

**Manchester City Council
Report for Information**

Report to: Audit Committee – 27 July 2021

Subject: Implications of the Redmond Review on External Audit

Report of: Deputy Chief Executive and City Treasurer

Summary

This report outlines the findings of the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting conducted by Tony Redmond which reported in September 2020.

The review was established in September 2019 by which time, it had become clear that there were problems in the local audit regime, specifically in relation to the audit of local government bodies such as councils, police bodies and this was evidenced by the fact that some 40% of audits were not completed in line with the 31 July reporting timetable set out in the Local Audit & Accountability Act 2014.

The Ministry of Housing and Local Government (MHCLG) has subsequently responded to the findings of the review and proposed a number of measures to be adopted in relation to the external audit function in Local Government.

Recommendations

To note the report

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

Independent Review into the Oversight of Local Audit and the Transparency of Local

Authority Financial Reporting

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916217/Redmond_Review.pdf

1.0 Introduction

- 1.1 In the summer of 2019, it became clear that there were problems in the local audit regime, specifically in relation to the audit of local government bodies such as councils, police bodies and this was evidenced by the fact that 40% of audits were not completed in line with the 31 July reporting timetable set out in the Local Audit & Accountability Act 2014.
- 1.2 The Audit firms were also reporting pressures created by the fee regime which had resulted in a significant reduction in the local government audit market when fees were rising in the corporate sector, thus making the provision of public sector audit unattractive to the main audit firms.
- 1.3 In response the Ministry of Housing Communities and Local Government (MHCLG) commissioned a review into the effectiveness of local audit. Sir Tony Redmond was commissioned to undertake the review and his report was published in September 2020.
- 1.4 The report is based on a Call for Views which received 156 responses, together with over 100 interviews carried out by the review team. The responses cover a wide range of stakeholders including local government practitioners, audit firms, accountancy bodies, academia, and the general public.
- 1.5 The report also took note of the Brydon and Kingman reviews of the audit profession, and a review commissioned by the Competition and Markets Authority, following a number of high profile audit failures including Carillion, BHS and Thomas Cook. These reports, whilst focussed on the corporate sector, have some relevance to the public sector.
- 1.6 Whilst the Redmond report covered a range of issues relating to the audit market (that is the supply of auditors and the fees), it also covered a number of points relating to accountability, transparency and governance, some of which are directly relevant to the Audit Committee.

2 The local audit regime

- 2.1 Redmond noted that, following the abolition of the Audit Commission, the responsibility for the local audit regime has been split across a range of stakeholders. All of the stakeholders undertake an important part of the overall framework and include:
 - the National Audit Office (NAO) – responsible for the Code of Audit Practice together with the supporting guidance. Their role also extends to providing advice and engagement to facilitate consistency on significant issues;
 - the Financial Reporting Council (FRC) – issues standards and guidance to auditors. The FRC also has responsibility for the quality assurance reviews of larger local authority audits;
 - the Institute of Chartered Accountants of England & Wales (ICAEW) – responsible for maintaining a register of audit firms and Key Audit

Partners (KAPs) authorised to sign local authority audit reports in line with the specified legislation. The ICAEW also undertakes quality review of smaller councils;

- the Chartered Institute of Public Finance & Accountancy (CIPFA) – has the statutory responsibility for preparing the local government code of accounting practice. CIPFA is also the professional body for finance professionals in the sector; and
- Public Sector Audit Appointments Ltd (PSAA) – responsible for the procurement of audit firms and contract management.

2.2 In his report, Sir Tony Redmond concludes that: “The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process”

Redmond Recommendation

2.3 To address this, Sir Tony recommended the creation of a new body, the Office of Local Audit and Regulation (OLAR), to manage, oversee, and regulate local audit with the following key responsibilities:

- procurement of local audit contracts;
- producing annual reports summarising the state of local audit;
- management of local audit contracts;
- monitoring and review of local audit performance;
- determining the code of local audit practice; and
- regulating the local audit sector.

2.4 It was proposed that the current roles and responsibilities relating to local audit would transfer to OLAR where they are currently discharged by the:

- Public Sector Audit Appointments (PSAA);
- Institute of Chartered Accountants in England and Wales (ICAEW);
- Finance Reporting Council; and
- The Comptroller and Auditor General (C&AG at the NAO).

Government Response and Proposals

2.5 The Government, in response, have in turn consulted and are not proposing to create the Office of Local Audit and Regulation, but instead creating a “unit” within a new organisation called the “Audit, Reporting and Governance Authority” (ARGA) which in turn will replace the Finance Reporting Council (FRC) and will sit in the Department for Business, Energy and Industrial Strategy (BEIS), with the Liaison Committee overseeing the system until ARGA’s start in 2023.

2.6 There is a concern that this may further complicate Local Government accounts with a continued focus on asset valuations and quantification of liabilities for accounting purposes, that impact on the financial statements but do not impact on the true ‘bottom line’ financial position or in turn the local tax payer.

3 Audit Procurement

- 3.1 At the time of the 2017 procurement process led by PSAA Ltd, there were nine firms registered with ICAEW to undertake local audit. Of these, one firm chose not to bid and a second firm was excluded on the basis it was too small to be able to compete.
- 3.2 The tender process was on the basis of an assessment split 50:50 between price and quality.
- 3.3 Five firms were appointed to supply services to local government. A further firm was appointed to a sixth contract lot intended to provide additional capacity in the market. However, subsequent audit firm mergers mean this firm no longer exists.
- 3.4 The next round of audit procurements are due to take place and the PSAA Ltd are consulting on a prospectus outlining the approach to the procurement of auditors commencing from 2023/24.

