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AUDIT COMMITTEE

Date: Tuesday, 17 November 2020
Time: 6.00pm
Location: Virtual (via Zoom)
Contact: Ian Gourlay (01438) 242703
committees@stevenage.gov.uk

Members: Councillors: T Callaghan (Chair), J Gardner (Vice-Chair), S Barr, S Booth, L Chester, D Cullen, L Kelly and G Lawrence.
Independent Member: Mr G Gibbs.

AGENDA

PART I

1. APOLOGIES FOR ABSENCE AND DECLARATIONS OF INTEREST

2. MINUTES - 10 SEPTEMBER 2020

To approve as a correct record the Minutes of the meeting of the Audit Committee held on 10 September 2020.
Pages 3 – 10

3. THE REDMOND REVIEW: INDEPENDENT REVIEW ON THE QUALITY OF LOCAL AUTHORITY REPORTING AND EXTERNAL AUDIT

To consider a report in respect of the Redmond Review on the quality of local authority reporting and external audit.
Pages 11 – 136

4. INTERNAL AUDIT PLAN 2020/21 - PROGRESS REPORT

To consider the Shared Internal Audit Service (SIAS) Internal Audit Plan 2020/21 progress report.
Pages 137 – 154

5. SECTION 106 (S106) ALLOCATION UPDATE

To provide Members with an update to how the Section 106 allocations process has historically worked and how it could more effectively work.
Pages 155 – 158

6. PROGRESS OF CORPORATE AND SERVICE GOVERNANCE ACTIONS

To consider a report detailing the progress of Corporate and Service Governance Actions.
Pages 159 – 180

7. MID YEAR REVIEW OF 2020/21 TREASURY MANAGEMENT STRATEGY

To consider a Mid Year review of the 2020/21 Treasury Management Strategy.
Pages 181 – 206

8. URGENT PART 1 BUSINESS

To consider any Part I business accepted by the Chair as urgent.

9. EXCLUSION OF PUBLIC AND PRESS

To consider the following motions –

1. That under Section 100A of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as described in paragraphs1 – 7 of Part 1 of Schedule 12A of the Act as amended by Local Government (Access to Information) (Variation) Order 2006.

2. That Members consider the reasons for the following reports being in Part II and determine whether or not maintaining the exemption from disclosure of the information contained therein outweighs the public interest in disclosure.

10. PART II MINUTES - AUDIT COMMITTEE - 10 SEPTEMBER 2020

To approve as correct record the Part II Minutes of the meeting of the Audit Committee held on 10 September 2020.
Pages 207 - 210

11. STRATEGIC RISK REGISTER

To note the latest Strategic Risk Register for Stevenage Borough Council and developments on risk management issues.
Pages 211 - 244

12. URGENT PART II BUSINESS

To consider any Part II business accepted by the Chair as urgent.

Agenda Published 9 November 2020

STEVENAGE BOROUGH COUNCIL

AUDIT COMMITTEE
MINUTES

Date: Thursday, 10 September 2020
Time: 6.00pm
Place: Virtual (via Zoom)

Present:	Councillors: John Gardner (Vice-Chair in the Chair), Sandra Barr, Laurie Chester and Graham Lawrence. Mr Geoff Gibbs (Independent Co-opted Member).
Start / End Time:	Start Time: 6.00pm End Time: 8.34pm

1 APOLOGIES FOR ABSENCE AND DECLARATIONS OF INTEREST

Apologies for absence were received from Councillors Teresa Callaghan (Chair) and Stephen Booth.

There were no declarations of interest.

2 MINUTES - 9 JUNE 2020

It was **RESOLVED** that the Minutes of the Audit Committee meeting held on 9 June 2020 be approved as a correct record and signed by the Chair.

In relation to Minute 4 – Public Sector Audit Appointments (PSAA) Annual Audit Fee Letter, the Strategic Director (CF) advised that all Hertfordshire Local Authorities with Ernst & Young as their external auditors had written to the PSAA expressing concerns about the proposed increased audit fee level for 2020/21.

3 SHARED ANTI-FRAUD SERVICES (SAFS) ANTI-FRAUD REPORT 2019/20 AND PROGRESS WITH DELIVERY OF 2020/21 ANTI-FRAUD PLAN

The Head of the Shared Anti-Fraud Service (SAFS) presented a report on the Anti-Fraud Plan 2019/20 and progress with delivery of the 2020/21 Anti-Fraud Plan.

The Head of SAFS referred to Appendix A to the report, which was the latest Government Strategy on Fighting Fraud and Corruption Locally. He commended this Strategy to the Committee.

In respect of the Covid-19 pandemic, the Head of SAFS advised that SAFS had continued to provide support to the Council, both in tackling a significant increase in cybercrime activities and in relation to SBC's small grants schemes, which were as risk of fraud.

With regard to the 2019/20 Anti-Fraud Plan, the Head of SAFS stated that all actions proposed for the year had commenced in-year, with the majority being completed. He drew attention to the SAFS Key Performance Indicators (KPIs) for 2019/20, which had been largely met. The two KPIs not met, namely allegations of fraud received/success rates for cases investigated and making better use of data to prevent/identify fraud (including implementation of the Herts Fraud Hub) had been carried over into 2020/21.

The Head of SAFS commented that, during 2019/20, SAFS had received 156 allegations of fraud affecting SBC services, with the report containing a breakdown of types of fraud reported and who had reported the fraud. The report also provided some case studies of a number of SAFS investigations.

The Head of SAFS referred to the proactive work undertaken by SAFS identifying fraud through the use of data, including Council Tax fraud. He then drew attention to the 2019/20 audit of SAFS carried out by the Shared Internal Audit Service, and was pleased to report that the service had achieved a Good level of assurance.

The Head of SAFS advised that Section 4 of the report contained the information/data required to be published by local authorities under the Government's Transparency Code, and concluded his presentation by referring to Appendix D to the report, which provided the SBC Reported Fraud statistics for 2019/20.

In response to Member's questions, the Head of SAFS stated:

- The National Fraud Initiative required, every two years, the upload of local authority fraud data in October to the Cabinet Office. The Cabinet Office provided a return to Councils the following February advising where fraud had been identified through data matching. There was often a delay in addressing the information provided by the NFI, with some service areas responding quicker than others. Officers were working to speed up this process in future years;
- He would contact SBC's Communications and IT Teams with a view to improving and simplifying the process for members of the public to report fraud, both through the Council's website and via the telephone;
- In respect of the achievement of 48% of fraud cases investigated and closed in 2019/20 against a target of 60%, he felt that this target was sufficiently challenging and allowed SAFS to concentrate its effort on delivering a significant level of savings for SBC; and
- The one grant application referred to in Paragraph 2.15 of the report that was the subject of suspected fraud was still under investigation.

It was **RESOLVED:**

1. That the Council's work to combat fraud in 2019/20 be noted.

2. That the performance of the Shared Anti-Fraud Service in meeting its Key Performance Indicators in 2019/20 be noted.

4 **JOINT ICT INVESTMENT STRATEGY - PRESENTATION ON PROGRESS**

The Strategic ICT Partnership Manager gave a visual presentation providing an update on the Joint ICT Strategy.

