

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

23 March 2021

Report of the Director of Finance & ICT

PSAA UPDATE

1 Purpose of the Report

To provide Audit Committee with an update from the Public Sector Audit Appointments (PSAA) Advisory Panel meeting on 1 February 2021, which covered an update and discussion on the Redmond Review, progress on issuing 2018-19 and 2019-20 audit opinions, audit fees and audit procurement.

2 Information and Analysis

Redmond Review Update

An overview of the Redmond Review (Review), the recommendations arising from it and comments on the Council's position, where relevant, were set out in a Report to Audit Committee on 8 December 2020. The Council has commenced a dialogue with its external auditors to discuss the findings of the Review.

MHCLG contacted several stakeholders, including PSAA, before issuing its response to the Review in December 2020. Some matters were reflected in the detail of MHCLG's response that were not the subject of a direct recommendation, or which were clarified in briefings after the issue of the Review report. The MHCLG response to each of the Review's recommendations is included alongside those recommendations and comments on the Council's position, from the previous Audit Committee report, at Appendix One.

MHCLG's response refers to £15m funding to help deliver recommendations for 2020-21 and support for the three main strands of the recommendations:

- Action required to support immediate external audit market stability.
- Enhancing the functioning of local audit, and the governance of responding to its findings.
- Improving the transparency of local authorities' accounts for the public.

In particular, MHCLG is supportive of:

- Training and skills uplift.
- Reform of Appointing Person Regulations.
- Improving the long-term supply of local auditors.
- Two-year extension of target audit deadline to 30 September, then a review.
- Accessible financial statements.
- Independent Audit Committee member.
- Auditor/statutory officers to meet annually.
- Audit presentation to main body.
- CIPFA/LASAAC to review simplification options.

In many of their responses, MHCLG has indicated that they will work with other parties to deliver the recommendations, including the LGA, NAO, CIPFA and PSAA. However, several of the Review's recommendations are centered around the establishment of a new body called the Office of Local Audit and Regulation (OLAR), a point which MHCLG is currently not persuaded on. There are three possible reasons for this:

- Centralised arms-length bodies are not favoured.
- Wariness about creating a new Audit Commission.
- Primary legislation is needed, so it would take too long.

MHCLG deferred six of the recommendations, five relating to OLAR, and will respond by Spring 2021. MHCLG is working through these, talking to stakeholders and exploring the alternatives to OLAR, including examining other options to deliver effective system leadership and reviewing how functions and responsibilities will be allocated in any new model. PSAA has stressed its view to MHCLG that a clear direction of what the objectives of public audit are is required to focus solutions.

The PSAA discussion that followed included the following matters of note:

- The regulator must have an understanding of local government audit and focus more on financial sustainability. The distinctive nature of local authorities is not properly recognised by the private sector audit model.
- A simplified statement of accounts has been in the pipeline for a while, but will add to the workload around audited accounts, rather than simplifying it. CIPFA did some work around this process and carried out a consultation in Autumn 2019.
- The FRC has taken the position that local government accounts should be on a par with company accounts, emphasising that the current accounting framework is the driver for what audit needs to do; and that it does not justify a different regulatory approach.

- 30 September is not a statutory date for audit sign off, it remains only a target date. The balance between timeliness of audit reporting and quality for local audit has been shifted. External audit firms' primary focus is on producing robust audit (based on FRC requirements) and they will only provide clean opinions once they have the necessary assurances, rather than qualified ones.
- Work on the next appointing person cycle must start imminently, but clarity is required around what the sector and its stakeholders need from audit and what the direction is.
- A question was posed as to whether getting the procurement right could be a solution to sustainability of the audit market. Changes in the private sector audit world will have an impact on public audit and on the firms. Potential suppliers may be looking at this market less favorably, given the pressures on current suppliers.
- FRC standards regarding the quality of external audits will not allow any reliance to be placed on internal audits for the financial statements work. When the NAO consulted on the new Code in 2019, one of the questions was: to what extent does the Code expect audit to have to comply with International Auditing Standards? It was agreed that alignment was important and should be maintained. Forums with CIPFA and internal auditors have encouraged auditors to look at how they can expand the relationship between internal and external audit, to help inform their commentary around VFM arrangements as this is not covered by the auditing standards.
- This is a very significant year, in which full responses to four reviews (Kingman, CMA, Brydon and Redmond) are awaited, the new Audit Code takes effect and further revised auditing standards are anticipated. The VFM commentary, for example, is designed to be more useful and to have more impact and has been welcomed accordingly but the current high levels of uncertainty and capacity challenges represent a tough environment for the successful introduction of this and other new requirements.
- It was noted that it is unlikely there will be a mandate for independent members on audit committees to be made compulsory. The sector can currently formulate its own governance structure.

