



FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

21 September 2021

Report of the Director of Finance & ICT

Redmond Review

1. Purpose

- 1.1 To provide Audit Committee with an update in respect of the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting, known as the 'Redmond Review'.

2. Information and Analysis

2.1 Background

- 2.2 Audit Committee considered a report on 8 December 2020 setting out details of Redmond Review (the Review). The Review was published in September 2020 and in December 2020, the Government delivered its response to the Redmond Review. That report set out the planned response to the 23 recommendations made by Sir Tony and grouped them under 5 themes:

- Action to support immediate market stability
- Consideration of system leadership options
- Enhancing the functioning of local audit, and the governance for responding to its findings
- Improving transparency of local authorities' accounts to the public
- Action to further consider the functioning of local audit for smaller

bodies

2.3 Action taken to address immediate market instability

2.4 The deadline for publishing local authority accounts has been extended to 30 September from 31 July. This deadline has been extended for two years from 2020-21 i.e. both the 2020-21 and 2021-22 annual accounts.

2.5 The Review also looked at the fee structures surrounding the audit contracts administered by Public Sector Audit Appointments Ltd (PSAA) (the appointing body for 98% of principal local authority audits) noting that the fee setting and variation process was insufficiently flexible and that local audit fees had reduced by 40% when compared against a 20% rise in central government and FTSE100 audit fees.

2.6 The Government has provided £15m to principal bodies to help support affected bodies to meet the anticipated increase in audit fees costs in 2021-22 and to support with new burdens relating to implementing the Redmond recommendations. The Government is currently seeking views via public consultation on the methodology for distributing this funding.

2.7 Consideration of system leader options

2.8 The Review identified a lack of coherence and join up across the current local audit framework, as none of the existing organisations in the system “had a statutory responsibility, either to act as a systems leader or to make sure that the framework operates in a joined-up and coherent manner”.

2.9 To address this, the Review recommended that all these functions should be transferred to a single organisation – with a new independent body, the Office of Local Audit and Regulation (OLAR), responsible for procurement, contract management, regulation, and oversight of local audit. This new body would liaise with the Financial Reporting Council (FRC) with regard to its role in setting auditing standards.

2.10 In March 2021, the Government published a White Paper setting out its plans to reform corporate audit, reporting and governance. The White Paper set out details of how the Government proposes to establish a new regulator, the Audit, Reporting and Governance Authority (ARGA), to replace the FRC. It also set out Government plans to create a new audit profession that is distinct from the accountancy profession, and to encourage competition in the market for audit of large listed companies.

The Government have looked at options for local audit in the context of these wider reforms.

2.11 **Functions of a System Leader**

- 2.12 The Government agree that there is a lack of coherence between different functions within the existing local audit system. It also agrees that a clearly accountable system leader is needed, with overarching responsibility for the local audit framework, including the Code of Audit Practice and the monitoring and review of local audit performance. However, it does not accept that the same organisation also needs to be responsible for the procurement and management of local audit contracts.
- 2.13 The Government does not wish to re-create the Audit Commission. It wants to build on the benefits of the 2014 Local Audit and Accountability Act. This includes the reduction in the cost to local authorities and government of local audit, delivering estimated savings of £1.35 billion over 10 years.
- 2.14 The Government also needs to be mindful of how local audit fits into the broader audit landscape. While a new body with responsibility for procurement, regulation and oversight of local audit would align some functions, it would also create new interfaces, for example with the FRC who has broader regulatory responsibility.
- 2.15 There are clear interdependencies with health audit, and there is a risk that a new local audit-focused body would lead to greater divergence with health audit, at a time when the Government's NHS White Paper Working Together to improve health and social care for all is driving greater integration between health and local government services.
- 2.16 The Government view is that it would be inappropriate for central government to act as a regulator of local government audit and it remains committed to the principles of a locally-led audit regime, as embodied in the 2014 Act. It is preferable to have a regulator who can both act independently and have the confidence of stakeholders and local bodies that they are acting independently.
- 2.17 In this context, it is the Government's view that ARGAs, the new regulator being established to replace the FRC, would be best placed to take on the local audit system leader role. The FRC is the only organisation that currently undertakes the full range of core functions relating to the quality framework. The Government think that it is

crucial that a new system leader has a core focus on ensuring competition on the market, and this will build on the proposals to introduce “promoting effective competition in the market for statutory audit work” as a core objective for ARGA.

2.18 Governance to deliver an ARGA local audit system leader

2.19 The Government have agreed a number of high-level principles to provide reassurance on this point. These include aligning ARGA’s proposed statutory objectives, principles and functions to explicitly include local audit, the specific needs of the sector and the additional responsibilities relating to system leadership. Also, the establishment of a new department within ARGA to take on responsibility for local audit-related work, including oversight and inspection.

2.20 There are a number of governance mechanisms that the Department for Business, Energy and Industrial Strategy (BEIS) is currently consulting on to ensure that the Government has the information it needs to shape the regulatory framework according to ARGA’s experience on the ground and that ARGA has clarity on the Government’s strategic priorities, while being clear to maintain ARGA’s legal and operational independence.

2.21 Sir Tony also recommended the establishment of a new Liaison Committee comprising key stakeholders and chaired by the Ministry of Housing, Communities and Local Government (MHCLG), to receive reports from the new regulator on the development of local audit.

2.22 Sir Tony also recommended that a system leader have responsibility for producing annual reports summarising the state of local audit. The Government strongly agrees with this recommendation. It notes that the report previously prepared by PSAA included detail on the number of audits completed by the statutory deadline and the number of qualified financial audit and value for money opinions, with the latter categorised by theme. It also listed all Public Interest Reports, Statutory Recommendations and Advisory Notices issued in the preceding year. The exact content of the report would be subject to further work, but the Government see this as an important mechanism for ARGA to report on progress to MHCLG, as well as to inform MHCLG’s stewardship of the local government accountability framework.