The Strategic ICT Partnership Manager advised that 80% of ICT capacity was spent delivering “business as usual”, including supporting 1,000 staff and Members (EHDC and SBC combined) and supporting over 2,000 devices and 150 systems/applications; carrying out scheduled maintenance of network and infrastructure; responding to the Covid-19 pandemic, such as remote working and deploying laptops; and handling major incidents.

The Strategic ICT Partnership Manager stated that the key focus of the current ICT programme was to ensure a stable platform, incorporating security, performance and resilience. He provided an update on the ICT Programme, including the Network upgrade; Virtual Desktop Infrastructure (VDI); Microsoft 365; Windows 7 to 10 upgrade; Windows server upgrade; Microwave link; and device upgrade and encryption. He then summarised the elements of the ICT programme which had been completed, including Meta-compliance (Cyber security); GCSX cessation; Windows server upgrades; Member laptop rollout; and e-mail and web filtering replacement.

The Strategic ICT Partnership Manager outlined the key risks facing the ICT service, including a potential second wave of Covid-19 (which may impact upon key project milestones); a possible delay to the Network upgrade project pending completion of additional work; and a knock on impact delaying other projects (such as VDI and Microsoft 365) should the network upgrade risk materialised.

The Strategic ICT Partnership Manager concluded his presentation by drawing attention to the budgetary position with the SBC share of the major ICT projects.

In response to a Member’s question, the Strategic ICT Partnership Manager stated that he was confident that the higher cost items in the Strategy would be delivered within budget. What was less quantifiable was, for example, the precise cost of upgrading up to 2,000 individual ICT devices.

The Chair requested that a further update presentation/report be submitted to the Committee in 6 months’ time (ie. to its March 2021 meeting).

It was **RESOLVED** that the presentation be noted.

5 **ANNUAL TREASURY MANAGEMENT REVIEW OF 2019/20 INCLUDING PRUDENTIAL CODE**

The Strategic Director (CF) presented a report on the Annual Treasury Management Review of 2019/20, including the Prudential Code.

The Strategic Director (CF) advised that, in 2019/20, the Council’s investment interest rates had remained low, due to low base rates. A rate of 0.75% had been originally estimated, which in March 2020 was cut to 0.25% and then 0.1%, due to the start of the Covid-19 pandemic. The Council's interest earned in 2019/20 was £624,000 (an average interest rate of 0.98%).

In respect of borrowing in 2019/20, the Strategic Director (CF) explained that there had been an unexpected increase of 1% in PWLB lending rates, although this was subsequently reversed for housing. This meant that the HRA could borrow at 1.54% over 20 years, compared to the targeted budget rate of 3.4%, with a resultant reduction in HRA spend. Much of the Council's borrowing (£169M) was longer term (10+ years), most of which related to the HRA Business Pln.

With regard to cash reserves, the Strategic Director (CF) commented that the chart in Paragraph 4.2.5.2 of the report showed how these were allocated at the end of March 2020. However, in 2020/21 there would be a draw down on balances of £3M due to the impact of Covid-19. The MTFS included an estimate that the total Covid-19 losses over the next few years could be in the region of £8M.

The Strategic Director (CF) referred to two land transfers set out in the report, one from the General Fund to the HRA and the other vice versa. In respect of the Council's projected external investment balances, she advised that the report showed a decline in these, although the Council was holding higher HRA balances deliberately, in order to take some borrowing due to the raising of the HRA debt cap, rather than the use of cash reserves.

In response to a Member's question regarding the Council's cash reserves, the Strategic Director (CF) confirmed that the vast majority of these were allocated, including £10M for Council Tax and Business Rates, the majority of the former being collected on behalf of HCC; £10M for restricted use capital receipts; £13M for Capital projects; £17M HRA balance for payment of debt; and £5M for HRA interest rate fluctuations.

In reply to another Member's question in respect of Government financial support to SBC throughout the Covid-19 pandemic, the Strategic Director (CF) stated that £1.2M had been received. The latest Government Income Guarantee Scheme including funding towards items such as lost car parking income, but excluded loss of income relating to Council Tax, Business Rates, Investments, all rents and Third Party Local Authority Leisure Providers (e.g. Stevenage Leisure Limited). She estimated that the Council may receive a further £1.5M to £1.7M of further Government support funding, bringing it to a maximum total of £3M, which was unlikely to cover 50% of SBC's overall losses during the pandemic. She was concerned that the Government's support funding was very much based on what had occurred since March 2020, and did not take into account the likely continued reduced income in 2021 and beyond.

It was **RESOLVED** that, subject to any comments from the Executive, the 2019/20 Annual Treasury Management Review be recommended to Council for approval.

6 URGENT PART 1 BUSINESS

The Chair accepted the following item of urgent Part I business.

Redmond Report

The Strategic Director (CF) outlined the major recommendations contained in the recently published Redmond Report, an independent review on the quality of local authority financial reporting and external audit. Consultation on the review ran from 17 September 2019 to 20 December 2019, and consultees included as external audit firms, the PSAA (the procuring body for local authority external auditors) and individual councils.

The Strategic Director (CF) explained the major recommendations, many of which would require primary or secondary legislation, and which were:

40% of auditors had failed to meet the statutory deadline in 2018/19, and this was considered to be a serious weakness in the ability of external auditors to comply with contractual obligations. The recommendation was that the deadline should revert back to the previous deadline of 30 September each year;

The creation of a new regulatory body (the Office of Local Audit & Regulation – OLAR), responsible for procurement, contract management, regulation and oversight. It would take on the work of the PSAA, Financial Regulatory Council and Comptroller & Auditor General;

There would be a resource implication of increased audit fees, as this new audit body would require about £5M a year for running costs;

There was recommendation for a simplified Statement of Accounts to allow comparison with the Council's budget. However, this would be in addition to the preparation of the formal Statement of Accounts, with a requirement for both documents to be audited;

The Annual Audit report would need to be submitted for approval to a Council Meeting (rather than the Statement of Accounts Committee);

A revision of the fee structure for local authority audit would be required, to ensure that adequate resources were deployed;

Audit firms with the requisite capacity and skills would no longer be excluded from bidding for local authority work; and

CiPFA and LASAAC would be required to review the statutory accounts with a view to the introduction of a standardised statement.

The Strategic Director (CF) advised that she would be submitting a full report on the Redmond Report to the next meeting of the Audit Committee. She undertook to arrange for Audit Committee Members to be sent a link to the Report on the Government's website.

7 EXCLUSION OF PUBLIC AND PRESS

It was **RESOLVED** that:

1. Under Section 100(A) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involved the likely disclosure of exempt information as described in paragraphs 1-7 of Part 1 of Schedule 12A of the Act as amended by Local Government (Access to information) (Variation) Order 2006.

2. Members considered the reasons for the following reports being in Part II and determined that the exemption from disclosure of the information contained therein outweighed the public interest in disclosure.

8 PART II MINUTES - AUDIT COMMITTEE - 9 JUNE 2020

It was **RESOLVED** that the Part II Minutes of the Audit Committee meeting held on 9 June 2020 be approved as a correct record and signed by the Chair.

9 QUEENSWAY NORTH PROJECT - FINANCIAL RISKS

The Assistant Director (Regeneration) presented a report and gave a visual presentation on the Queensway North Scheme, in particular the financial risks associated with the project.

The Assistant Director (Regeneration) and Strategic Director (CF) answered a number of Members' questions regarding the report.

