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By email: Redmond.Review@communities.gov.uk

20 December 2019

The Redmond Review of local authority financial reporting and external audit

Introduction

1. ICAS Public Sector Panel welcomes the opportunity to comment on this consultation. ICAS is a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally.
2. ICAS's Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key messages

3. The annual report and accounts is a key statement of accountability regarding the use of public money and achievement of value. The narrative statement/ management commentary is important in terms of communicating key messages (see also responses to Q38 and 39).

Audit and governance

4. We support a single, consistent approach to audit quality and standards whatever the sector.
5. We believe that financial sustainability and governance would be better addressed as part of the remit of a "wider scope audit" rather than VFM to give the appropriate level of attention to these topics.
6. We note the relative concentration of the audit market for local authorities and downward pressure on fees. This risks reducing the quality of service and competition, as the commercial feasibility of an audit engagement becomes a consideration. In this context it is particularly important to clarify the need for wider scope audits, implications, costs and benefits.
7. We emphasise the importance of having the Finance Director or equivalent on the leadership team and developing audit committees with two independent members, including appropriate financial expertise to enable effective scrutiny and challenge of the financial statements. We would encourage all authorities to take a more active role in evaluating their auditors, whether procured centrally or not¹.

Financial reporting framework – reducing complexity

8. There are 3 main opportunities to simplify financial reporting and present clearer, more understandable information about local authorities:
 - a) Allowing a greater number of bodies to prepare accounts in accordance with either FRS 101, a more proportionate form of IFRS, or FRS 102 (response to Q37).
 - b) Improving existing presentation through reducing specialisation, in particular removing the statutory driver which conflates the funding and accounting purpose of local authority accounts, creating

¹ [Evaluating your auditor in the public sector \(ICAS\)](#)

unnecessary complexity. It is not in the public interest for local authority accounts to persist with this anomaly (response to Q37).

- c) Introducing an annual report to strengthen the narrative front-half report to focus on key areas of interest to taxpayers and aid interpretation of the more complex technical accounts (response to Q39).

- 9. Our detailed responses to the questions of this review are in Annex A. Please do not hesitate to contact us if you have any questions.

Contact

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Detailed questions and responses

Q1. Who, in your opinion, are the primary users of/main audience for local authority accounts?

This may vary from local residents, service users and taxpayers to central government, parliamentarians, banks and other finance providers, credit rating agencies, suppliers and others. Moreover, as councils evolve their funding arrangements and increase commercial activity, there is potentially a wider stakeholder group reading financial statements who are likely to benefit from an annual report.

For a wide-ranging user group, it would be pragmatic to assume that a publicly funded body, accountable to the taxpayer prioritises transparency, user-friendliness and understandability. Sector specialism and complexity in the accounts should be minimised so accounts better reflect general practice and are understandable by the majority, not just the specialist.

Q2. Who are the other users of local authority accounts? Are any of these other users of accounts particularly important?

See the response to Q1.

Q3. What level of financial literacy/familiarity with accounts and audit is it reasonable to expect the primary users of accounts to have and what implications does this have for the information presented in accounts and/or the information that should be subject to external audit?

Annual accounts fulfil a specific stewardship purpose and there is an inherent level of complexity to comply with accounting standards. Whilst there is a practical limit to how simplified accounts can be when they must comply with accounting standards, the objective should be for local authority accounts to be understandable by a reasonably financially literate individual who can understand a typical set of company accounts.

Adoption by local authorities of a generally accepted accounting framework (IFRS) is important combined with narrative commentary to support interest, understanding and accountability. For further comments on simplification please refer to our response to Q37.

Communicating to taxpayers the key points they may be interested in does not need to be limited to the accounts. There is a role for another brief and simple summary to address this in an understandable way.

Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

We are supportive of the overall approach and principles of public audit the NAO Code (“the Code”) is based on². However, we believe that it could go further in addressing key risks such as financial sustainability (similar to the approach used by Audit Scotland). There is a need to differentiate between going concern (as technically defined) which can be narrower than an assessment of financial sustainability, the public sector context³ and judgements on financial sustainability which includes the wider dimension audit, adding insight and value. Differentiating between the two can be confusing for stakeholders. This needs to be managed as it can impact on the value of the audit insight.