In summary, PSAA are contributing to MHCLG's deliberations and await MHCLG's final response. Moving forward may be more about a suite of small changes, rather than a single radical proposal.

Audit Opinions Update

The table below shows progress in delivering 2019-20 public sector audit opinions, by audit firm. In summary, at the statutory deadline of 30 November 2020, there remained 264 opinions that had yet to be delivered, from a total of 479 audits (55%). A further 62 opinions, including the Council's, were signed off in December 2020. Of the audit opinions outstanding at 31 December 2020, the Council's auditor, Mazars, had proportionately the fewest (34%).

Firm	Total Audits	Outstanding at 30 November 2020		Outstanding at 31 December 2020	
BDO	25	14	56%	12	48%
DL	26	16	62%	15	58%
EY	161	103	64%	81	50%
GT	179	82	46%	64	36%
Mazars	88	49	56%	30	34%
Total	479	264	55%	202	42%

As at 31 December 2020, there remained eighteen objections under investigation in respect of the 2019-20 audits.

For 2018-19 public sector audits, there remained 26 opinions that had yet to be delivered and eighteen objections under investigation at 31 December 2020.

Audit Fees

PSAA is soon to issue a paper on a new approach to national fee variations.

2021-22 audit scale fees must be set by 31 March 2021. Once these fees are set and the financial year has started, PSAA cannot change them.

Audit Procurement

Arrangements for the next PSAA procurement have yet to be determined by MHCLG but the process will need to start very soon. The opt-in/opt-out model is expected to continue.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property, transport and social value considerations.

4 Background Papers

Papers held electronically by Technical Section, Finance & ICT Division, Room 137.

5 Officers' Recommendation

That Audit Committee notes this PSAA Update in respect of the Redmond Review, issuance of audit opinions, audit fees and audit procurement.

PETER HANDFORD
Director of Finance & ICT

APPENDIX ONE

**Redmond Review
– Recommendations, Council’s Position and MHCLG Response**

The recommendations of the Redmond Review are as follows, alongside comments - where relevant - on the Council’s position *and MHCLG’s response in December 2020*:

External Audit Regulation

1. A new body, the Office of Local Audit and Regulation (OLAR), be created 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.

MHCLG – *We are considering this recommendation further and will make a full response by Spring 2021.*

2. The current roles and responsibilities relating to local audit discharged by the:
 - Public Sector Audit Appointments (PSAA);
 - Institute of Chartered Accountants in England and Wales (ICAEW);
 - FRC/ARGA; and
 - The Comptroller and Auditor General (C&AG)

to be transferred to the OLAR.

MHCLG – *We are considering this recommendation further and will make a full response by Spring 2021.*

3. A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.

MHCLG – *We are considering this recommendation further and will make a full response by Spring 2021.*

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4. The governance arrangements within local authorities be reviewed by local councils with the purpose of:
- an annual report being submitted to Full Council by the external auditor;
 - consideration being 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.

The results of the annual audit are reported each year to Full Council. It has been agreed with Mazars that in future they will attend that meeting to present their report in person. In the past consideration has been given to the involvement of an independent member on the Audit Committee, perhaps now is the time to consider the option again, perhaps utilising a joint appointment with another public body but without compromising the role of elected representatives. At present the auditor meets frequently with the key statutory offices in the council, formalising this process will be a sensible move.

MHCLG – Agree; we will work with the LGA, NAO and CIPFA to deliver this recommendation.

