

# Audit and Governance Committee



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| Date of meeting:         | 30 November 2020   |
| Title of Report:         | <b>Redmond Review - Independent Review of the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting</b> |
| Lead Member:             |  |
| Lead Strategic Director: | Councillor Mark Lowry (Cabinet Member for Finance)   |
| Author:                  | Andrew Hardingham (Service Director for Finance)<br>Paul Looby – Head of Financial Planning and Reporting                              |
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| Key Decision:            | PL2O   |
| Confidentiality:         | No<br>Part I - Official  |

## Purpose of Report

This report:

- Outlines the key conclusions and recommendations from the Redmond Review which is an independent review of the external audit and reporting framework for local government.

## Recommendations and Reasons

### That Audit and Governance Committee:

- I. Notes the report and potential implications for Plymouth City Council if all recommendations are fully implemented by Government.

## Alternative options considered and rejected

None – this report is for information.

## Relevance to the Corporate Plan and/or the Plymouth Plan

This report is for noting but if the recommendations from the review are agreed and fully implemented there will be implications to the Corporate Plan.



**Sign off:**

|     |                  |     |                           |            |  |    |  |            |  |               |  |
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| Fin | djn20.<br>21.158 | Leg | 35671/<br>AC/19/<br>11/20 | Mon<br>Off |  | HR |  | Asset<br>s |  | Strat<br>Proc |  |
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Originating Senior Leadership Team member: Andrew Hardingham (Service Director For Finance)

Please confirm the Strategic Director(s) has agreed the report? Yes

Date agreed: 16/11/2020

Cabinet Member approval: Councillor Mark Lowry (Cabinet Member for Finance)

Date approved: 17/11/2020

## 1. Introduction

1.1 In June 2019, Sir Tony Redmond was commissioned by the Ministry of Housing Communities and Local Government to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. Tony Redmond is an experienced public servant and was the Chief Executive at London Borough of Harrow and a Treasurer at a Metropolitan Borough.

1.2 The purpose of the review was to look at:

- How are local authorities accountable to service users and taxpayers;
- How are auditors accountable for the quality of their work;
- How easy is it for auditors to understand how the local authority has performed and what assurance can services users and taxpayers take from external audit work.

1.3 The Redmond Review has made a large number of recommendations. These impact upon External Audit colleagues, the closure of the Accounts and the operation of the Audit Committee. This report summarises the key issues which will impact upon local government and Plymouth City Council.

1.4 The detailed report by Sir Tony Redmond can be reviewed on the attached link:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/915806/Redmond\\_Review.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/915806/Redmond_Review.pdf)

## 2. Summary of Key Recommendations

2.1 The main recommendations can be summarised under the following areas.

### **External Audit Regulation and Fee Structure**

2.2 The headline proposal is for the creation of a new regulator, the Office of Local Audit and Regulation (OLAR) to oversee local audit work, which will undertake the registering of audit firms, the award and management of contracts and review of auditor performance. The involvement of Public Sector Audit Appointments (PSAA), Institute of Chartered Accountants in England and Wales (IAEW), the Financial Reporting Council (FRC) and the National Audit Office (NAO) in the framework would come to an end.

2.3 The regulator would have ultimate responsibility for the external audit regime and should in theory provide consistency in approach, set audit fees and mediate where differences exist.

2.4 In addition to external regulation, the review did identify that it was clear that the local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. With 40% of audits failing to meet the required deadline for report in 2018/19, Redmond concluded “this signals a serious weakness in the ability of auditors to comply with their contractual obligations”. In addition, the ambition of attracting new audit firms to the

local authority market has not been realised. Redmond does suggest that without prompt action to implement his recommendations, there is a significant risk that the firms currently holding local audit contracts will withdraw from the market.

- 2.5 A combination of an inadequate fee structure in relation to the external auditing requirements has meant the current system is not working effectively. Therefore the current fee structure for local audits needs to be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements or the breadth and depth of external auditing requirements need to be revised.
- 2.6 A paper was presented to this Committee setting out its concerns with regard to the fee structure and the Section 151 officer has expressed his concerns and wrote to the PSAA on this issue. The PSAA concluded that Plymouth will have to pay an additional fee for the 2018/19 which amounts to £77,505. Whilst we accept the additional cost, our auditors gain some compensation for additional time incurred the Council has no recourse.
- 2.7. In relation to the 2019/20 audit which is still ongoing, Grant Thornton have already written to the Section 151 officer stating the fee for the 2019/20 audit will be at least £37,000 higher than the original contract fee that was agreed. We can see no justification for a significant proportion of this and will therefore be referring the matter back to the PSAA to adjudicate in due course. A further report will be made to this Committee once the current audit has been completed and the final fee note issued. The Council accepts that third party legal fees are passed onto us but it does seem unfair that the fees relate to matters where the Council has sort legal advice and paid for it. We end up paying twice.
- 2.8 The PSAA are consulting on a new system for audit fee variations from 2020/21. They are proposing to introduce:
  - a) **national variations** – fee changes which would reflect changes to the auditing and accounting codes, standards and regulatory requirements, where a standard cost can be reasonably estimated;
  - b) **local variations** – fee changes that relate to local factors arising from an audit, such as the additional audit work required if accounts reflect complex transactions that are not built into the scale fee.
- 2.9 These proposals are prompted by the findings from the Redmond Review. The PSAA are proposing a 25% increase in the hourly rates for external audit staff. The PSAA acknowledge that these proposals will be unwelcome by local authorities and will place further challenges on already stretched budgets.
- 2.10 Redmond also states that quality of the audit must be consistent with the highest standards of audit within any revised fee structure. Therefore any increase to the fee levels must be linked to the performance of the external audit function and in particular to meeting deadlines for signing off the annual accounts by the statutory deadline. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.
- 2.11 Nationally the evidence would seem to suggest that external auditors are struggling to deliver against the contracts that were signed up to two years ago which includes having the resources

and capacity to deploy qualified auditors. This is despite the deferred timetable agreed in for the 2019/20 audit due to the Covid 19 Pandemic.