We believe that financial sustainability could be defined more broadly in the context of “wider scrutiny” beyond a focus on going concern. Including financial sustainability and governance within the value for money category is not ideal and we believe that these topics would be better addressed as part of the remit of a wider scope audit to give the appropriate level of attention to these topics. For example, governance covers topics such as systems, processes, leadership and behaviours which are not directly related to economy, efficiency and effectiveness in the use of resources.

A VFM conclusion can be difficult to explain to members and the wider public, which may contribute to an expectations gap. A complex range of issues and judgements supporting improvement can be involved so

² See [ICAS consultation response to the NAO on their Code of Audit Practice](#)

³ FRC Practice Note10

audit opinions cannot be a binary yes or no. Extending the audit approach to clarify what is within a wider scope audit can assist. Conducting a wider scope audit will have a resource impact and involve additional costs. This needs greater emphasis and investment. Highlighting wider audit responsibilities separately may support recognition of the need for investment and an expectation of the need to ensure audit fees are commensurate with responsibilities to avoid the risk of low pricing affecting audit quality.

In the current climate, financial pressures and commercialisation are increasing complexity in English local authority audits and the levels of public interest and scrutiny are greater than before. We therefore support the greater visibility of joint working in the Code as part of this, however we also suggest that it would be helpful for the Code to broaden its approach to this risk. For example, commercialisation has broader implications around governance (including the level of skills and experience in the audited body's management, audit committee and the audit team), ethics, public perception and reputation as well as financial exposure.

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it?

See the response to Q4.

Q6. In your opinion, what should an external audit of a set of local authority financial statements cover?

See the response to Q4 and case for an audit which covers the wider dimensions of a council, not just its financial statements.

Q7. In your opinion, what should the scope of the external auditor's value for money opinion be?

See the response to Q4. A binary opinion is unlikely to be appropriate for VFM as the opinion will cover a range of issues and need to be clear to readers. The best value regime offers a relevant comparative in Scotland.

Q8. What is your view on the scope of an external audit engagement as described in Chapters 1 and 2 of this Call for Views? If it is different from your expectations, does this have implications for the reliance you place on external audit work?

See the response to Q4 for the first question.

Q9. Should the external audit engagement be extended? If so, which additional areas/matters are most important for external auditors to look at? What would be the cost implications of extending the engagement to the areas/matters you consider to be most important be?

See the response to Q4. There may be particular areas that users would like assurance on and which auditors could provide but the potential cost needs to be recognised.

Respective responsibilities for preventing and detecting fraud could be clarified. A sound internal control framework reduces the risk of material error in the accounts. This includes arrangements to prevent and detect fraud. The outcomes of the Brydon Review into the Quality and Effectiveness of Audit will need consideration. To set reasonable parameters on the authority's responsibilities, a parallel can be offered from existing law which applies the defence of having adequate procedures in place. Examples include the [Criminal Finances Act 2017 section 45\(2\)](#) and the [Bribery Act 2020 s7\(1\)](#).

In defence, a business may avoid criminal liability where it can show that:

- it had implemented reasonable prevention procedures, or
- where it can show that in the circumstances it would have been unreasonable or unrealistic to have expected it to have had procedures in place ([Criminal Finances Act 2017 section 45\(2\)](#)).

Q10. Should the scope of the vfm opinion be expanded to explicitly require assessment of the systems in place to support the preparation of some or all of the reports that statute requires to be presented to full Council? If you do, which reports should be within scope of the external audit vfm engagement? If not, should these be assessed through another form of external engagement? If you believe that the vfm opinion should be extended to cover these reports will there be implications for the timing of audit work or auditor reporting?

See the response to Q4.

Q11. Should external auditors be required to engage with Inspectorates looking at aspects of a local authority's service delivery? If you believe that this engagement should happen, how frequent should such engagement be and what would be the end purpose of doing so?

