



CORPORATE GOVERNANCE COMMITTEE – 31 JANUARY 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

AUDIT AND GOVERNANCE UPDATE

Purpose

1. The purpose of this report is to present to the Corporate Governance Committee for its consideration an update on current audit and governance issues.

Background

2. A series of large-scale corporate governance and financial failings in both the private and public sectors e.g. Carillion, BHS and Northamptonshire County Council, has led to criticisms of the roles taken by auditors. The interest generated has resulted in several reviews of audit and governance arrangements in all sectors.
3. In response to an action from the 1st November Corporate Governance Committee meeting that officers 'consider with the Chairman of the Committee how best to share information arising from reviews and consultations with Members of the Committee in future', the following approach was agreed with the Chair:

Consultations that have the potential to materially impact the governance arrangements of the County Council will be highlighted to the Chair and Vice-Chair of the Corporate Governance Committee for awareness.

Officers will prepare a response and share this with the Chair and Vice-Chair in advance of submission. The submitted response will be reported at the next committee meeting so that members can understand the issues the consultation is tackling and the impact upon the County Council.

4. In local government, financial resilience and provision of services persist as the main themes for those running and delivering local government services. The Chartered Institute of Public Finance and Accountancy (CIPFA) has launched tools to assist local authorities via the Financial Management Code and supporting packages launched in November, as well as the Resilience Index released in December.

Developments in Local (External) Audit

Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England (the Redmond Review)

5. The responsibilities for how local authority audits are conducted is set down within the Local Audit and Accountability Act 2014. The 2014 Act put in place a localised audit regime, refocussing local accountability on improved transparency. An independent review is taking place which will meet the Ministry of Housing, Communities and Local Government's (MHCLG) commitment to undertake a post implementation review of the audit framework and financial reporting elements of the Act.
6. The scope of the review and potential implications for this Committee were explained at its meeting on 1 November 2019. The Consultation closed on 20 December 2019. A copy of the Councils response to the Redmond Review is attached as Appendix A. A final report is scheduled to be published in March 2020.

Proposals to Revise the Local Audit in England Code of Audit Practice

7. The 2014 Act makes the National Audit Office (NAO) under the leadership of the Comptroller and Auditor General (C&AG) responsible for the preparation and maintenance of the Code of Audit Practice (the Code) and gives the C&AG power to issue guidance to auditors in support of the Code, to which auditors must have regard when carrying out their work. The Code must be reviewed, and revisions considered at least every five years. The NAO released a consultation in the Autumn of 2019, closing date 22 November 2019. The scope of the consultation and potential implications for this Committee were explained at its meeting on 1 November 2019. The Council was supportive of the proposals. A copy of its response is attached as Appendix B.
8. The revised Code was scheduled to be finalised by the end of 2019, ready to be laid in Parliament early in 2020. The new Code will apply from audits of local bodies' 2020/21 financial statements onwards. The proposals were for significant change to the Audit Guidance Notes (AGN's) covering value for money arrangements and reporting, and so the NAO will further consult on detailed guidance that underpins the Code during the summer and publish finalised AGNs in the Autumn.

Independent Review into the Quality and Effectiveness of Audit (the Brydon Review)

9. The year-long review into the British audit industry, undertaken by Sir Donald Brydon, recommends a breakaway from the accounting profession and the formation of a separate industry with its own governing principles. The 138-page report makes 64 recommendations on how to increase confidence in the audit sector and prevent unnecessary corporate collapses.
10. Key recommendations that could impact local government include: -
 - A redefinition of audit and its purpose, providing greater clarity about who audit is for and reinforcing its role as a public interest function
 - The creation of a stand-alone and transparent audit profession (defined as corporate auditing), rather than as an adjunct to the accounting profession, to be governed by overarching principles