The Chair requested that a further update report on the Queensway North project be submitted to the Committee in 12 months' time.

It was **RESOLVED:**

1. That the latest position of the project and the progress made to deliver the scheme be noted.

2. That the governance arrangements implemented to ensure the efficient delivery of the project be noted.

3. That the progress on mitigating key risks to the Council be noted.

10 STRATEGIC RISK REGISTER

The Committee received the Council's latest Strategic Risk Register.

The Performance & Resilience Officer updated the Committee on changes to key risks and answered Members' questions.

It was **RESOLVED:**

1. That the latest Strategic Risk Register (set out in Appendices A1 – A3 to the report) be noted.

2. That developments on risk management issues be noted.

11 URGENT PART II BUSINESS

None.

CHAIR

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Part I – Release
to Press

Stevenage
BOROUGH COUNCIL

Meeting: **AUDIT COMMITTEE**

Portfolio Area: Resources

Date: **17 November 2020**

THE REDMOND REVIEW: INDEPENDENT REVIEW ON THE QUALITY OF LOCAL AUTHORITY REPORTING AND EXTERNAL AUDIT

Authors –Clare Fletcher Ext No. 2933

Lead Officer – Clare Fletcher Ext No. 2933

Contact Officer –Clare Fletcher Ext No. 2933

1. PURPOSE

1.1. To update Members on the Redmond Review and advise Members of any impending changes to future Statement of Accounts and External Audit.

2. RECOMMENDATIONS

2.1. That the outcome of the review is noted by the Audit Committee.

2.2. That the views of the Council's Chief Finance Officer (CFO) are noted.

2.3. That the views of the Council's External Auditors are noted (Appendix B).

3. BACKGROUND

3.1. The Local Audit and Accountability Act 2014 (the 2014 Act) introduced a new Audit regime for local government to replace the previous arrangements, under which the Audit Commission performed that role.

3.2. In June 2019, Sir Tony Redmond was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting by the government and the Review examined the effectiveness of local audit under this new regime.

3.3 The purpose of the Review was not only to test the impact of external audit activity in local government but also to look, critically, at how this helps to demonstrate public accountability, particularly to service users and council taxpayers. In a similar context the brief of the Review extended to the issues of transparency in financial reporting of local authorities, with attention being directed towards whether the annual accounts and associated published financial information can be readily understood by the public.

3.4 The review included procurement, contract management and delivery of External Audits and the code of audit practice and regulation and accountability for performance. Whilst the focus of the Review was on local audit and public accountability there were a number of related factors which have contributed to the shape and nature of the findings. Such matters include: the breadth and complexity of International Financial Reporting Standards (IFRS); the role of the sponsoring department (MHCLG); and the current state of the local audit market. Local authorities include Councils, Police and Crime Commissioners (PCCs), Fire and Rescue Authorities (FRAs), and National Parks Authorities. NHS bodies are not local authorities and are outside the scope of this Review.

3.5 The Review received 156 responses to the Calls for Views and there were more than 100 interviews carried out.

3.6 The report is appended to this report at Appendix A.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1. Key recommendation -A new body, the Office of Local Audit and Regulation (OLAR), be created.

4.1.1 This body will manage, oversee and regulate local audit with the following key responsibilities:

- procurement of local audit contracts;
- producing annual reports summarising the state of local audit;
- management of local audit contracts;
- monitoring and review of local audit performance;
- determining the code of local audit practice; and
- regulating the local audit sector.

4.1.2 The current roles and responsibilities relating to local audit are discharged by a number of bodies who are:

- Public Sector Audit Appointments (PSAA); (to be transferred to the OLAR).
- Institute of Chartered Accountants in England and Wales (ICAEW);
- FRC/ARGA; and
- The Comptroller and Auditor General (C&AG) (to be transferred to the OLAR).

4.1.3 A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.

4.1.4 **CFO Commentary:** The current arrangements are disjointed and the role of the PSAA in mediating fee variations and arbitrating on fees has not been clear from a Stevenage perspective.

4.2. Key Recommendation: The governance arrangements within local authorities be reviewed by local councils.

4.2.1 **The external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year** , this is irrespective of whether the accounts have been certified; OLAR will decide the framework for this report, but as such this would mean the terms of the SOA committee would need to be reviewed and a report of the Council's Accounts from the External Auditors would go either to both the Audit Committee and Council or just the latter.

4.2.2 **Consideration being given to the appointment of at least one independent member**, suitably qualified, to the Audit Committee. The Stevenage Audit Committee has appointed a n independent member with related experience of Audit Committees.

4.2.3 **Formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually**. The Audit Partner meets with the CFO quarterly and there are scheduled meetings with the CE, but currently not the Monitoring officer. The Monitoring Officer writes a letter annually to the Auditors on governance and any legal issues that the External Auditors should be aware of, as part of their review of the accounts.

4.2 Key Recommendations for External Audit Firms and Fees

4.2.1 **All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority**. The CFO would welcome this as lack of understanding how Local Authority accounts work can put an onus on the finance team. In discussion with the Council's External Audit Client Lead, he has given assurances that EY provides LA specific training and understanding at all grades.

4.2.2 **The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.** The current system does not work for External Audit firms or Local Councils, the report does note that the fee system is not adequate. This is likely to mean fee increases but it is hoped by the CFO that this will be consistent across all councils.

4.2.3 **That quality be consistent with the highest standards of audit within the revised fee structure**. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions, this is welcomed by the CFO as the current position on this is not clear.

4.2.4 **Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work**. Increasing the number of Audit Firms capable of carrying out the audits must be seen as a way of ensuring competition and capacity in the market to complete Audits on time. The External Audit firms who responded to the review also stressed the need to ensure there is sufficient capacity and availability of public sector audit specialists. Just increasing the number of suppliers might improve competition but may not address the underlying issues in Redmond report and result in competition for those staff between more firms, which doesn't increase the number of LA specialists.

4.2.5 **The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.** This is seen by the CFO as a backward step, the Council has been able to meet the deadlines in completion of the accounts by end of May and that by putting the deadline for Audit back to the end of September, has an impact on other functions provided by the Finance service, such as budget monitoring and medium term planning and budget setting.

4.2.6 The Audit Companies welcomed this change as auditing all accounts in a two month window (including NHS clients) caused pinch points in resources in a narrow time frame. EY's responses to the consultation are summarised in Appendix B to this report.

4.3 Transparency of Financial Reporting

4.3.1 **A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts. (see Appendix 4a to the Redmond Review).**

4.3.2 The standardised statement should be subject to external audit, which will naturally increase the scale fee, however the CFO feels this was an opportunity missed to simplify the accounts, rather than overlay another document to make the accounts more transparent. The CFO raised the point with the Author of the report that the language used in the example given included wording which did not necessarily would be understandable to the 'person on the street'. It was expected that this statement would evolve. The example given has similarities with the SBC's outturn report to the Executive and this could be adapted to meet the changes required.