5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.

MHCLG – Agree; we will work with key stakeholders to deliver this recommendation.

6. 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.

Whilst this may mean an increase in costs it is time to reverse the recent decreases in fee levels as it has resulted in an unstable market for audit services and an audit that has, on occasion, not been fit for purpose across some parts of the local government sector.

MHCLG – Agree; we will look to revise regulations to enable PSAA to set fees that better reflect the cost to audit firms of undertaking additional work.

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7. 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.

MHCLG – *We are considering this recommendation further and will make a full response by Spring 2021.*

8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

MHCLG - *Part agree; we will work with the FRC and ICAEW to deliver this recommendation, including whether changes to statute are required.*

9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.

External Audit reliance on the work of Internal Audit has diminished over the years and now is an appropriate time to rebuild that relationship, to assess whether collaboration can assist External Audit in obtaining the assurance they require in respect of the accuracy and completeness of the statement of accounts. The Council has an established External and Internal Audit Protocol which provides a firm basis for further development of this relationship.

MHCLG – *Agree; we will work with the NAO and CIPFA to deliver this recommendation.*

10. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.

Whilst such a change is understandable due to the capacity issues in External Audit firms, it is regrettable that such a move is necessary and we would hope that when some element of stability has returned to the market then consideration may be given to a return to a July date.

MHCLG - *Part agree; we will look to extend the deadline to 30 September for publishing audited local authority accounts for two years, and then review.*

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11. The revised deadline for publication of audited local authority accounts be considered in consultation with NHSI(E) and DHSC, given that audit firms use the same auditors on both Local Government and Health final accounts work.

MHCLG – Agree.

12. 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.

MHCLG – Agree; we will work with the LGA, NAO and CIPFA and other key stakeholders to deliver this recommendation, including whether changes to statute are required.

13. The changes implemented in the 2020 Audit Code of Practice are endorsed; OLAR to undertake a post implementation review to assess whether these changes have led to more effective external audit consideration of financial resilience and value for money matters.

MHCLG – We are considering this recommendation further and will make a full response by Spring 2021.

Smaller Authorities Audit Regulation

14. SAAA considers whether the current level of external audit work commissioned for Parish Councils, Parish Meetings and Internal Drainage Boards (IDBs) and Other Smaller Authorities is proportionate to the nature and size of such organisations.
15. SAAA and OLAR examine the current arrangements for increasing audit activities and fees if a body's turnover exceeds £6.5m.
16. SAAA reviews the current arrangements, with auditors, for managing the resource implications for persistent and vexatious complaints against Parish Councils.

APPENDIX ONE**Financial Resilience of local authorities**

17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.

This is welcomed in view of the recent financial failures in local authorities.

***MHCLG** – We are considering this recommendation further and will make a full response by Spring 2021.*

18. Key concerns relating to service and financial viability be shared between Local Auditors and Inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's Annual Report.

***MHCLG** – Agree; we will work with other departments and the NAO to deliver this recommendation.*

Transparency of Financial Reporting

19. 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.

If such a statement can be made to simplify reporting into an easily understandable explanation of the Council's financial position, then it is to be welcomed.

***MHCLG** – Agree; we will look to CIPFA to develop a product through consultation with local government. We will work with CIPFA to deliver this recommendation.*

20. The standardised statement should be subject to external audit.

***MHCLG** – Agree; we will work with CIPFA, the LGA and the NAO to deliver this recommendation.*

21. 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.

***MHCLG** – Agree; we will work with the LGA and CIPFA to deliver this recommendation.*

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22. 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.

Such a move has been required for a long time and it is hoped real simplification can be achieved.

MHCLG – Agree; we will look to CIPFA to deliver this recommendation.

23. JPAG be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered:
- Whether “Section 2 – the Accounting Statements” should be moved to the first page of the AGAR so that it is more prominent to readers;
 - Whether budgetary information along with the variance between outturn and budget should be included in the Accounting Statements; and
 - Whether the explanation of variances provided by the authority to the auditor should be disclosed in the AGAR as part of the Accounting Statements.