

# RIBBLE VALLEY BOROUGH COUNCIL

## REPORT TO ACCOUNTS AND AUDIT COMMITTEE

Agenda Item No 9

meeting date: 12 FEBRUARY 2020  
title: REVIEW OF LOCAL AUTHORITY FINANCIAL REPORTING AND EXTERNAL  
AUDIT – CALL FOR VIEWS  
submitted by: DIRECTOR OF RESOURCES  
principal author: LAWSON ODDIE

### 1 PURPOSE

1.1 To provide members with details of the Council's response to the call for views on the independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England.

1.2 Relevance to the Council's ambitions and priorities:

- The council aims to be a well-managed council.

### 2 BACKGROUND

2.1 The Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) invited Sir Tony Redmond to conduct a review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014.

2.2 At your meeting on 27 November members were provided with a copy of the Call for Views consultation document and any comments for inclusion in the Council response were invited.

### 3 REVIEW OBJECTIVES

3.1 The Review will examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework in order to determine:

- Whether the audit and related regulatory framework for local authorities in England is operating in line with the policy intent set out in the Act and the related impact assessment
- Whether the reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
- Whether the current statutory framework for local authority financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold local authorities to account; and
- To make recommendations on how far the process, products and framework may need to improve and evolve to meet the needs of local residents and local taxpayers, and the wider public interest.

### 3.2 SCOPE

3.3 The review's scope is taken to include the objectives and context included in these terms of reference. In practice, this means the review is likely to focus on the following questions;

- Have the financial savings from local audit reforms been realised?

- Is there a more accessible audit market and has there been an increase in audit providers?
  - Have audit standards been maintained or improved, and not been compromised?
  - Is there an 'expectation gap' in what external audit provides? What is the nature of the gap and how can it be filled?
  - Are auditors properly responding to questions or objections by local taxpayers?
  - Are auditors using their reporting powers in an appropriate way?
  - Are audit recommendations effective in helping local authorities to improve their financial management?
  - Are councils responding to auditor recommendations in an appropriate manner?
  - Whether local authority accounts report financial performance including use of resources against budget in a manner that is transparent and comprehensible to council tax payers and the general public?
  - Does the financial information provided in local authority accounts facilitate scrutiny by local taxpayers and by the local press?
- 3.4 The financial reporting and audit framework for Clinical Commissioning Groups, NHS Trusts and Foundation Trust and special trustees for hospitals is outside the scope of this Review. This is because these bodies have significantly different statutory bases and governance frameworks to other bodies covered by the Act
- 3.5 The Council's response to the Call for Views document is attached at Annex 1.
- 4 CONCLUSION
- 4.1 The Review will examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework.
- 4.2 The Council submitted a response to the Call for Views consultation document and details are attached to this report. The consultation is now closed and feedback is being analysed.

HEAD OF FINANCIAL SERVICES

DIRECTOR OF RESOURCES

AA6-20/LO/AC  
3 February 2020

For further information please ask for Lawson Oddie

# **Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England: Call for Views**

## **RESPONSE FROM RIBBLE VALLEY BOROUGH COUNCIL**

### **PART 1: STRATEGIC CALL FOR VIEWS**

#### **Chapter 1: Definitions of audit and users of the accounts**

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

*A1. From an idealistic perspective we would agree with the definition provided by CIPFA, however due to the increased complexity that has been brought in to local authority accounts over recent years to bring them in line with IFRS, it is felt that such audiences as service recipients (residents, elected members, workforce) have been failed and are not reflected in reality as primary users.*

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

*A2. Pressure groups, potential suppliers, press. These users are important as they often influence public opinion and a distorted understanding of local authority accounts can result in misunderstanding and misrepresentation of the financial position and performance of a local authority.*

##### **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?**

*A3. Financial literacy, but not in the context of local authority accounting, can lead to an inaccurate understanding of the financial position of a local council. It is unfortunate that the drive for the presentation of the accounts under IFRS has had the side effect of local authority accounts being interpreted on a commercial basis and without understanding of the public sector context and associated accounting adjustments that also take place.*

##### **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?**

*A4. Whilst the financial landscape in local government has changed dramatically over recent years, the focus of the external audit does not appear to have followed suit. Whilst some issues may be covered within the Value for Money opinion, there is little audit over such high impact areas as council tax base calculation and also business rates and the associated returns. These are areas that have huge impacts on the level of funding that local authorities receive and have the potential to substantially distort the council's financial position.*

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

*A5. The going concern opinion is not meaningful in the context of a local authority. An opinion on the long-term sustainability of local services would be more fitting and sits comfortably alongside the new CIPFA Financial Management Code.*