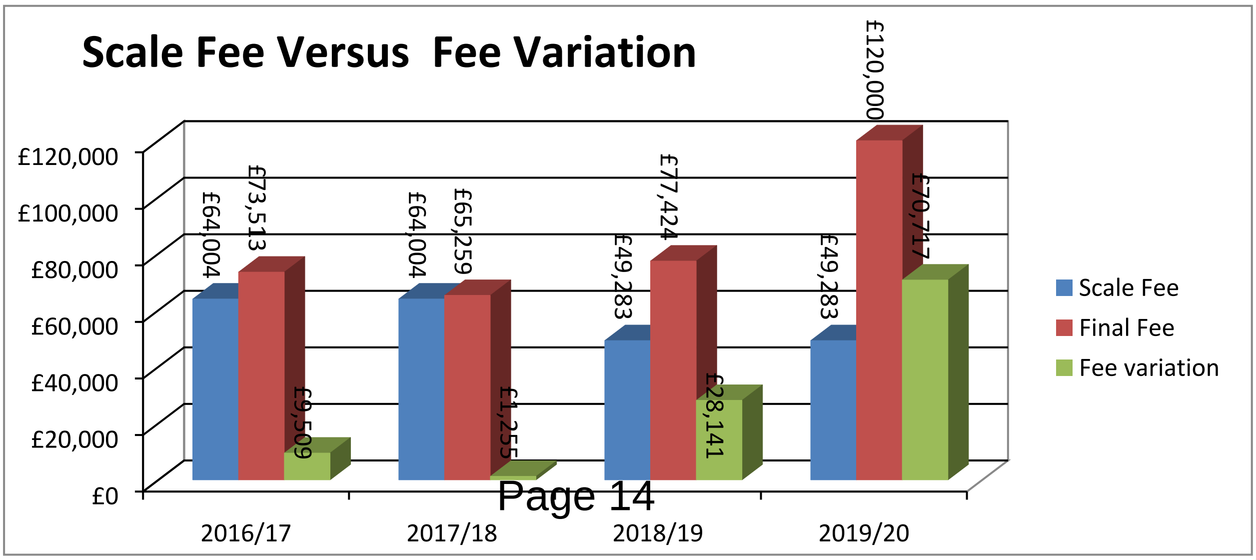
4.3.3 **Councils should consider the optimum means of communicating such information to council taxpayers/service users.**

4.3.4 **CIPFA/LASAAC be required to review the statutory accounts,** in the light of the new requirement to prepare the standardised statement, to determine whether there is scope to simplify the presentation of local authority accounts. The CFO considers this would be the optimum solution to the transparency issue, by removing disclosures that may no longer be considered to be necessary or applicable to LA's as opposed to the private sector.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 There will be financial implications of a revision to the fees, the audit of the additional simplify statement and financial resilience. The increase in fee variation is shown in the table below.



**2016 fee variation reduced by 50% by PSAA, 2018/19 Fee referred to PSAA*

5.1.2 The review identifies that the resource implications of the new regulatory body would amount to approximately £5Million per annum after taking into account the amount related to staff subject to transfer under the TUPE arrangements**.** This cost is likely to also increase fees.

5.2 Legal Implications

5.2.1 The review recommends the Monitoring Officer meets once a year with the Audit Partner. A letter of disclosure is completed by the Monitoring Officer as part of the closure of accounts.

5.2.2 The review will also require a review of the terms of the SOA Committee to determine whether the Accounts and the Annual Audit report both go to Full Council.

5.2.3 Some of the recommendations in the review require a change in legislation and cannot be implemented until then.

5.3 Policy Implications

5.3.1 None.

5.4 Equalities and Diversity Implications

5.4.1 The Council must have due regard to the requirements of the public sector equalities duty under the Equalities Act 2010.

5.4 Climate change

5.4.1 The SOA is heavily regulated in terms of the disclosures required. The Council has a Climate Change Strategy and items contained with the budget pertain to delivery of the Strategy.

6 BACKGROUND DOCUMENTS

None.

7 APPENDICES

Appendix A – the Redmond Report (including relevant annexes).

Appendix B – Ernst & Young's comments on the Redmond Report.

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Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting

Sir Tony Redmond
September 2020

This document/publication is also available on our website at www.gov.uk/mhclg

If you have any enquiries regarding this document/publication, complete the form at
http://forms.communities.gov.uk/ or write to us at:

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September 2020

The Rt Hon Robert Jenrick MP

Secretary of State for Housing, Communities and Local Government
Ministry of Housing, Communities & Local Government
2 Marsham Street
London, SW1P 4DF

Dear Secretary of State,

In June 2019, I was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. I am grateful for the opportunity given to me by ministers to conduct this Review. Whilst conducting the Review my guiding principles have been accountability and transparency. How are local authorities accountable to service users and taxpayers and how are auditors accountable for the quality of their work; and how easy is it for those same individuals to understand how their local authority has performed and what assurance they can take from external audit work.

This report sets out my conclusions. It makes detailed proposals for a new organisation with the clarity of mission and purpose to act as the system leader for the local audit framework; and for a standardised statement of service information and costs, compared to the annual budget, that is aimed at taxpayers and service users.

As I conducted my work, it became clear that the local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in the ability of auditors to comply with their contractual obligations. In addition, the ambition of attracting new audit firms to the local authority market has not been realised. Without prompt action to implement my recommendations, there is a significant risk that the firms currently holding local audit contracts will withdraw from the market.

It will be possible to achieve part, but only part, of what needs to be done without legislation. However, it is important to emphasise that to fully achieve the vision set out in the Review, primary legislation will be essential. Only this can give the new organisation the tools it needs to do its job and to rebuild the sustainability of the local audit market.

I should like to thank:

- First, all those stakeholders who have engaged with the Review and responded to the Review's Call for Views;
- Second, the excellent team which has supported the Review's work: Ollie Hulme, Joe Pilgrim, Beth Addison and Gareth Caller; and
- Third, all the members of the Review's advisory group: Lynn Pamment, Maggie McGhee, Professor Laurence Ferry, Catherine Frances, Vicky Rock, Richard Hornby and Mark Holmes. This formidable group provided much wise guidance and counsel, as well as lively challenge and debate, for which I am hugely grateful.

Responsibility for the Review's conclusions and recommendations, is however, mine and mine alone.

Sir Tony Redmond

Sir Tony Redmond

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Executive Summary

- This Review has examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It has also considered whether the current means of reporting the Authority's annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of the authority are sound. It is important to note that this Review encompasses not only principal local authorities but also PCCs, Fire and Rescue Authorities, Parish Councils and Meetings and Drainage Boards.

- The Review has received 156 responses to the Calls for Views and carried out more than 100 interviews. Serious concerns have been expressed regarding the state of the local audit market and the ultimate effectiveness of the work undertaken by audit firms. This is not to say that the audits are carried out unprofessionally but there remains a question of whether such audit reports deliver full assurance on the financial sustainability and value for money of every authority subject to audit. A particular feature of the evidence submitted relates to concern about the balance of price and quality in the structure of audit contracts.

- A regular occurrence in the responses to the calls for views suggests that the current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. To address this concern an increase in fees must be a consideration. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in the ability of auditors to comply with their contractual obligations. The current deadline should be reviewed. A revised date of 30 September gathered considerable support amongst respondents who expressed concern about this current problem. This only in part addresses the quality problem. The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process. Although there is some scope to effect alterations to the individual roles, appropriately fulfilled with the existing framework, this would not achieve the overriding objective of providing a coherent local audit function which offers assurance to stakeholders and the public in terms of performance and accountability of the local authority and the auditor.

