

Status of Report: Public

Meeting: Corporate Governance Committee

Date: 14 July 2021

Subject: Further update on developments in local (external) audit arrangements

Report by: The Treasurer and the Monitoring Officer

**Author: Neil Jones, Head of Internal Audit and Assurance Service
Leicestershire County Council**

For: Information Only

Purpose

1. The purpose of this report is to provide the Committee with a further update on developments in local (external) audit arrangements following the independent review of the effectiveness of local (external) audit and the transparency of local authority financial reporting (the Redmond Review).

Recommendation

2. The Committee is asked to note the report and to refer any observations to the Combined Fire Authority, Interim Chief Fire Officer (CFO), Treasurer or the Monitoring Officer as they see fit.

Executive Summary

3. In June 2019 Sir Tony Redmond was asked by the Ministry of Housing Communities and Local Government (MHCLG) to undertake an independent review of the effectiveness of local (external) audit and the transparency of local authority financial reporting.
4. The Committee has previously received three reports on this matter. The first on 20 November 2019 explained about the formal call for views and contained the questions being asked by the review. The second report on 17 November 2020, summarised the review's key findings, outlined its 23 recommendations, explained how the report was being taken forward and communicated to stakeholders, and what the next steps were, including awaiting a formal response from MHCLG, which duly occurred on 17 December 2020. The third report on 10 March 2021, informed that the MHCLG response was mostly positive and that it had agreed to work with a wide range of key stakeholders to deliver the review's recommendations. However, a key area of disagreement was the recommendation to develop and implement a new body, the Office of Local Audit and Regulation (OLAR), to be created to provide systems leadership and manage, oversee, and regulate local audit. This was rejected primarily because creating a new body would have required new legislation

from central government. Nevertheless, MHCLG recognised certain areas needed to be addressed so it proposed further engagement in the Spring.

5. This report provides an update on the Government's proposals for system leadership, explains that two consultations on audit fees have recently taken place and informs about local (external) audit arrangements from 2023 and beyond.

Redmond review into local (external) audit – Spring update report

6. On 19 May 2021, the MHCLG wrote to all local authority Chief Executives informing that it had published its update report that was promised in its December 2020 response.
7. The report provided an update on the MHCLG's progress with implementing the Government's response to the Redmond review, including on the delivery of measures to support immediate market stability and towards implementation of the other recommendations.
8. It set out the Government's views on systems leadership for local audit. The Government agrees that a clearly accountable system leader with overarching responsibility is needed to make sure the local audit framework operates in a coherent and joined up manner, however it does not believe a new arm's length body is needed to achieve this. The Government's view is that the new Audit, Reporting and Governance Authority (ARGA), being established to replace the Financial Reporting Council (FRC), as part of the Department for Business, Energy and Industrial Strategy (BEIS) broader corporate audit reforms, would be best placed to take on this role. The FRC already undertakes the core functions relating to the audit quality framework necessary for a single responsible body to have. Establishing ARGA as system leader for the local audit framework would also ensure alignment with, and harness the positive impact of, the broader audit reforms.
9. To ensure the new regulator acquires the necessary focus and expertise on local audit, a standalone unit will be established within ARGA. Development and maintenance of The Code of Audit Practice will transfer from the National Audit Office to ARGA, however the latest Code (introduced in 2020), which includes the new Value for Money commentary, will be retained. ARGA will not conduct procurement or contract management as this could create a conflict of interest. Therefore, the new arrangements will encompass a separate appointing body. MHCLG confirmed that Public Sector Audit Appointments Ltd (PSAA) will continue as the appointing body for local audit, in charge of procurement and contract management for local government external auditors, with commercial support from MHCLG for the next procurement.
10. As the proposed reforms to the local audit framework will take time, MHCLG will take an increased leadership role in the interim, including setting up and chairing a Liaison Committee of key stakeholders, that will oversee the governance of the new audit arrangements and ensure they are operating effectively, which Redmond recommended be created.

11. The Government intends to launch a public consultation on the proposals ahead of summer recess.
12. Two further MHCLG consultations recently occurred: -
 - i. A consultation proposing changes to the fee setting and fee variation arrangements set out in the Local Audit (Appointing Person) Regulations 2015 to provide additional flexibility to the appointing person for principal bodies (PSAA) to reflect the changing nature of the local audit market, closed on 1 June.
 - ii. A consultation seeking views on the most appropriate methodology for allocating £15 million additional funds to assist councils to meet the rise in audit fees and new burdens resulting from the implementation of additional requirements closed on 18 May.
13. The Government's proposals on local audit have gained a qualified welcome from stakeholders although concerns around audit supply and market instability remain. Additionally there are questions around: -
 - i. Will the standalone unit within ARGA have the specialist skills and capacity it needs?
 - ii. To what extent will the standalone unit be able to tailor ARGAs corporate approach to the application of International Auditing Standards, to local authority audits?
 - iii. Will the PSAA succeed in securing audit contracts that are both competitively priced and enable audit suppliers to deliver audits that local authorities and the public deserve?