This is logical and is part of the Shared Risk Assessment in Scotland, however, for efficiency it would be less burdensome for Inspectorates/other bodies if they could coordinate with one central body rather than several different auditors.

Q12. Does the current procurement process for local authority audit drive the right balance between cost reduction, quality of work, volume of external audit hours and mix of staff undertaking audit engagements?

We note a downward pressure on fees through prior PSAA rounds of audit tendering. This risks both reducing the quality of service and competition, as the commercial feasibility of an audit engagement becomes a consideration⁴. In this context it is particularly important to clarify the need for wider scope audits, implications, costs and benefits.

Developments in audit more generally and the impact on the profession, audit approach and quality, expectations and costs etc. will need to be monitored to assess the impact on local authority/ wider public sector audit.

Q13. How should regulators ensure that audit firms and responsible individuals have the skills, experience and knowledge to deliver high quality financial and vfm audits, whilst ensuring the barriers to entry do not get too high?

We support a level playing field in terms of audit quality standards across different organisation types as the basis, with supplementary guidance as required,⁵ which is grounded in the ISAs and FRC framework.

Understanding the business of local authorities with complex service delivery activities is important and an audit firm should be able to demonstrate its commitment to understanding its prospective client. The over-specialisation of local authority accounts (see also the response to Q37) has had the consequence that not only accountants but also auditors need additional specialist knowledge to understand the differences to do their job effectively. We reiterate the need for more generally understandable local government accounts as the current level of specialisation contributes to additional costs.

Achieving appropriate understanding of the business is essential, however greater emphasis should be on the core skills of scrutiny, challenge and professional judgement enabling cross-sector perspectives and broader challenge. We do not believe it should be necessary to be prescriptive in terms of the years of public sector experience for a key audit partner (FRC local audit requirements). This risks reducing competition, favouring incumbents and missing out on wider challenge opportunities and good practice.

We also note that the multi-disciplinary audit firm offers access to specialist expertise and support which can be helpful to authorities with a range of complex functions and responsibilities.

⁴ See pages 8 and 15 [ICAS guide to audit tendering in the public sector](#) and page 9 [Evaluating your auditor \(public sector\)](#).

⁵ FRC Practice Note 10

Q14. What metrics should regulators use when assessing whether financial and vfm audits are delivered to an appropriate level of quality?

Please refer to the [ICAS guide on auditor evaluation](#).

Q15. Do you agree with the Independent Review of the Financial Reporting Council's findings and recommendations; and why do you agree/not agree? If you agree with the recommendations do you think the 'single regulatory body' should be the "successor body to the FRC" or a sector specific entity? If you do not agree with the recommendations are there any other changes you would make to the regulatory framework for local authority audit?

We support a level playing field and believe that a single body should oversee audit and not split public audit from the rest of the economy. A common platform promotes consistency.

Q16. Do external audit firms have enough understanding of the local authority regulatory framework to focus audit work on the right areas? How do they/should they demonstrate this? Who should regulate this work?

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Q17. Do auditing standards have a positive impact on the quality of local authority financial audits?

Auditing standards are an important part of the control framework to achieve consistency and quality standards. We believe that the same principles of auditing standards should apply across both the public and corporate sector. We do not support a two-tier system which risks cherry-picking standards and confusion.

Q18. Do audit firms allocate sufficient resources to deliver high quality and timely audits? How is consistency and quality maintained in external audit work? To what extent is there consistency in audit teams year on year? What more can be done to ensure consistency between firms?

Tendering periods can be shorter in the public sector. There is a balance to achieve the benefits of audit tendering rotation yet avoiding a rotation period which is so frequent that it incurs unnecessary cost and reduces the efficiency of the audit. There should be sufficient time for a professional client/auditor working relationship to be developed and optimised. It is good practice to periodically reassess and challenge what is an appropriate frequency for tendering. Too long may impact on independence and too short may not be maximising efficiency and productivity⁶.

Q19. To what extent are senior audit staff, particularly the responsible individual signing the audit certificate, visibly involved in audit work? Who do senior audit staff meet with?