- Consequently, a key recommendation is to create a new regulatory body responsible for procurement, contract management, regulation, and oversight of local audit. It is recognised that the new body will liaise with the Financial Reporting Council (FRC) with regard to its role in setting auditing standards. The engagement of audit firms to perform the local audit role would be accompanied by a new price/quality regime to ensure that audits were performed by auditors who possessed the skills, expertise and experience necessary to fulfil the audit of local authorities. These auditors would be held accountable for performance by the new regulator, underpinned by the updated code of local audit practice. A further recommendation is to formalise the engagement between local audit and Inspectorates to share findings which might have relevance to the bodies concerned.

- The Regulator would be supported by a Liaison Committee comprising key stakeholders and chaired by the Ministry of Housing, Communities and Local Government (MHCLG). The new regulatory body would be small and focused and would not represent a body which has the same or similar features as the Audit Commission.

- The report recognises that local audit is subject to less critical findings in respect of audit procurement and quality relating to smaller authorities. However, the recommendations include a review by Smaller Authorities' Audit Appointments (SAAA) of current arrangements relating to the proportionality of small authority audits together with the process for managing vexatious complaints where issues have been raised by those bodies which have experienced such challenges.

- Governance in respect of the consideration and management of audit reports by authorities has also been examined in considerable detail. Based on evidence presented, there is merit in authorities examining the composition of Audit Committees in order to ensure that the required knowledge and expertise are always present when considering reports, together with the requirement that at least an annual audit report to be submitted to Full Council. This demonstrates transparency and accountability from a public perspective which is currently lacking in many authorities.

- The issue of transparency is of equal relevance to the current presentation and publication of the annual accounts. Given that the feedback from practitioners and other key stakeholders revealed that current statutory accounts prepared by local authorities are considered to be impenetrable to the public, it is recommended that a simplified statement of service information and costs is prepared by each local authority in such a way as to enable comparison with the annual budget and council tax set for the year. This would enable Council taxpayers and service users to judge the performance of the local authority for each year of account. The new statement would be prepared in addition to the statutory accounts, which could be simplified. All means of communicating such information should be explored to achieve access to all communities.

- The outcome of this Review is designed to deliver a new framework for effective local audit and an annual financial statement which enables all stakeholders to hold local authorities to account for their performance together with a robust and effective audit reporting regime.

- Aside from the additional costs arising from a fee increase, the resource implications of the new regulatory body would amount to approximately £5m per annum after taking into account the amount related to staff subject to transfer under the TUPE arrangements.

- Implementation of recommendations contained in this Review would, in part, require regulatory or legislative change but it is important to note that many of the issues identified in this report require urgent attention, given the current concerns about local audit demonstrated in this Review.

Recommendations

The recommendations of this Review are as follows:

External Audit Regulation

1. A new body, the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit with the following key responsibilities:
    - procurement of local audit contracts;
    - producing annual reports summarising the state of local audit;
    - management of local audit contracts;
    - monitoring and review of local audit performance;
    - determining the code of local audit practice; and
    - regulating the local audit sector.

2. The current roles and responsibilities relating to local audit discharged by the:
    - Public Sector Audit Appointments (PSAA);
    - Institute of Chartered Accountants in England and Wales (ICAEW);
    - FRC/ARGA; and
    - The Comptroller and Auditor General (C&AG)

    to be transferred to the OLAR.

3. A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.

4. The governance arrangements within local authorities be reviewed by local councils with the purpose of:
    - an annual report being submitted to Full Council by the external auditor;
    - consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and
    - formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.

6. The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.

7. That quality be consistent with the highest standards of audit within the revised fee structure. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.

8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.

10. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.

11. The revised deadline for publication of audited local authority accounts be considered in consultation with NHSI(E) and DHSC, given that audit firms use the same auditors on both Local Government and Health final accounts work.

12. The external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year, irrespective of whether the accounts have been certified; OLAR to decide the framework for this report.

13. The changes implemented in the 2020 Audit Code of Practice are endorsed; OLAR to undertake a post implementation review to assess whether these changes have led to more effective external audit consideration of financial resilience and value for money matters.

Smaller Authorities Audit Regulation

14. SAAA considers whether the current level of external audit work commissioned for Parish Councils, Parish Meetings and Internal Drainage Boards (IDBs) and Other Smaller Authorities is proportionate to the nature and size of such organisations.

15. SAAA and OLAR examine the current arrangements for increasing audit activities and fees if a body's turnover exceeds £6.5m.

16. SAAA reviews the current arrangements, with auditors, for managing the resource implications for persistent and vexatious complaints against Parish Councils.

Financial Resilience of local authorities

17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.

18. Key concerns relating to service and financial viability be shared between Local Auditors and Inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's Annual Report.

Transparency of Financial Reporting

19. A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts.

20. The standardised statement should be subject to external audit.

21. The optimum means of communicating such information to council taxpayers/service users be considered by each local authority to ensure access for all sections of the communities.

22. CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope

to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary.

23. JPAG be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered:
    - Whether “Section 2 – the Accounting Statements” should be moved to the first page of the AGAR so that it is more prominent to readers;
    - Whether budgetary information along with the variance between outturn and budget should be included in the Accounting Statements; and
    - Whether the explanation of variances provided by the authority to the auditor should be disclosed in the AGAR as part of the Accounting Statements.

1. Introduction

1.1 The Local Audit and Accountability Act 2014 (the 2014 Act) introduced a new Audit regime for local government to replace the previous arrangements, under which the Audit Commission performed that role. This Review examines the effectiveness of local audit as now practised.

1.2 The purpose of the Review is to test not only the impact of external audit activity in local government but also to look, critically, at how this helps to demonstrate public accountability, particularly to service users and council taxpayers. In a similar context the brief of the Review extends to the issues of transparency in financial reporting of local authorities, with attention being directed towards whether the annual accounts and associated published financial information can be readily understood by the public.

1.3 The framework for local audit encompasses procurement, contract management and delivery, the code of audit practice and regulation and accountability for performance. All of these aspects of local audit have been examined in depth. Whilst the focus of this Review is on local audit and public accountability there are a number of related factors which have contributed to the shape and nature of the findings. Such matters include: the breadth and complexity of International Financial Reporting Standards (IFRS); the role of the sponsoring department (MHCLG); and the current state of the local audit market. Local authorities include Councils, Police and Crime Commissioners (PCCs), Fire and Rescue Authorities (FRAs), and National Parks Authorities. NHS bodies are not local authorities and are outside the scope of this Review.

1.4 It is also important to emphasise that the Review includes the functions of Police and Fire Services as well as Parish Councils and Drainage Boards and due regard has been paid to the specific requirements of these bodies, as appropriate.

1.5 Substantial evidence has been collated from the 'Call for Views' and individual stakeholder meetings and this has formed the basis of the Report's findings. The co-operation received from all interested parties including local government practitioners, audit firms, professional accounting bodies, academia and the media and the general public has been much appreciated. All parties who have participated in the Review share a desire to ensure local audit is effective and that public accountability is seen to be achieved. The approach to the Review has sought to harness those valuable contributions.

1.6 Attention has been paid to the findings of the Brydon and Kingman Reviews as well as the study carried out by the Competition and Markets Authority (CMA). Each of these reviews offers an insight into the principles and practices of auditors in the corporate sector, which have relevance to the public sector, including local government.