## **Chapter 2: The Expectation Gap**

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

*A6. Accuracy of presentation with comment on financial sustainability. Less focus on items that are added and reversed out of the accounts due to being a local authority – ie accumulated absence adjustments, pensions adjustments, depreciation adjustments.*

*If the presentation of the accounts were simplified, by the removal of the many adjustments that were introduced by IFRS (which are then reversed back out of local authority accounts), the audit focus could be shifted from these accounting entries that are time consuming to produce and audit, and which cause confusion for the reader, masking the true message.*

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

*Q7. Perhaps with the introduction of the CIPFA Financial Management Code the themes could be reflected in the vfm audit: leadership; accountability; transparency; standards; assurance; sustainability – making recommendations on areas of failings.*

**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?**

*Q8. The going concern principle for local authorities is confirmed as meaningless, and the fact that auditors are bound to the requirement to report all local authorities as going concerns adds to this. This can give a totally distorted picture of the financial position of a local authority and can give false assurance to the reader of the accounts of the sustainability of services.*

**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?**

*A9. Service focused value for money work/projects would add value, comparability and sharing of best practice across local authority audit areas. This could follow varying themes/service areas from year to year and be focused on service improvements and accountability.*

## **PART 2: TECHNICAL CALL FOR VIEWS**

### **Chapter 3: Audit and Wider Assurance**

**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?**

*A10. Yes, we agree that the scope of the vfm opinion should be expanded to explicitly require assessment of the systems in place to support the preparation of the reports that statute requires to be presented to full Council, notably the Balanced Budget Report; Mid-Term Financial Strategy; Capital Strategy, Investments Strategy and Minimum Revenue Provision Strategy.*

**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?**

*A11. We feel that it is important that the external auditors should be required to engage with Inspectorates. This would allow a more joined up approach to the overall inspection regime, with each party being able to see all parts of the jigsaw.*

### **Chapter 4: The Governance Framework for the Audit System**

**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?**

*A12. Whilst the reduction in audit fees has been welcomed at a local authority level, the ability of external audit firms to meet the demands upon them within quoted contract values seems questionable. This has particularly been evident with more recent demands around PPE Valuations and also Pensions (including McCloud).*

*Whilst not directly experienced at this council, there appear to be instances of difficulties in audits being able to be completed within deadlines, compounded by recruitment difficulties.*

*The robustness of the procurement process in gaining assurances that the service levels quoted for can be achieved at the prices quoted is called in to question.*

**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?**

*A13. There should be more robust challenge of the statements that are made within tender documents, and of the ability of the firms to meet demand.*

*Perhaps the standards required are adequate, but the challenge from regulators is not robust enough and perhaps the penalty for not satisfying the requirements of awarded contracts are not high/strong enough.*

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

*A14. A standardised review framework which is reported on 'centrally', but unsure who that central body should be in the current landscape (MHCLG?).*

**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?**

*A15. Yes, we agree with the Financial Reporting Council's findings and recommendations.*

## **Chapter 5: Audit Product and Quality**

**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?**

*A16. A number of external audit firms are fortunate to have the expertise of past Audit Commission employees or long-standing staff from past local authority audits and have that understanding. A balance of relevant qualifications (CIPFA) for audit staff which reflect the specialist nature of local authority accounting should help maintain the necessary skills and focus of audit work.*

*Perhaps MHCLG have a role in the regulation of this work.*

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

*A17. Whilst these provide for consistency of approach, this can detract from other areas of local importance or local circumstance which may present areas of high risk.*

**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?**

*A18. The availability of adequately qualified staff appears to be causing issues around a number of audit firms, and this is impacting on the timeliness of audit work for some local authorities, potentially impacting on local authority reputation due to speculation around any delays.*

**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?**

*A19. Periodic meetings are held with the responsible individual signing the audit certificate. There is feedback and queries relayed from the responsible individual signing the audit certificate during the audit itself.*

**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?**

*A20. We agree that external auditors should consider financial resilience as a key factor when designing their vfm work programme and sits comfortably alongside the new CIPFA Financial Management Code and the factors included within it.*

**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?**

*A21. Based on the information with the Call for Views document it is not felt that the Code of Audit Practice provides enough guidance on how much work needs to be done to support the vfm opinion. Again, we feel that the new CIPFA Financial Management Code and the factors included within it should act as the backbone for forming the vfm opinion.*

**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?**

*A22. We do not feel that the auditing standards provide appropriate guidance (to allow consistency across all audits) on quality standards for vfm audits.*

**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?**

*A23. There is currently a limited relationship between the external and internal audit teams. Sharing of risk areas and also best practice would help in raising the profile of the work of the internal audit teams.*