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Q20. Should external auditors consider financial resilience as a key factor when designing their vfm work programme? If so, what factors do they/should they consider as indicative of a lack of financial resilience?

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Q21. Does the Code of Audit Practice provide enough guidance on how much work needs to be done to support the vfm opinion? If not, what should it cover?

See the response to Q4.

Q22. Do auditing standards provide appropriate guidance on quality standards for vfm audits? If not, is guidance needed and should it be included in the Code of Audit Practice or elsewhere?

INTOSAI offers a useful reference.

Q23. What is the current relationship between external and internal audit? How should that relationship be developed to add most value to local authorities and local residents?

⁶ [Guide to audit tendering in the public sector \(ICAS\)](#) – page 4,5

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Q24. What should happen when a regulator finds that a local authority audit has not met quality standards? Where should the balance between ensuring effective enforcement action against auditors and maintaining participants in the audit market lie?

We believe that a single system should operate for audit quality standards and enforcement regardless of sector to achieve trust in the profession and its work.

Q25. Do you think that the format of the vfm audit opinion provides useful information? If not what would you like it to cover?

See the response to Q4 and 7.

Q26. Do you think the vfm opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate?

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Q27. Do you think that the vfm opinion is presented at the right point in a local authority's annual financial management and budgeting cycle? If not when do you think it would be most useful?

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Q28. Where auditors have identified significant issues, audit certificates and reports have often been delayed? Why do you think this is and can changes be made to the framework to encourage earlier reporting of significant issues?

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Q29. In your view, what sorts of issues should Public Interest Reports be used to highlight?

These are useful for giving profile and supporting accountability on significant matters.

Q30. Statistics demonstrate that very few Public Interest Reports and Statutory Recommendations have been issued. Why do you think this is? Does it indicate an issue with the framework or common behaviours? If you think this is an issue, what can be done to incentivise more frequent and timely reporting of significant issues?

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Q31. Does a publication summarising the results of local authority audits add value? If so who should publish it and what information would they need to have access to perform this function effectively?

Yes, it is helpful to provide a strategic perspective of the issues to inform decision-making and support accountability.

Q32. To whom should external auditors present audit reports and findings; is it the audit committee, to full council or equivalent or another committee? If findings are not presented to full council or equivalent what information (if any) should full council or equivalent receive?

As part of good governance and to support effective scrutiny and challenge, this should be part of the responsibility of an audit committee. An audit committee should include members with appropriate financial expertise and we suggest a minimum of 2 independent members to fulfil its duties. We agree that findings should also be presented to full council with the audit committee's decision.

We support the principles of good practice as set out in the [UK Corporate Governance Code](#).

Another aspect of good governance would be for all authorities to have the Finance Director or equivalent (section 151 officer) as part of the leadership team at the highest level.

Q33. In your authority, what is the membership of the audit committee (number of members, how many are independent etc) and which officers typically attend?

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Q34. How should local authorities track implementation of recommendations made by internal audit, external audit and relevant statutory inspectorates? What should the external auditors do if recommendations are not being implemented?

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Q35. Should there be a role for an external body in tracking action taken in response to modified audit opinions and/or statutory recommendations and public interest reports? If so should that responsibility sit with MHCLG, the sector specific oversight body recommended by the Independent Review of the Financial Reporting Council or another body?

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Q36. Do local authority accounts allow the user to understand an authority's financial performance and its financial resilience? If not, how could they be revised to be more understandable? What information could be presented to enable users of the accounts to understand whether the financial position of a specific LA is getting better or worse?

Not well enough. Please refer to our response in Q37.

Q37. The UK Government is committed to maintaining IFRS based accounting for the UK public sector. Given this, how would you recommend resolving the mismatch between the accruals and funding basis to improve the understandability of local authority accounts?