Local (external) audit arrangements from 2023 and beyond

14. Under the Constitution, as part of its 'Functions', the Committee has a responsibility, 'To monitor the adequacy and effectiveness of the external audit of the Authority's services and functions'.
15. During Autumn 2021 all local government (including fire and rescue authorities) and police bodies will need to make important decisions about their external audit arrangements for the period commencing from the financial year 2023/24. In relation to appointing auditors local bodies have options to arrange their own procurement and make the appointment themselves or in conjunction with other bodies, or they can join and take advantage of the national collective scheme administered by Public Sector Audit Appointments Limited (PSAA). The Authority has previously chosen to opt in to the PSAA scheme.
16. On 10 June, PSAA launched its draft prospectus for 2023 and beyond which provides an introduction to the PSAA national scheme and invites views and comments from local bodies and other interested parties in relation to the aims of the scheme and how it needs to develop going forward.
17. The prospectus explains in some detail how the audit market quickly destabilised starting in 2018 when a series of financial crises and failures in the private sector gave rise to questioning about the role of auditors and the focus

and value of their work. In rapid succession there has been the results of four independent reviews commissioned by Government including Redmond's review of local authority financial reporting and external audit. Much of this has been explained to the Committee in previous reports.

18. It is PSAA's view that the audit market will continue to be relatively unstable and difficult to predict for a further period of time as the Government continues to develop and implement its policy response to the four independent reviews; as further regulatory pressure is applied; and as firms respond and adapt. It considers that local government audit will not be immune from these difficulties.
19. The prospectus includes plans to adjust the procurement ratio between quality and costs from an equal 50:50 to 80:20 (i.e. the focus of appointing external auditors will be clearly on quality, not cost). This change in approach would be supported by key performance indicators on audit approach, quality assurance arrangements, resourcing, capacity and capability. There is some nervousness in the local government sector about this proposal, in that whilst quality is clearly important, costs must not get out of hand.
20. Consultation on the prospectus closes on 8 July 2021.

Next stages

21. The Treasurer and Monitoring Officer will consider the consultations outcomes. A further report will be brought back to this Committee at the appropriate time.

Report Implications/Impact

22. Legal (including crime and disorder)

The proposals in the recent review call for some potentially significant changes to how the Corporate Governance Committee performs its functions. Further reflection and analysis will follow, after which time any local Constitutional implications can be considered. Lauren Haslam, Director of Law & Governance, Leicestershire County Council, 0116 305 6240

23. Financial (including value for money, benefits and efficiencies)

There are no resource implications arising directly from this report at this stage, although there is a potential for higher external audit fees and accounts preparation costs in future years. Colin Sharpe, Deputy Director of Finance, Leicester City Council, 0116 454 4081

24. Risk (including corporate and operational, health and safety and any impact on the continuity of service delivery)

There are no risks arising from this report.

25. Staff, Service Users and Stakeholders (including the Equality Impact Assessment)

There are no staff, service user or stakeholder implications arising from this report.

26. Environmental

There are no environmental implications arising from this report.

27. Impact upon Our Plan Objectives

Within the CFA's priority of Finance and Resources is the aim of providing a value for money service. The provision of a robust local (external) audit provides assurance to Members and local taxpayers that value for money is being delivered and provides public confidence in the system of local democracy.

Background Papers

Local Authority financial reporting and external audit Spring update -

<https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-spring-update/local-authority-financial-reporting-and-external-audit-spring-update>

Public Sector Audit Appointments – Draft Prospectus for 2023 and beyond -

<https://www.psa.co.uk/about-us/appointing-person-information/appointing-period-2023-24-2027-28/prospectus-2023-and-beyond/draft-prospectus-for-2023-and-beyond/page/7/>

Reports to the Corporate Governance Committee

Report to Corporate Governance Committee 20 November 2019 - Developments in audit and governance

<https://leics-fire.gov.uk/wp-content/uploads/2019/11/item-10-developments-in-audit-and-governance.pdf>

Report to Corporate Governance Committee 18 November 2020 - Update on developments on local (external) audit arrangements

<https://leics-fire.gov.uk/wp-content/uploads/2020/11/item-9-update-on-audit-dev-final.pdf>

Report to Corporate Governance Committee 10 March 2021 - The Government's response to the Redmond Review recommendations

<https://leics-fire.gov.uk/wp-content/uploads/2021/03/item-16-redmond-review.pdf>

Officers to Contact

Alison Greenhill, Treasurer
alison.greenhil@leicester.gov.uk
0116 454 5552

Lauren Haslam, Monitoring Officer
Lauren.Haslam@leics.gov.uk
0116 305 6240

Neil Jones, Head of Internal Audit & Assurance Service, Leicestershire County Council
neil.jones@leics.gov.uk
0116 305 7629