

Audit and Risk Committee 20th November 2019

Report of Leicestershire County Council's Head of Internal Audit & Assurance Service

Developments in audit and governance

PURPOSE OF REPORT

1. The purpose of this report is to inform the Audit and Risk Committee (the Committee) about current and planned developments in audit (mostly external audit) and governance, that are associated with the Committee's responsibilities.

RECOMMENDATIONS

2. This report is for information only

SUMMARY

3. 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, and criticisms of the roles taken by auditors has generated much interest into reviewing audit and governance arrangements in all sectors.
4. This report provides information on a number of current consultations, the findings of associated reviews and other developments and informs the Committee of the Council's plans to respond.

REPORT

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)

<https://www.gov.uk/government/consultations/review-of-local-authority-financial-reporting-and-external-audit-call-for-views>

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. The independent review 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 Review, led by Sir Tony Redmond the former President of the Chartered Institute of Public Finance and Accountancy (CIPFA), is to examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework to determine whether: -
 - a. It is operating in line with the intent set out in the Act;
 - b. The reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;
 - c. 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;
 - d. The process, products and framework need to improve and evolve to meet the needs of residents and local taxpayers, and the wider public interest.
7. A call for views, information and evidence (containing 43 questions) is underway. **Appendix 1** lists the questions. The deadline for responding to the consultation has been extended until 20 December. In terms of the responsibilities of the Committee, the Review is interested in whether the governance framework for considering internal and external audit findings encourages local authorities to take prompt action in response to issues raised and whether it supports continuous improvement. It asks for details on committee membership, whether there are any independent members, and which officers typically attend the audit committee. It is also interested in how the implementation of both internal and external audit recommendations is tracked and in exploring the relationship between internal and external audit, particularly if a closer or more codified relationship could lead to higher quality outcomes.
8. The Director of Finance will respond to the consultation.
9. CIPFA is preparing a comprehensive response to the Review. Essentially it believes that it provides an opportunity to develop the profile, influence and support for audit committees going forward and it is keen that the internal audit perspective is heard. Leicestershire County Council's Head of Internal Audit Service has responded with his own generic and specific views to a separate set of questions which is contained in **Appendix 2**.
10. The Review is due to report in March 2020.

Proposals to revise the Local audit in England Code of Audit Practice

<https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/>

11. 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. A new Code needs to be laid in Parliament in time for it to come into force no later than 1 April 2020.
12. The NAO recently issued Stage 2 of the current consultation, which closes on 22 November 2019. There are some key improvements proposed in the draft Code including the need for local auditors to ensure that:
 - a. Teams have the necessary skills and knowledge of the relevant financial reporting and regulatory frameworks to enable them to deliver their audit work.
 - b. They have open and transparent arrangements in place for engaging with the public effectively
 - c. When reporting their findings, making recommendations, or exercising any of their wider functions, they ensure their reporting to local bodies – and to the wider public – is as effective and-transparent as possible and promotes local improvement
13. The 2014 Act places a specific duty on the local auditor to be satisfied whether the body they are auditing has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. The draft Code proposes a new approach to auditors' work in this area, putting a sharper focus on value for money (VfM) and an expectation of clearer and more timely reporting. The NAO considers the new approach will extract more value from current audit work and make auditor reporting more useful to the audited body and the wider public. It will not result in any form of scored judgement or rating or require local bodies to compile any form of self-assessment.
14. While the focus on the arrangements the body has in place and the risk-based approach to auditors' work is retained, the draft Code revises the previous reporting criterion to cover the following:
 - a. Financial sustainability: How the body plans and manages its resources to ensure it can continue to deliver its services.
 - b. Governance: How the body ensures that it makes informed decisions and properly manages its risks and finances.

- c. Improving economy, efficiency and effectiveness: How the body uses information about its costs and performance to improve the way it manages and delivers its services.
- 15. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether (or not) proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances.
- 16. For work on arrangements to secure VfM, the draft Code introduces the expectation that where work identifies significant weaknesses in arrangements, the auditor will issue a recommendation to the body, setting out the auditor's judgements clearly along with a summary of the evidence on which those judgements are based. The auditor should also explain the impact the judgement has on the body itself and set out clearly the actions the body should take in response. The draft Code also expects that, when they identify significant weaknesses in arrangements, the auditor considers whether to make their recommendation immediately, rather than wait until the end of the audit.
- 17. The Director of Finance will respond to the consultation.