Reducing complexity through accounting standards

The size of local authorities varies considerably. We welcome the achievement of local authorities to successfully adopt IFRS. However, the application of full (i.e. EU endorsed) IFRS has contributed to the increasing length and complexity of accounts. Since the decision to adopt EU endorsed IFRS, more recent developments include the introduction of IFRS with a reduced disclosure framework (FRS 101) and new UK GAAP (FRS 102), which is substantially based on IFRS for SMEs. This is a less complex and more succinct version compared to full IFRS, which has been tailored to the UK environment. FRS 101 is useful for smaller group entities consolidating with a parent entity applying IFRS. This may be most appropriate for smaller public bodies who fall within the scope of Whole of Government Accounts.

Potential users of public sector accounts include a wide range of financially and non-financially literate stakeholders. To support continuous improvement, current financial reporting developments need to be considered and a question raised, if it is balanced and reasonable for all local authorities (and the wider public sector) to apply full IFRS as opposed to the new UK GAAP. Consideration should be given to how a reduced financial reporting disclosure framework could help to streamline the accounts for smaller authorities. We suggest that there is potential to allow a greater number of bodies to prepare accounts in accordance with FRS 101 (or FRS 102).

Reducing complexity through legislative framework

Local authority accounts are an important and necessary document to demonstrate accountability and stewardship of public funds to taxpayers and other stakeholders. Their particular complexity and specialism create a barrier to wider understanding and reduces the ability to hold local authorities to account. This is not in the public interest. Moreover, we are concerned that local authority financial statements do not give a clear picture of the true cost of providing services given the use of statutory adjustments through the Movement in Reserves Statement.

We do not believe that the necessary fundamental reduction in complexity of local authority accounts can be achieved without removing the root cause in the legislative framework which governs the published financial reporting of local authorities. The resulting conflation of the council tax calculation and accounting purpose of financial statements creates obfuscation and complexity. This considerably weakens the ability of the taxpayer to hold their authority to account for financial performance.

We recommend that the legislation is revised to remove this driver of complexity and barrier to simpler and more understandable accounts. This would increase the transparency of the performance of local government and support engagement and accountability. Whilst the original intention may have been to reduce the impact of volatility on council tax bills and protect council taxpayers, the accounting landscape has significantly changed and the legislative framework has not kept pace. Updating the legislation to

separate the funding purpose from the accounting would remove the need for the protection which statutory mitigations offer.

Q38. Do you think that summary financial information should be reported in the annual report section of the accounts? If so, on what basis and should this information be covered by the financial audit opinion?

We agree that the narrative statement should present the key points regarding delivery of objectives and performance. We are supportive of alignment of existing audit requirements with the comparable Strategic Report as set out by the FRC⁷. See also our responses to Q1 and 3.

Q39. If you think that summary financial information should be reported in the annual report section of the accounts, should it be presented with performance information? If so, what performance information would be of most interest to stakeholders?

Narrative reporting – improving understanding and engagement

A key engagement tool is the annual report. We believe that, as in other sectors, local authorities should introduce an annual report as the key publication for communicating with stakeholders. This is not currently a requirement for local authorities although elements have been introduced to the financial statements and various other publications exist. This is not a full “annual report” per se.

An annual report type document with a summary narrative would help to make the technical accounts of local authorities more understandable and accessible to the public. This is a more appropriate platform to give taxpayers a clearer picture of what they are paying for, how resources are used, how well the authority performs, stewardship and risks.

To meet varying user needs a one-stop shop to facilitate navigation to other information provided by the authority and cross-refer to other sources or more detailed information is needed. This would help to support accountability, transparency, effective independent challenge and scrutiny.

Q40. For larger authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner? If not, how should the regime be modified?

The system would benefit from a review to identify current needs and how these can best be met. This should include consideration of why only local authorities have this regime.

Q41. Is more guidance needed to help auditors assess the impact of significant changes to common business models? If so is this guidance needed to support the financial audit, the vfm audit or both?

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Q42. Is the financial reporting and audit framework for larger category 2 authorities appropriate? If not, what additional information should be subject to audit/assurance and what would be the cost implications of this?

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Q43. For smaller authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner and is the cost of processing and responding to objections proportionate? If not, how should the regime be modified?

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⁷ [FRC guidance on Strategic Report](#) pages 10/11.