2.23 Focus of Local Audit

- 2.24 Local audit comprises two elements. It includes an opinion that the statutory financial accounts, produced in accordance with CIPFA's Code of Practice on Local Authority Accounting, are true and fair, in accordance with statutory duties and a further, value for money opinion from public audit, which includes an assessment on whether the auditor is satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources, including consideration of financial sustainability and governance arrangements.
- 2.25 The new value for money requirements in the updated Code including a new commentary on governance, arrangements for achieving financial sustainability, and improving economy, efficiency and effectiveness - should help to address this. However, the Government agree with Sir Tony's recommendation that a new system leader should 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.
- 2.26 The Government recognise that this new requirement will increase the cost of local audit. Therefore, it has provided £15m to help meet the increased cost of audit in 2021-22, including the new Code of Audit Practice requirements, and will ensure that the New Burdens Doctrine will apply to any future increases in requirements.
- 2.27 More broadly, the Government also want the new system leader, as well as existing stakeholders, to look at whether there are opportunities to reduce some of the accounting and audit requirements where these relate to areas of less risk to local bodies. The intention would be to ensure that local authority accounts and the statutory audit are proportionate, noting that they need to be consolidated into the Whole of Government Accounts, prepared in accordance with International Financial Reporting Standards, and meeting the necessary standards of reporting and scrutiny.
- 2.28 As there will inevitably be a period of transition while new arrangements are put in place, in the interim the Government will work with the CIPFA, CIPFA/LASAAC, the FRC, National Audit Office, HM Treasury, the Financial Reporting Advisory Board and others to look at opportunities to address these issues around accounting and audit requirements at pace, including through modifications to the Accounting Code.

2.29 Procurement/ appointing person arrangements

- 2.30 There is a balance to be struck between cost and quality. Historically, there were concerns that fees were too high and it was right that real savings were delivered for the taxpayer following the abolition of the Audit Commission. However, the context has changed since 2014, including the structure of the market, plus new obligations and the complexity of the work.
- 2.31 It is striking that local audit scale fees reduced by 40% between 2014-15 and 2018-19, while central government and FTSE100 fees have increased by 20%. The Government has been working closely with PSAA in recent months to develop its plans for allowing greater flexibility to reflect additional costs in audit fees.
- 2.32 These measures will help to address the immediate market fragility issues, as well as ensure that, in the longer-term, there is a mechanism to reflect additional costs more quickly if new audit requirements are introduced during the course of an appointing period, thereby removing the financial risk from the audit firms.
- 2.33 It remains the Government's view that PSAA is the organisation best placed to act as the appointing body, including overseeing the next procurement, due to their strong technical expertise and the proactive work they have done to help identify improvements that can be made to the process. This will also help to provide continuity, given the proximity of the next procurement exercise.
- 2.34 As the Redmond Review highlighted, with only three firms covering over 80% of local audit, a withdrawal by one could create a very challenging gap to fill. Looking ahead to procurement for the next round of contracts that will commence from 2023-24, a priority needs to be expanding the number of firms engaged in the market. The Government's engagement with the audit firms who currently hold local audit contracts indicates that this is a view that they share.
- 2.35 Progress implementing other recommendations relating to auditor training and qualifications, the functioning of local audit, and governance, the transparency of local authorities' accounts and the audit of smaller bodies.
- 2.36 In relation to the recommendations around auditor capacity, skills, training and experience, the Government is working closely with the FRC, ICAEW and CIPFA to review the current guidance on entry requirements for Key Audit Partners in local audit - and to consider what

else is possible to ensure that firms with the capacity, skills and experience are not excluded from bidding on local audit work.

2.37 The Government have also been engaging with the LGA, CIPFA and others to consider the recommendations around audit committees, their status and membership, with a view to developing new guidance endorsed by all stakeholders.

2.38 The Government is also working with CIPFA to develop the new Standardised Statements of accounts, and consideration is also being given to making further amendments to the Accounts and Audit Regulations – subject to consultation – to require the development and auditing of the new Standardised Statement. New burdens for local bodies resulting from these new requirements will be met from part of the additional £15m provided to local bodies for 2021-22.

2.39 **Next steps**

2.40 The Government will work closely with stakeholders, including local bodies and audit firms, to refine its proposals for implementing its commitments around system leadership, as well the range of other commitments it has made in response to the Redmond Review, ahead of publishing a public consultation on the proposals in advance of summer recess.

2.41 Some of these changes would require primary legislation, and so the Government would look to introduce them, subject to public consultation, as part of broader draft legislation with BEIS to implement the Government's broader corporate audit reforms when Parliamentary time allows. It will continue to work closely with the FRC, PSAA, NAO and others in the intervening period to consider how we can make more immediate changes that do not require primary legislation.

3. **Alternative Options Considered**

3.1 Not applicable.

4. **Implications**

4.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

5. **Consultation**

5.1 Not applicable

6. Background Papers

- 6.1 Local authority financial reporting and external audit: government response to the independent review. Ministry of Housing Communities and Local Government.

7. Appendices

- 7.1 Appendix 1 – Implications.

8. Recommendation(s)

That Audit Committee:

- a) notes the Government's response to the Redmond Review and details of the next steps.

9. Reasons for Recommendation(s)

- 9.1 To ensure that the Audit Committee understands the Government's response to the Redmond Review.

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Implications

Financial

1.1 None.

Legal

2.1 None.

Human Resources

3.1 None.

Information Technology

4.1 None.

Equalities Impact

5.1 None.

Corporate objectives and priorities for change

6.1 Not applicable.

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None.