1.7 While testing the quality of outcomes has been a key feature of this approach, attention has been directed towards the governance arrangements in the way in which audit reports are managed and reported. The focus here has been on the level of public awareness of audit findings. Current practices relating to the annual publication of financial information have also been reviewed with an emphasis on the transparency, access and intelligibility of such reports.

1.8 In examining options for change to the current local audit arrangements, account has also been taken of the potential resource implications of any new initiative or development contained in the recommendations.

Sir Tony Redmond

Sir Tony Redmond

2. The direction and regulation of local audit

2.1 Introduction

2.1.1 The direction and regulation of local audit must be structured as to enable public accountability to be served. Each stage of the local audit process must adhere to this and remain consistent throughout. Ultimately, the direction and regulation of audit must be coherent, consistent in quality monitoring and fulfil the public accountability principle. The test, therefore, is whether the current arrangements deliver that, or can be altered to achieve that, or whether a new structure for the local audit regulatory framework needs to be put in place.

2.1.2 Public Interest Reports may be seen as relating to the local community's serious concern, but these are rarely used. In any event, council taxpayers are entitled to know the outcome of the annual statutory audit whether it be positive or negative.

2.2 Overview of the Regulatory Framework

2.2.1 The 2014 Act split the responsibilities formerly carried out by the Audit Commission between a range of bodies. **Figure 2.1** summarises the entities that have a significant role or influence on the accounting, audit and governance framework within which local authorities operate.

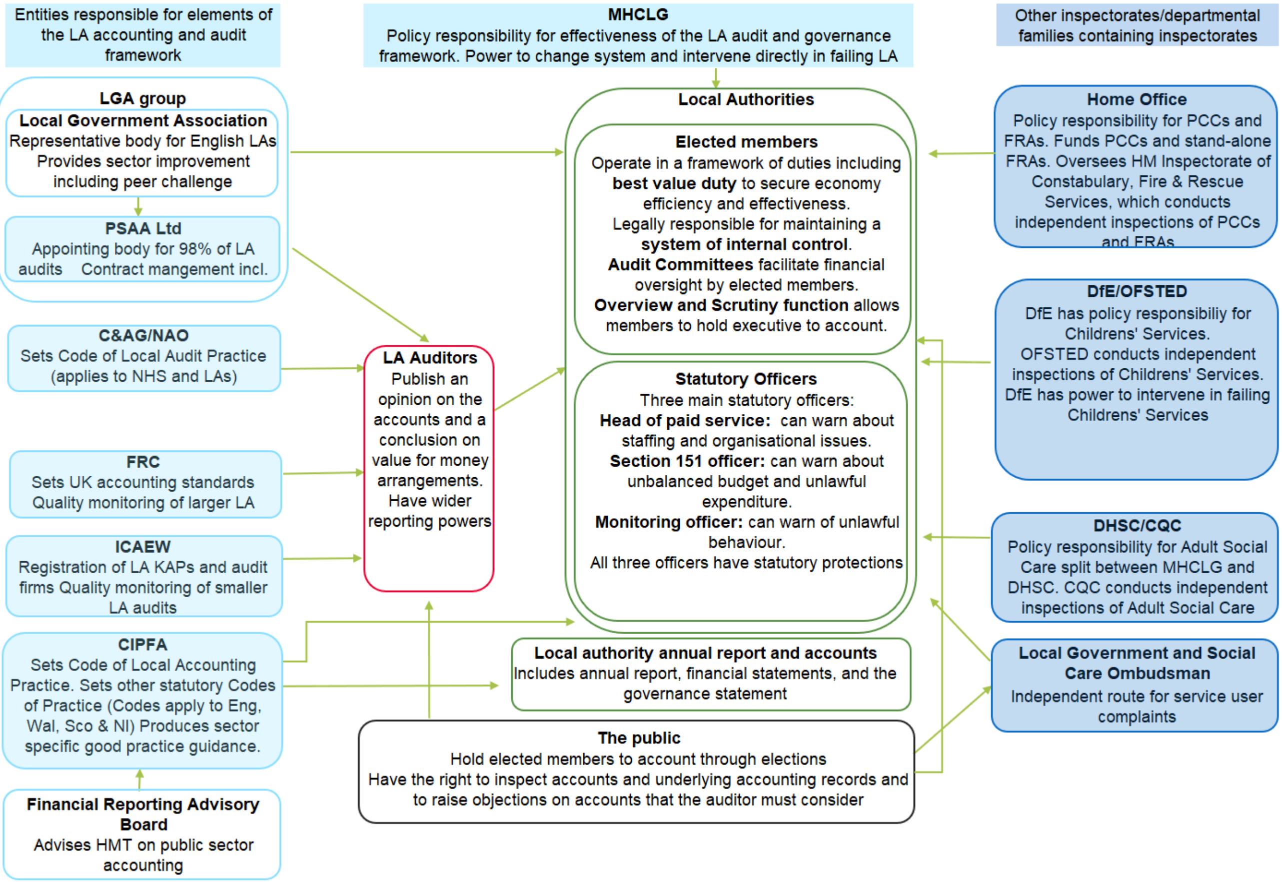
2.2.2 Currently there are six different entities with a statutory role in overseeing and/or regulating elements of the local authority accounting and audit framework. This framework is further complicated by the fact that different elements apply to different sectors. The elements of the audit framework undertaken by the C&AG, FRC and the ICAEW apply jointly to the local authorities and NHS bodies in England. However, whereas PSAA is the appointing body for 98% of local authority audits, NHS bodies do not have an appointing body and as such appoint their own auditors. By comparison the accounting framework applies to local authorities in England, Scotland, Wales and Northern Ireland, but not to the NHS.

2.2.3 Another challenge is that the local authority sector is not the main focus for some of the regulatory bodies; specifically:

- The C&AG and National Audit Office's (NAO's) responsibilities relate mainly to holding central government departments to account on behalf of Parliament.
- The vast majority of the FRC's and the ICAEW's work relates to the private sector, and in the FRC's case, to regulating the audit and corporate governance arrangements within listed companies known as Public Interest Entities ("PIEs").

2.2.4 Finally, none of the six entities with responsibility for the different elements of the framework has a statutory responsibility, either to act as a system leader or to make sure that the framework operates in a joined-up and coherent manner. Although various ad hoc forums have been set up to share information, it is not clear how the membership and remit of these has been agreed. As a result, the lack of co-ordination and the lack of a system leader is widely recognised as a weakness in the framework by most of the stakeholder groups.

Figure 2.1
The Local Authority Governance, Audit and Accounting Framework 2018-19



Notes
1. Adapted from Figure 1 in NAO report *Local Authority Governance* (Jan 2019)
2. There are other statutory officers in local authorities, but between them, the three listed have overall responsibility for effective goverance
3. Arrows show the influences on local authority governance arrangements
4. In a Police and Crime Commissioner or Fire and Rescue Authority, the Commissioner is the sole elected member; in a Mayoral Combined Authority, the mayor is the sole
5. Audit Committees are mandatory in PCCs, stand-alone FRAs and mayoral combined authorities. They are not mandatory for other LAs.
6. ICAS also has the power to act as a registering body for KAPs and audit firms. However, following mergers, no firms active in England are currently registered with ICAS.
7. MHCLG part funds the LGA's sector improvement work

2.3 Functions of the bodies responsible for the framework

PSAA Ltd

2.3.1 One of the original objectives behind the 2014 Act was to widen participation in the local audit market by allowing local authorities to appoint their own auditors. Once the Act had passed, it became clear that the auditor appointment provisions in the 2014 Act were onerous and there was little appetite amongst local authorities to appoint their own auditors. As a result, MHCLG ran a tender exercise to identify an entity which would act as an appointing person for local authority audits.