Other developments relating to the wider external audit field

- 18. Whilst the two consultations above are specifically relevant to the local government sector, other reviews into the audit domain could impact on local authorities and the public sector. These include: -
 - a. 'The Independent Review of the Financial Reporting Council (FRC)' – the Kingman review was concluded in December 2018. The FRC regulates auditors, accountants and actuaries in the UK, sharing this responsibility with the professional membership bodies. The review recommended that the FRC be replaced with an independent statutory regulator, accountable to Parliament, with a new mandate, new clarity of mission, new leadership and new powers. The new regulator would be called the Audit, Reporting and Governance Authority.
 - b. 'Statutory Audit Services Market Study', final report, April 2019. The Competition and Markets Authority. recommended changes to the statutory audit market that will impact on local audit. This review also made a specific recommendation that audit committees should come under greater scrutiny by the new regulator (see Kingman). This should increase accountability of audit committees. This recommendation could translate into the public sector and local government.

- c. 'Independent review into the quality and effectiveness of audit' (the Brydon review). The review was commissioned in response to the perceived widening of the "audit expectations gap" - the difference between what users expect from an audit and the reality of what an audit is and what auditors' responsibilities entail. Recent company failures have brought this gap into greater focus. There may be an additional gap between the information users of audited accounts believe is needed and what is available to them through audited financial statements or other publicly available information. A report to the Secretary of State for Business, Energy and Industrial Strategy is expected by the end of 2019.
19. The findings from these separate areas of reform and enquiry have considerable relevance to the quality of the local authority audit and financial reporting processes along with the governance framework for local authority audit.

Developments in internal audit

CIPFA Statement on the Role of the Head of Internal Audit in Public Sector Organisations

<https://www.cipfa.org/policy-and-guidance/reports/the-role-of-the-head-of-internal-audit>

20. The revised Statement was published in April 2019. It is aimed at audit committees and leadership teams, helping them to understand the role of the head of internal audit and the organisational arrangements that should be in place to provide effective support to the role.
21. The Statement underlines that an audit committee plays a key role in relation to internal audit, providing oversight of the arrangements for the service and holding it to account for its delivery of the audit plan. It also plays a vital role in providing high-level support and helping to ensure that its reports and recommendations are considered and addressed by managers. A head of internal audit can organise their team and ensure professional internal audit standards are met, but unless there is the right level of engagement with the audit committee and leadership team the impact and effectiveness of internal audit is likely to be undermined. Therefore, it is important that the audit committee understands its role and plays it effectively.
22. The Statement has five principles that should be applicable to any public-sector organisation. For each principle the organisational arrangements are identified along with the characteristics of the role and of the individual. The principles are aligned to the professional standards for internal audit: The Public Sector Internal Audit Standards (PSIAS).
23. CIPFA advises that an audit committee can use the Statement when it reviews internal audit agenda items at its meetings, for example, an update of the internal audit charter or consideration of the annual opinion and report. The

Statement can also inform the committee's review of its own terms of reference, preparation of an annual report or self-evaluation.

24. Leicestershire County Council's Head of Internal Audit and Assurance Service will conduct a self-assessment against the Statement timed to take account of any governance changes identified in this report and will report back to a future Committee.

Developments in governance

'Local Authority Governance', Report by the Comptroller and Auditor General to the Ministry of Housing, Communities and Local Government, January 2019.

<https://www.nao.org.uk/wp-content/uploads/2019/01/Local-authority-governance.pdf>

25. This report examined whether local governance arrangements provided local taxpayers and Parliament with assurance that local authority spending achieved value for money and that authorities were financially sustainable. The report addressed the questions in three separate parts: the pressures on the local governance system; the extent to which local governance arrangements function as intended; and whether the MHCLG was fulfilling its responsibilities as steward of the system.
26. The report was critical of the MHCLG and commented that as steward of the system it had a responsibility for assuring itself that there was an effective local governance system in place. There were 6 recommendations including a key one relative to the responsibilities of the Committee, 'The MHCLG should work with local authorities and stakeholders to assess the implications of, and possible responses to, the various governance issues the NAO had identified, including:
 - a. the status of section 151 officers and the efficacy of their statutory reporting arrangements;
 - b. the effectiveness of audit committees, and how to increase the use of independent members;
 - c. the effectiveness of overview and scrutiny functions and ways to enhance their impact; and
 - d. the sustainability and future role of internal audit.
27. The report also recommended that the MHCLG should address the system-wide gaps in its evidence base on governance; set out its expectations of network partners to address the current weaknesses in local governance arrangements; lead the sector in considering the issues and concerns raised about external audit; examine ways of introducing greater transparency and openness in relation to its formal and informal interventions in local authorities and adopt a stronger leadership role in relation to overseeing and coordinating the network of organisations managing key aspects of the governance framework.

