England, also known as the Redmond review.

Recommendation

To appoint members to a working group to respond to the Redmond review on behalf of the Norwich City Council audit committee.

Corporate and service priorities

The report helps to meet the corporate priority of a healthy organisation.

Financial implications

None

Ward/s: All wards

Cabinet member: Councillor Kendrick - Resources

Contact officers

Karen Watling, chief finance officer	01603 212440

Background documents

None

Report

1. The independent Review is looking at the transparency and quality of:

    a) Local authority financial reporting

    b) The external audit process, including arrangements introduced by the Local Audit and Accountability Act 2014

2. The key objective of the review is to make recommendations on improving the accounts and audit process to meet the needs of local residents and taxpayers. In particular the review is seeking:

    a) Views on how effective we perceive the framework to be in providing helpful information to elected members and local residents.

    b) Information on how often we engage with external auditors both formally (e.g. at audit committees) or informally.

    c) Thoughts on how helpful audit recommendations are in driving continuous improvement.

    d) Insight on how useful LA accounts are in enabling stakeholders to understand financial resilience and how the money is being managed.

    e) Suggestions on how the framework and/or products can be improved to make the process more useful.

3. The deadline for providing a response is 22 November 2019. Due to the tight timescales, it is proposed that a small working group is appointed to respond to the review on behalf of the audit committee.

4. The chair and vice chair of the audit committee will sit on the working group with two other members of the audit committee with relevant officers from the council being in attendance.

5. The meeting to consider these questions and the response will be held at 9:30am on 28 October 2019.

6. A copy of the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England is attached to this report at appendix A. This document includes the questions that the working group will be asked to provide a response to.

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

Tony Redmond

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 Study[1], the independent review of the Financial Reporting Council[2] and Sir Donald Brydon's review of audit quality[3].

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

[4] International 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 percent[9] 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.psaa.co.uk/201516-work-programme-and-scales-of-fees/
[9] https://www.psaa.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 councils[16] 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 2018-19[17] 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 survey[19] 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.

Table 2: Financial Statements – example of number of pages

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.

Table 3: Local Authority Accounts – Primary Statements and Supplementary Accounts (local authority specific statements in red)

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 Polices 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	x/(x)
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 that 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.