- 2.12 These demands have been exacerbated by the auditing requirements which include excessive review of the pension fund and its valuation and the focus on asset valuations – all complex accounting issues which do not directly impact upon the revenue outturn for any local authority.

### **Reporting Requirements and Governance**

- 2.13 Due to the Covid Pandemic the statutory deadline for publishing the draft annual accounts was moved to 31 August 2020 and final sign off by the external auditors to the end of November 2020. At present the expectation is these deadlines will revert back to the normal statutory deadlines i.e. 30 May and 31 July respectively.
- 2.14 The Redmond Review has proposed that the target date for final sign off for the audited statement of accounts is moved back from 31 July to 30 September. The review concluded that this should allow audit firms more scope to resource audits effectively and achieve the target deadline.
- 2.15 Whilst this proposal to move the publication date will allow more opportunity for the accounts to be finalised within the target date, it is disappointing that local authority accounting teams are still required to close and publish their draft accounts by the 31 May each year and there is no planned relaxation of the accounting requirements that must be met. Of course there is an incentive to complete the accounts closing process at the earliest opportunity. This would allow resources to be focused on financial planning, reporting and forecasting. However due to FRC requirements and the subsequent greater scrutiny of technical accounting issues by Grant Thornton, it will become increasingly difficult for these timescales to be met without making a number of estimates and assumptions on the financial statements which will inevitably be subject to challenge and further work after 31 May.
- 2.16 The Review has made proposals for strengthening the overall governance arrangements which Councils have in place and the review has recommended an annual report is submitted to Full Council by the external auditor after 30 September each year, irrespective of whether the final accounts have been certified. OLAR to decide the framework for this report.
- 2.17 The report also says “consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee” which is something Plymouth already has in place.
- 2.18 The review recommends formalising the facility for the Chief Executive Officer (CEO), Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually. Regular meetings already take place with our external auditors so Plymouth support this recommendation.

### **Financial Resilience of local authorities**

- 2.19 The review recommends the Ministry of Housing Communities and Local Government (MHCLG) reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained and any concerns relating to service and financial viability be

shared between Local Auditors and Inspectorates including Ofsted and Care Quality Commission prior to completion of the external auditor's Annual Report.

- 2.20 External auditors have paid considerable attention to the concept of a Going Concern and the statement of accounts must include a statement of this nature. In essence this is to demonstrate the "business" or local authority will "continue in the future" unless there is evidence to the contrary. The vast majority of local authority finance practitioners think the concept for local government is meaningless due to the statutory nature of the services and the nature of its public funding which is significantly different from the private sector.

### **Transparency of financial reporting**

- 2.21 The publication of the Statement of Accounts is governed by the CIPFA Accounting Code of Practice and is extremely prescriptive. In addition the statement is a complex and long document. All local authorities must adhere to the Code to ensure they do not get an adverse opinion from their external auditors.
- 2.22 The review raises the issue of transparency of financial reporting and makes suggestions for reform. This has been a debating point for a number of years. The Review concludes that major changes to existing reporting is not considered a viable option due to issues of consistency across the public sector and the need for adherence to International Financial Reporting Standards (IFRS). The review says:
- *"The UK public sector is held up as applying a gold standard of accounting, primarily because it is one of the few to apply IFRS fully. If part of the sector moved away from this it could generate considerable reputational risk. As a result, HM Treasury and Financial Reporting Advisory Board (FRAB) may well oppose any significant modification of the English local authority accounting framework."*
- 2.23 The review suggests local authorities prepares a new Summary Financial Statement. This would be a standardised statement of service information and costs which would be prepared by each authority and be compared with the budget agreed and presented alongside the statutory accounts. Redmond suggest the standardised statement should be subject to external audit.
- 2.24 In principle a simplified version of the accounts would be welcomed due to the reasons explained above. However, this can only be realistically achieved if there is a relaxation of other requirements for the main accounting statements or additional local government resources are allocated to the year-end accounting process. Accountancy teams are under considerable pressure to produce a full set of accounts by the end of May each year, so the requirement to produce a further statement will only add to the challenge of preparing the accounts each year.

## **3. Conclusion**

- 3.1. In summary the review by Sir Tony is welcomed. A combination of an inadequate fee structure in relation to the external auditing requirements has meant the current system is not working effectively for either local government or audit firms.

- 3.2 The fee structure and work undertaken must provide value for money to taxpayers. The year end accountancy process is essential to ensure the Council is providing value for money and a core part of the Council's internal control framework and decision making process. Members need this assurance with respect to the financial management arrangements for the Council.
- 3.3 Some of these recommendations do attempt to address these issues. A new regulator should help, however, there will still be tensions with respect to the range of measures that have been suggested and the added value they will provide in the context of ever increasing demands and ever reducing resources for local government.
- 3.4 Due to all of the various accounting standards and guidance there needs to be a wider debate on the differences between public and private sector accounting. Local government is not a private company and therefore the accounting requirements should be different. This should be reflected in the audit and financial reporting requirements for local government.