28. Based on the NAO report, the Committee of Public Accounts took evidence from the MHCLG, the Centre for Public Scrutiny, the LGA and CIPFA and produced a report on Local Government Governance and Accountability on 15 May 2019.

<https://publications.parliament.uk/pa/cm201719/cmselect/cmpubacc/2077/2077.pdf>

29. This report was generally scathing of the MHCLG and contained 5 conclusions that the MHCLG: -
- a. Was not yet providing effective leadership of the local governance system
 - b. Did not know why some local authorities were raising concerns that external audit was not meeting their needs
 - c. Lacked reliable information on key governance risks, or relied on weak sources of information, meaning it had no way of pinpointing the at-risk councils
 - d. Monitoring was not focused on long-term risks to council finances and therefore to services
 - e. Had a complete lack of transparency over both its informal interventions in local authorities with financial or governance problems and the results of its formal interventions
30. MHCLG has agreed all 8 of the recommendations and for 5 of them the target dates for implementation are November 2019. A key recommendation that may impact the Committee is to implement a Local Authority Governance and Accountability Framework Review Panel. The prime objective of the panel is to review the local government accountability framework and ensure it remains fit for purpose. Evidence may be called for.
31. The Committee will be updated as required.

CIPFA Financial Management Code (published October 2019)

32. The Financial Management Code (the FM Code) provides guidance for good and sustainable financial management in local authorities. By complying with the principles and standards within the code authorities will be able to demonstrate their financial sustainability.
33. The FM Code requires authorities to demonstrate that the processes they have in place satisfy the principles of good financial management. The FM Code identifies risks to financial sustainability and introduces a framework of assurance. This framework is built on existing successful practices and sets explicit standards of financial management. Complying with the standards set out in the FM Code is the collective responsibility of elected members, the chief finance officer and their professional colleagues in the leadership team. Complying with the FM Code with help strengthen the framework that surrounds financial decision making.

34. The FM Code is principles based and covers, Organisational leadership; Accountability; Transparency; Professional standards; Assurance and Sustainability of services
35. The code applies to all local authorities. By following the essential aspects of the FM Code, local authorities are providing evidence to show they are meeting important legislative requirements in their jurisdictions. The FM Code is not specified by legislation, but CIPFA's judgement is that, 'compliance with the CIPFA FM Code is necessary for local authorities to demonstrate that they are meeting important legislative requirements'
36. The first full year of compliance will be 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.
37. The Director of Finance will update the Committee as required on the application of the FM Code.

Centre for Public Scrutiny – Research into the strengthening of local governance (launched October 2019)

38. A range of national bodies are working together to enhance councils' understanding of how they can diagnose and reduce the risk of failure in corporate governance, and what success factors can point the way to greater strength in this area. Research is being led by the Centre for Public Scrutiny and funded by a consortium of partners including the MHCLG, the LGA and CIPFA.
39. The research will focus on specific governance issues in order to: -
 - a. Better understand what evidence can be found that could signpost to the risk of governance failure and help councils to mitigate those risks by strengthening governance systems.
 - b. Provide practical advice to councils as to how they can recognise and act on the risk in their own area. Researchers will consider whether it is possible to come up with a consistent "typology" of local failure, and how this can be deployed at local level to improve.
40. Findings alongside a practical toolkit for councils will be published in mid-May 2020. The Committee will be updated as required.

FINANCIAL, LEGAL AND OTHER IMPLICATIONS

Financial Implications

41. None directly, but the Audit and Risk Committee is a key component of the Council's governance framework. It provides those charged with governance independent assurance on the on the adequacy and integrity of the financial reporting and governance processes. By monitoring the quality and effectiveness of both external and internal audit, it makes an important

contribution to ensuring that effective assurance arrangements are in place.
The Committee *Colin Sharpe, Head of Finance, ext. 37 4081*

Legal Implications

42. The Council may need to implement any further statutory requirements arising from the post implementation review of the audit framework and financial reporting elements of the Local Audit and Accountability Act 2014. *Kamal Adatia, City Barrister & Head of Standards, x37 1401*

Other Implications

OTHER IMPLICATIONS	YES/NO	Paragraph references within supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Climate Change	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities	No	
Risk Management	No	

8. BACKGROUND PAPERS – LOCAL GOVERNMENT ACT 1972

REPORT AUTHOR

Neil Jones,
Head of Internal Audit & Assurance Service
Leicestershire County Council
Telephone 0116 305 7629
Email neil.jones@leics.gov.uk

APPENDICES

Appendix 1 – The Redmond Review questions

Appendix 2 - Leicestershire County Council's Head of Internal Audit Service responses to CIPFA questionnaire on the Redmond Review