- An obligation on auditors to inform and the need to be suspicious as well as sceptical
 - The opportunity to extend auditing beyond just examining financial statements, to reflect the wider interests of everyone who depends on (a company's) ongoing viability
 - A clarification of the opinion given by auditors and greater granularity of information about estimates
 - New reporting requirements for directors about resilience, public interest and audit policy
 - A responsibility for directors to explain the actions they have taken to prevent material fraud and to report on internal controls
11. Whilst the review's focus is on facilitating the establishment of a corporate auditing profession based on a core set of principles, inevitably it will have implications for local (authorities) audit since the firms providing local audit also provide company audit. The Chief Executive of the Chartered Institute of Public Finance and Accountancy (CIPFA) believes that whilst the recommendations should help restore public confidence in audit as a vital, independent public interest activity, they could have massive implications for the cost and quality of public sector including local audit supply chains.
12. The value of assurance and audit generally and internal audit's contributions to it are recognised by the final report. However, further exploration will be required into any future impact upon local government. Accepting that they are only recommendations, and further consultation would be required on how far they might apply to local government, the review refers to an audit committee publishing a three-year rolling Audit and Assurance Policy which should encompass assurance beyond that required for the financial statements. It is here that the directors will be able to report, for example, on cyber risk and climate change impacts and explain the degree of assurance sought. Additionally, there is a recommendation that the International Standard on Auditing (UK) 610 which governs how auditors may make appropriate use of internal audit work without receiving direct assistance, is complex to adhere to and should be reviewed with a view to encouraging greater but still appropriate use of internal audit by the external auditor.
13. The Redmond Review into local audit will need to take the Brydon recommendations into account.
14. Brydon hopes that the report can, together with other action being taken by government and regulators, help auditors earn back shareholder and wider public confidence. In order that the recommendations can be taken forward with appropriate urgency, it is important that the Audit, Reporting and Governance Authority ("ARGA"), the successor body to the Financial Reporting Council, be established with the necessary powers as soon as possible.
15. Further updates will be brought to this Committee as appropriate.

Developments in Financial Governance

CIPFA Financial Management Code

16. Towards the end of 2019, CIPFA published its Financial Management Code (FM Code). The Code provides guidance for good and sustainable financial management in Local Authorities.
17. The Code contains six key principles supported by 17 financial standards. The principles of the Code are:
 - Leadership
 - Accountability
 - Transparency
 - Standards
 - Assurance
 - Sustainability
18. By complying with the principles and standards within the Code, authorities will be able to demonstrate their financial sustainability. The FM Code identifies risks to financial sustainability and introduces a framework of assurance. This framework is built on existing successful practices and sets out standards of financial management. Complying with the standards is the collective responsibility of the Cabinet, Elected Members, the Chief Finance Officer and other senior officers.
19. The first full year of compliance is 2021/22. This reflects the recognition that organisations will need time to reflect on the contents of the code and can use 2020/21 to demonstrate how they are working towards compliance. CIPFA will be releasing detailed guidance notes (now expected in April 2020), to support the application of the FM Code in practice.
20. An initial review has been undertaken by officers which shows that the County Council is likely to comply with most of the requirements of the Code. Further work will be undertaken, informed by the FM Code guidance notes, and presented to the Committee at its next meeting in May 2020.

CIPFA Financial Resilience Index

21. On 16 December 2019 CIPFA published its Financial Resilience Index. The Financial Resilience Index is a comparative analytical tool that may be used by Chief Financial Officers to support good financial management. The index shows a Council's resilience against nine key indicators. These include the level of earmarked and unallocated funds, reserves depletion over time, comparisons of children's and adult social care budgets, external debt, Ofsted judgements and auditors' value for money assessments.
22. The indicators use publicly available data and compare similar authorities across a range of factors. There is no single overall indicator of financial risk, the index instead highlights areas where additional scrutiny should take place in order to provide additional assurance.

23. When compared with other County Councils, Leicestershire is in the lower risk range across the board. A presentation on the Index will be given to the Committee at its next meeting in May 2020.

Recommendation

24. The Committee is asked to note the updates provided in this report.

Equal Opportunities

25. None.

Circulation Under the Local Issues Alert Procedure

26. None.

Background Papers

27. Developments in Audit and Governance – 1 November 2019.
<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MId=5782&Ver=4>

Appendices

Appendix A – LCC Response to the Redmond Review
Appendix B – LCC Response to the NAO Consultation

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