4 Audit Delivery

- 4.1 The Redmond report identified a number of points about the services provided to local authorities by the five firms appointed as suppliers. These include, but are not limited to:
 - a) concerns about the availability of sufficient audit staff with the right knowledge;
 - b) skills and experience to undertake local authority audit;
 - c) opportunities for engagement with the senior audit staff (for example the contact with the Key Audit Partner);
 - d) the focus of audit work on specific elements of the financial statements;
 - e) working with internal audit, and
 - f) communication difficulties between the respective teams.
- 4.2 Underpinning this was a concern that the current level of audit fees does not adequately support the work required to complete an audit to the appropriate quality standards. This is evidenced by the extent to which requests for fee variations have increased in both number and value. Since 2015, audit fees paid by councils have reduced by over 42%. Audit firms are now raising concerns about the sustainability of these fees, particularly given the trend of increasing fees in the corporate sector. In addition there have been additional expectations regarding the scope of the audits around valuations, assumptions and estimates that have been driven by the private sector accounting regulations and of concern to the FRC and therefore auditors.
- 4.3 To address these concerns, the review made a number of recommendations:
 - the current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements;
 - that quality be consistent with the highest standards of audit within the revised fee structure. In cases where there are serious or persistent

breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions;

- all auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority;
- statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work;
- External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice; and
- the deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.

Government Response and Procurement Proposals

- 4.4 The MHCLG has responded to the pressure on fees and made £15m available nationally to councils to support the increase in fees associated with new requirements on auditors included in the 2020 Code of Audit Practice and to support councils to develop standardised statements of service information and costs, to improve readability and transparency.
- 4.5 The reduction of fees coupled with tighter deadlines which resulted in the commissioning of the Redmond review has resulted in a change of approach from PSAA Ltd.
- 4.6 PSAA Ltd are proposing that the reprocurement will take place from the 2023/24 financial year and it is proposed that contracts will be let to a wider group of suppliers for a period of 5 years with an option to extend for a further 2 years. The procurement is intended to create sustainability and resilience in the audit market that will give assurance to local authorities. It is proposed to evaluate the tenders on 80% quality and 20% price (up from 50:50 under the previous procurement) and have a social value weighting of 4% (Manchester City Council employs a 20% social value weighting).

5 The Accounts

- 5.1 The review acknowledges the status of the annual statement of accounts as an important part of a Council's accountability and governance framework. There is a recognition that local taxpayers should be both interested in, and able to understand, the way in which the Council spends its money, including knowing the performance outcomes that are being achieved. The rights of the public to inspect the accounts are also recognised as important.
- 5.2 However, the report also notes the complexity of local government accounts. This complexity arises partly because of the requirements of the CIPFA Code of Practice for Local Authority Accounting (the Code) which effectively takes the corporate sector financial reporting framework and adapts it for the sector, including for specific statutory requirements that override the standards, or require additional disclosures to be made in the accounts.
- 5.3 The consequence of this is that council accounts are often much longer than a private sector body. Redmond concludes that the "current statutory accounts

prepared by local authorities are considered to be impenetrable to the public”.

- 5.4 The recommendations in the report include:
- CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary;
 - a standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts;
 - the standardised statement should be subject to external audit; and
 - the optimum means of communicating such information to council taxpayers/service users be considered by each local authority to ensure access for all sections of the communities.
- 5.5 It is likely that there will be a need to include a simplified statement to the accounts, as an additional section rather than the simplified statement replacing the existing form, which itself will have to be audited. Whilst this will give a more accessible version of the accounts to the lay reader, it will result in an increase in the size of the accounts and subsequent audit.

6 Wider Governance Matters

- 6.1 Local authorities are required to have an Audit Committee. Amongst the key elements of the terms of reference is the requirement to receive external and internal audit plans and reports.
- 6.2 Audit Committees are sub-committees of Full Council and membership of the committee tends to follow the political balance of the Council although this is not always the case.
- 6.3 The Redmond review reports that: “Elected members may or may not have relevant skills, expertise or background to fulfil the role of a member of an Audit Committee” To address this, some 40% of councils, including Manchester City Council, have appointed one or more independent members.
- 6.4 The report also concluded that the scope of audit committees in local government varies significantly. The report notes that not all committees cover all of the areas identified in CIPFA’s 2013 report “Position Statement and Supporting Guidance on Audit Committees”. Redmond draws specific attention to the fact that many committees have only minimal or no consideration of matters related to partnership governance and Value for Money. Manchester City Council’s Audit Committee is compliant with best practice.
- 6.5 Whilst the report does not include any specific recommendations in this respect, Councils are nevertheless, encouraged to review the Terms of Reference for Audit Committee to ensure all the required areas are covered

and how this can be demonstrated.

- 6.6 External Auditors tend to report to Audit Committee. The Chair of the Committee then determines if there are matters raised by the auditor which ought to be referred to or considered by Full Council. Whilst the auditor does have a right to report directly to Full Council, this tends not to be the normal course of reporting. Whilst this is generally considered to be appropriate by councils, there is evidence that some significant matters reported by auditors, such as qualified VFM conclusions, have not been reported on to Full Council. This gives rise to a risk that significant issues in relation to governance or financial resilience are not being brought to the attention of all members.
- 6.7 To address this, Redmond recommends that:
- the external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year, irrespective of whether the accounts have been certified; OLAR to decide the framework for this report;
 - an annual report be submitted to Full Council by the external auditor;
 - consideration be given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and
 - formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

7 Recommendations

- 7.1 The Audit Committee are asked to note the report.