



## **CORPORATE GOVERNANCE COMMITTEE – 4 JUNE 2021**

### **JOINT REPORT OF THE DIRECTOR OF CORPORATE RESOURCES AND THE DIRECTOR OF LAW AND GOVERNANCE**

#### **UPDATE ON DEVELOPMENTS IN LOCAL (EXTERNAL) AUDIT ARRANGEMENTS**

##### **Purpose of report**

1. The purpose of this report is to provide the Corporate Governance Committee (the Committee) with an update on developments in local (external) audit arrangements, that are associated with the Committee's responsibilities.

##### **Policy Framework and Previous Decisions**

2. A series of large scale corporate governance and financial failings in both the private and public sectors and criticisms of the roles taken by auditors prompted a number of reviews of audit and governance arrangements in all sectors.
3. In June 2019 Sir Tony Redmond was asked by the Ministry of Housing, Communities and Local Government (MHCLG) to undertake an independent review of the effectiveness of local (external) audit and the transparency of local authority financial reporting. The review met the MHCLG's commitment to undertake a post implementation review of the audit framework and financial reporting elements of the Local Audit and Accountability Act 2014.
4. At its meeting on 1 November 2019, the Committee received a report containing a link to the formal call for views. The Director of Corporate Resources responded to the consultation and shared the response with the Chair of the Committee.
5. Because of delays caused by the coronavirus pandemic, the review report was not issued until 8 September 2020. At its meeting on 25 November 2020, the Committee received a report summarising the review's key findings, outlining its 23 recommendations, how the report was being taken forward and communicated to stakeholders and what the next steps were, including awaiting a formal response from MHCLG which had commissioned the review.
6. At its meeting on 29 January 2021 the Committee received a further report on the MHCLG's formal response to the review report. MHCLG's response was mostly positive to the review's recommendations and the MHCLG agreed to work with a wide range of key stakeholders to deliver the recommendations. However, a key area of disagreement was the recommendation to develop and implement a new body, the Office of Local Audit and Regulation (OLAR), to be created to provide systems leadership and manage, oversee, and regulate local audit. This was

rejected primarily because creating a new body would have required new legislation from central government. Nevertheless, MHCLG recognised certain areas needed to be addressed so it proposed further engagement in the Spring.

### **Redmond review into local (external) audit – Spring update report**

7. On 19 May 2021, the MHCLG Deputy Director (Local Government Stewardship) wrote to all local authority Chief Executives informing that the Department had published its update report that was promised in MHCLG's December response. The full report is contained in the Appendix.
8. The report provides an update on the MHCLG's progress with implementing the Government's response to the Redmond Review, including on the delivery of measures to support immediate market stability and towards implementation of the other recommendations.
9. It sets out the Government's views on systems leadership for local audit. The Government agrees that a clearly accountable system leader with overarching responsibility is needed to make sure the local audit framework operates in a coherent and joined up manner, however it does not believe a new arm's length body is needed to achieve this. The Government's view is that the new Audit, Reporting and Governance Authority (ARGA), being established to replace the Financial Reporting Council (FRC), as part of the Department for Business, Energy & Industrial Strategy (BEIS) broader corporate audit reforms, would be best placed to take on this role. The FRC already undertakes the core functions relating to the audit quality framework necessary for a single responsible body to have. Establishing ARGA as system leader for the local audit framework will also ensure alignment with, and harness the positive impact of, the broader audit reforms
10. To ensure the new regulator acquires the necessary focus and expertise on local audit, a standalone unit will be established within ARGA. Development and maintenance of The Code of Audit Practice will transfer from the National Audit Office to ARGA, however the latest Code (introduced in 2020), which includes the new Value for Money commentary, will be retained. ARGA will not conduct procurement or contract management as this could create a conflict of interest. Therefore, the new arrangements will encompass a separate appointing body, in which role Public Sector Audit Appointments (PSAA) will be reconfirmed, with commercial support from MHCLG for the next procurement.
11. As the proposed reforms to the local audit framework will take time, MHCLG will take an increased leadership role in the interim, including setting up and chairing the Liaison Committee of key stakeholders, which Redmond recommended be created.
12. The Government intends to launch a public consultation on the proposals ahead of summer recess.
13. Members of the Committee have recently been informed of the Director of Corporate Resources' responses to two further consultations that have occurred: -
  - a. The public consultation proposing changes to the fee setting and fee variation arrangements set out in the Local Audit (Appointing Person) Regulations 2015 to provide additional flexibility to the appointing person for

principal bodies (PSAA) to reflect the changing nature of the local audit market, remains open until 1 June;

- b. the consultation seeking views on the most appropriate methodology for allocating £15 million additional funds to assist councils to meet the rise in audit fees and new burdens resulting from the implementation of additional requirements closed on 18 May.

14. The Government's proposals on local audit have gained a qualified welcome from stakeholders although concerns around audit supply and market instability remain. Additionally there are questions around: -
- a. Will the standalone unit within ARGA have the specialist skills and capacity it needs?
  - b. To what extent will the standalone unit be able to tailor ARGAs corporate approach to the application of International Auditing Standards, to local authority audits?
  - c. Will the PSAA succeed in securing audit contracts that are both competitively priced and enable audit suppliers to deliver audits that local authorities and the public deserve?

### **Timetable for decisions**

15. A further report will be brought to the Committee once the consultation is concluded.

### **Recommendation**

16. The Committee is asked to note the Ministry of Housing, Communities and Local Government (MHCLG) report 'Local authority financial reporting and external audit: Spring update'.

### **Circulation under the Local Issues Alert Procedure**

17. None.

### **Equality and Human Rights Implications**

18. There are no discernible equality and human rights implications resulting from the audits listed.

### **Resource implications**

19. There are no resource implications arising directly from this report at this stage, although there is a potential for higher external audit fees and accounts preparation costs in future years.

### **Legal Implications:**

20. The proposals in the Redmond Review call for some potentially significant changes to how the Corporate Governance Committee performs its functions. Further reflection and analysis will follow, after which time any local constitutional implications can be considered.

## **Background Papers**

Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting (the Redmond review)

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/916217/Redmond\\_Review.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916217/Redmond_Review.pdf)

Local authority financial reporting and external audit: government response to the Redmond review

[www.gov.uk/government/news/government-publishes-response-to-audit-review](http://www.gov.uk/government/news/government-publishes-response-to-audit-review)

Reports to the Corporate Governance Committee:

1 November 2019 - Developments in Audit and Governance -

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MId=5782&Ver=4>

25 November 2020 – Updates on Developments in Local (External) Audit Arrangements

<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=434&MId=6361&Ver=4>

29 January 2021 – Updates on Developments in Local (External) Audit Arrangements

<http://politics.leics.gov.uk/documents/s159358/Update%20on%20developments%20in%20local%20external%20audit%20arrangements.pdf>

## **Appendix**

Local authority financial reporting and external audit: Spring update

### **Officers to Contact**

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