2.3.2 PSAA, a new company set up by the Local Government Association (LGA), was the only bidder and accordingly was designated as an appointing person under legislation. Under the transitional arrangements, PSAA was given the responsibility of managing the framework contracts let by the Audit Commission in 2012 and 2014, and during the period to 2017-18 producing a report summarising the results of local authority and NHS audits.

2.3.3 Category 1 Authorities[1] were given the choice of opting in or out of the PSAA arrangements. Most (currently 98%) chose to opt in.

2.3.4 In 2017 PSAA let the new local audit framework contracts, active from the 2018-19 financial year. PSAA's current responsibilities[2] are:

- To perform the functions of an appointing person for local authority audits;
- To take steps to ensure that public money is properly accounted for and protected;
- To oversee the delivery of consistent high quality and effective audit services; and
- To ensure effective management of audit contracts.

More detail on the contracting process and on audit quality is contained in **Chapters 3 and 4** respectively.

The C&AG and the NAO

2.3.5 The C&AG is responsible for laying the Code of Local Audit Practice in Parliament. The C&AG is supported in this work by a small Local Audit Code and Guidance (LACG) team, which is part of the NAO. The LACG team is responsible for the preparation, maintenance and publication of the C&AG's Code of Audit Practice and supporting guidance to auditors. LACG undertakes the full range of activities associated with these responsibilities including:

- providing a point of contact to address significant issues raised by auditors and other stakeholders that may require the update of the Code of Audit Practice or issuing guidance to auditors; and
- facilitating timely engagement with, and advice to, auditors and other stakeholders to facilitate consistency of approach on significant issues – for example, through convening and providing secretariat support to a Local Auditors Advisory Group.

2.3.6 The 2014 Act provides the C&AG with the power to issue guidance to auditors which may explain or supplement the provisions of the Code of Audit Practice. The Act requires auditors to have regard to such guidance. The NAO maintains a series of Auditor Guidance Notes (AGNs) to support auditors in their work and facilitate consistency of approach between auditors of the same types of entity. The 2015 Code is supplemented by seven AGNs. These apply equally across local government and the NHS. The AGN on value for money arrangements is supplemented by sector specific supporting information.

2.3.7 The 2014 Act gives the C&AG the responsibility for undertaking value for money investigations on local government. However, the C&AG does not have the power to make recommendations directly to local authorities. This means that when a value for money study finds that one or more local authorities have breached either the letter or the spirit of the statutory framework, the accompanying recommendations must be addressed to MHCLG or Treasury, if they relate to the Public Works Loan Board, as the responsible central government departments.

[1] "Category 1 authority" means a relevant authority that either— (a) is not a smaller authority; or (b) is a smaller authority that has chosen to prepare its accounts for the purpose of a full audit in accordance with regulation 8 of the Smaller Authorities Regulations
https://www.legislation.gov.uk/uksi/2015/234/pdfs/uksi_20150234_en.pdf

2.3.8 The main roles of the C&AG and the NAO are to support Parliament in holding government to account, through auditing the accounts of government departments and arms-length bodies and undertaking value for money investigations. When the NAO undertook the 2019 study on Local Authority Governance, which included work on local authority audit, the team did not include the Audit Code within the scope of the review. This was to avoid the risk of self-review. As a result, the findings of that report could not take account of an element of the governance framework.

The Financial Reporting Council

2.3.9 The FRC is responsible for issuing standards and guidance to auditors for use in the UK. The suite of standards is known as *International Standards on Auditing (UK)*, and apply equally to audits of local authorities and entities in other sectors.

2.3.10 During the transitional arrangements operating from 2015-16 to 2017-18, the FRC had no formal responsibility for assessing the quality of local authority audit. PSAA took the decision to contract the FRC to undertake six quality assurance reviews of local authority audits, with coverage of at least one from each firm. In practice, the FRC conducted quality assurance reviews of seven audits in both 2016-17 and in 2017-18. This is because the FRC's methodology requires them to re-review all audits that received an unsatisfactory quality assurance review score in the prior year. The results of these quality reviews are discussed in **Chapter 4**.

2.3.11 From 2018-19, the FRC has taken on statutory responsibility for quality assurance reviews of the 230 larger local authority audits. It treats the NHS and local government bodies as a single population and, to maintain equivalence with their coverage of the audit of PIEs, look to cover at least 5% of that population in each year. For 2018-19, the sample included 3 NHS bodies and 12 local authorities. Because some of the audits originally selected for quality review were not complete when the FRCs Audit Quality Review team conducted its fieldwork, these had to be replaced with other audits. The results of the 2018-19 quality assurance reviews are expected to be available in the Autumn of 2020.

2.3.12 The methodology adopted for quality assuring audits in local authority sector is broadly equivalent to that of the Public Interest Entities sector. The review team focuses on what is on the audit file and assesses the extent to which that complies with the applicable quality framework. The document review is supplemented by meetings with the audit team and the Chair of the Audit Committee.

2.3.13 Formal client communications are included within the scope of the quality review. However, ongoing liaison between auditors and local authorities would be assessed only if included on the audit file.

2.3.14 Unlike for PIE audits, the FRC does not have the power to fine audit firms if the quality of their local authority audits proves to be deficient. However, all of the firms active in the market indicated that they are very conscious of the reputational damage of a poor rating from the FRC for one of their local authority audits.

2.3.15 FRC is of the view that the perception that it focuses mainly on asset valuations understates the scope of their quality reviews. It also believes that if a focus on asset and pension valuations is inappropriate, this is the responsibility of the partnership between CIPFA (England, Northern Ireland and Wales) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) known as CIPFA/LASAAC to resolve, through modifications to the Accounting Code.

2.3.16 The FRC is in the process of being reconstituted as the Audit Reporting and Governance Authority (ARGA) in line with the recommendations made in the Kingman Review. Sir Donald Brydon also recently published a report that made a number of recommendations to develop corporate auditing as a profession. As the FRC and the Department for Business, Energy & Industrial Strategy (BEIS) consider these recommendations, there is a risk of divergence between the focus and methodologies used to quality assure external audit engagements. Managing this interaction will require ongoing engagement.

ICAEW

2.3.17 The ICAEW has two statutory functions. Since 2015 it has been responsible for maintaining the register of audit firms and Key Audit Partners (KAP) authorised to sign off local authority audits; and since 2018-19 it has been responsible for quality assurance reviews of the 313 smaller local authority audits. The framework for approving firms and partners is tightly controlled by legislation.

2.3.18 Like the FRC, the ICAEW treats local authorities and NHS bodies as a single population for quality assurance review purposes. The 2018-19 quality assurance process is ongoing. ICAEW has selected 15 audits for quality assurance review, split roughly two thirds local government and one third health. The results of this quality assurance review process are not yet available.