**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?**

*A24. We believe that there should be enforcement action against auditors, however the failure to meet the earlier deadlines for the closedown and audit of financial statements perhaps highlights that such earlier deadlines are not realistically achievable or sustainable, particularly as more technical changes are introduced, which in turn adds to the burden on the external audits.*

*There is a risk of compounding existing issues around recruitment for external auditors if the inability to meet these deadlines continues and the views of potential recruits of the industry become tainted.*

## **Chapter 6: Auditor Reporting**

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

*A25. The themes of the new CIPFA Financial Management Code may be appropriate.*

**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?**

*A26. Whilst this authority is not directly affected by the issues raised in the Call for Views document it would appear problematic for an auditor to be able to provide an unqualified vfm opinion where services have been deemed inadequate by other inspection regimes. It is difficult to see how an authority can be providing value for money, when being classified as inadequate for services it provides.*

**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?**

*A27. We feel that the opinion sits at the right point within the annual financial management and budgeting cycle. It allows for reflection on the full financial year gone and is timely for actioning anything that may impact on the forthcoming budget cycle, and allows time for action within the current year where needed.*

**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?**

*A28. Timeliness of reporting for identified significant issues would allow any action to be undertaken sooner. As highlighted in the Call for Views document, if not reported in a timely manner reporting can become meaningless/toothless as matters have been addressed by the time reports are issued. An understanding of the reasons for these delays would be needed to comment any further.*

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

*A29. Major failures in governance arrangements.*

**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?**

*A30. Unable to comment*

**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?**

*A31. This would depend on the intended audience and what it is thought such a publication would be seeking to achieve. Due to such varying local circumstance and the need for contextual information to reflect properly on any summarised information it is difficult to understand the benefits that would be achieved from such a publication.*

## **Chapter 7: The Framework for Responding to Audit Findings**

**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?**

*A32. We believe that audit reports and findings should be reported to a dedicated Audit and Governance Committee. This would help ensure the high profile of not only the audit reports and findings, but also other key accountancy, audit and governance issues where adequate time can be dedicated to these key issues.*

**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?**

*A33. Our Audit Committee consists of 11 members. There are also two independent persons. Officers typically attending are Chief Executive, Director of Resources (S151 Officer), Head of Financial Service (Head of Internal Audit role), Head of Legal Services (Monitoring Officer).*

**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?**

*A34. These should be reported to members as an action plan and progress monitored, with officers answerable to members for failure to implement any agreed actions.*

*With regard to the failure to implement external audit recommendations, this would be dependant upon the nature of the recommendation and whether this warranted any qualification of the accounts.*

*Once again, the failure to implement external audit recommendations could be reported to Audit Committee members – or direct to Full Council or equivalent where appropriate.*

**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?**

*A35. This council believes that responsibility should sit with MHCLG*

## **Chapter 8: The Financial Reporting Framework**

**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?**

*A36. The many IFRS related accounting entries to the accounts cloud the real message that local authority accounts should be trying to convey. The narrative report helps explain the real messages and to some extent can be seen to have taken over the role once satisfied purely by the statements themselves. The complexity of the statements and the accounting adjustments now makes them inaccessible to the majority of those who should be the real 'primary users of the accounts'.*

**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?**

*A37. Whilst the commitment to continue with IFRS based accounting for the UK public sector remains (with the associated accounting adjustments and notes required to restate figures within them for local authority context) there appears little ability to provide a simple solution to the complexity we now see in many local authority accounts.*

**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?**

*A38. It is strange that the Narrative Report, as the most understandable and therefore probably the most read element of the statement of accounts document is not subject to audit. As previously expressed, a simplification of the accounts themselves would provide a better solution and avoid confusion to the lay-reader, rather than the presentation of the same information in two different formats within the same document that are difficult to reconcile without more specific accounting knowledge.*

**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?**

*A39. In order to allow the reader to gain a more rounded opinion of the performance of the council we feel that this should include both qualitative and quantitative measures. Qualitative measures could include measures of performance against corporate strategy targets in year, whilst quantitative measures could provide a range of relevant ratios/statistics.*

## **Chapter 9: Other Issues**

**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?**

*A40. We believe that the opportunities are already there for local residents to hold their council to account in an effective manner. We feel that the regime is adequate, but that the complexity of local authority accounts is the issue and acts as a barrier.*

**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?**

*A41. Whilst not directly affected, this council can see the benefits of more guidance to support both the financial audit and the vfm audit.*

**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?**

*A42. Unable to comment*

**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?**

*A43. As has been seen in recent years, there are instances where increased amounts of spend is being directed through smaller authorities by a number of local authorities. With this in mind, the inspection regime around these smaller authorities is seen as very 'light touch' and a more rigorous approach would be encouraged around financial statements and governance arrangements.*