2.3.19 Similarly to the FRC, the ICAEW quality assurance reviews focus on what is on the audit file and assesses the extent to which that complies with the applicable quality framework. The methodology used to assess the audits of English local authorities is the same as is used to assess audits undertaken by the Auditor General for Wales. This methodology does not require review teams to meet with Audit Committee chairs. As with the FRC, the ICAEW does not have any powers to fine or otherwise sanction auditors whose audits do not meet appropriate quality standards.

2.3.20 ICAEW and the FRC liaise to make sure that all audits fall within one or other of their sample populations and use, broadly, the same quality ratings. Both use well established methodologies to arrive at those ratings.

CIPFA

2.3.21 CIPFA has a dual role. It has been given the statutory responsibility for producing many of the finance related codes of practice that local authorities are required to observe. At the same time, it is a professional institute that represents the majority of accountants working in the local government sector, including most CFOs.

2.3.22 The Accounting Code is prepared by a small secretariat employed by CIPFA who report to the CIPFA/LASAAC Accounting Code Board ("CIPFA/LASAAC"). CIPFA/LASAAC is responsible for preparing, maintaining, developing and issuing the Code of Practice on Local Authority Accounting for the United Kingdom. Its membership primarily comprises accounts preparers representing the different types of authorities in England, Scotland, Wales and Northern Ireland, the Supreme Audit Institutions, and a representative of one of the external audit firms active in the sector in England. The FRC along with representatives of MHCLG and the Scottish, Welsh and Northern Irish governments have observer status on CIPFA/LASAAC.

2.3.23 In England CIPFA/LASAAC is supported by a CIPFA facilitated Local Authority Accounting Panel, which focuses on local government accounting and financial reporting issues and produces guidance for practitioners.

2.3.24 The Accounting Code could be characterised as long and complex. Part of the reason for this is the challenge of writing a Code that covers four countries, each of which has its individual statutory framework with a different set of statutory adjustments and disclosures. In addition to this, CIPFA has taken the decision to draft a highly prescriptive Code that provides detailed guidance on the correct accounting for each class of transactions. An alternative approach would be to draft a principles-based Code, which requires local authorities to comply with generally accepted accounting practice ("GAAP") and only provides detailed guidance where GAAP is adapted or interpreted, specifically for the local authority context. **Chapter 7** covers the accounting framework in more detail.

Assessment of whether an existing body could act as the system leader

2.3.25 The detailed analysis of the bodies responsible for the framework supports the conclusion reached in Sir John Kingman's Independent Review of the Financial Reporting Council:

"*The structure is fragmented and piecemeal. Public sector specialist expertise is now dispersed around different bodies. The structure means also that no one body is looking for systemic problems, and there is no apparent co-ordination between parties to determine and act on emerging risks*"[2]

2.3.26 The Kingman Review recommended that the fragmented structure be resolved by designating a single body as the system leader. When asked whether an existing body or a new body would be best placed to take on the role of a system leader, 82% of respondents expressed a preference for a single regulatory body. Many stakeholders who were interviewed also agreed. The other suggestions made were either that the C&AG or the FRC should take the role of system leader.

2.3.27 The C&AG clearly has the relevant experience and expertise to take on such a role. However, taking on responsibility for an element of a framework that is the policy responsibility of a government department could significantly increase the risk of a conflict of interest with the C&AG's main responsibility, which, as already stated, is to hold government departments to account on behalf of Parliament.

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[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

2.3.28 As the regulator for the audit profession in the UK, the FRC will continue to have an important role in setting standards for all external auditors, including those working in local public audit. However, the FRC's main focus is corporate sector external audit, and to be fully effective the system leader for local public audit will need to demonstrate detailed expertise and a clear focus on that sector.

2.4 Interactions with other inspectorates

2.4.1 There are a number of other inspectorates who cover the local authority sector. Ofsted and the CQC assess the effectiveness of children's services and adult social care respectively in authorities with those statutory responsibilities; HM Inspectorate of the Constabulary and Fire and Rescue Services (HMICFRS) undertakes independent inspections of PCCs and FRAs covering both service delivery and financial planning; the Local Government and Social Care Ombudsman (LGSCO) looks at individual complaints against councils, all adult social care providers in both public and private sector, FRAs, and some other organisations providing local public services; and the Independent Office for Police Conduct performs the same function for PCCs.

2.4.2 Evidence suggests that where a local authority receives an "Inadequate" rating for its children's services, the auditor as a general rule qualifies the value for money conclusion. For example; when PSAA published its summary report on the results of 2017-18 audit work, it listed 32 qualified Value for Money (VfM) opinions; half of these were due to an "inadequate" Ofsted rating[3]. The auditor's value for money conclusion remains qualified until a future Ofsted inspection finds that children's services are no longer "Inadequate". Local authorities questioned the benefits of including Ofsted judgements in the audit report. The circumstances supporting an "inadequate" Ofsted rating are fully explained in a detailed and publicly available report. In the light of this there is a question as to how qualifying the VfM opinion solely for this reason fully reflects the governance arrangements within the authority that could be brought to the attention of elected representatives and other key stakeholders. When asked whether a value for money opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate, 97% of respondents thought that it should not. There is no evidence of reports by other inspectorates leading to modifications to the auditor's opinion.

2.4.3 We have been told by external audit firms and local authorities that external auditors utilise inspectorate reports on a case by case basis. There is little evidence of any additional dialogue between external audit and other inspectorates to discuss inspectorate reports or take into consideration any improvements that a local authority may have made since an inspectorate rating had been issued. This is a change from practice since prior to 2015, where external auditors and inspectorates liaised much more frequently. Whilst external audit firms were broadly in agreement that there should be engagement with inspectorates, many felt that the current arrangements were sufficient.

[3] Report on the results of auditor's work (Oct 2018) – list of qualified opinions will not include LAs where the 2017-18 audit was concluded after the PSAA report was published.

2.4.4 Whilst recognising that each inspectorate focuses on a different area, there is a question as to whether more liaison may add value. Many examples of service delivery and financial failures are underpinned by weaknesses in governance and senior leadership. Given this, it may be valuable for the auditor or an inspector that has concerns, to find out if those concerns are reflected in other areas of a local authority's business or indicative of wider financial resilience issues.

2.5 The role of MHCLG

2.5.1 The Ministry of Housing, Communities and Local Government (MCHLG) has a statutory role in regulating and monitoring the financing and service delivery of local government. The Accounting Officer within the Department has responsibility for overall expenditure control within local authorities given the funding regime under which the sector operates. In addition, he has policy responsibility for the effective operation of the local authority audit and accounting framework.

2.5.2 Support to the Accounting Officer in fulfilling these responsibilities is split between two directorates:

- Local Government Finance; and
- Local Government and Communities (formerly Local Government Policy)

Local Government Finance

2.5.3 This Directorate covers payments to local authorities through the grant system, has responsibility for business rates and council tax policy, oversees borrowing, capital and fiscal arrangements and is responsible for assessing the financial sustainability of local government. When a local authority experiences financial difficulty, it is the Local Government Finance Directorate that usually leads the government response. It also provides the MHCLG representation on CIPFA's accounting panels.

Local Government and Communities

2.5.4 This Directorate has overall responsibility for MHCLG's local government assurance framework as set out in the Accounting Officer's system statement. Regular advice is given to the Accounting Officer on whether the framework for which he is responsible is operating effectively.

2.5.5 The directorate includes a team that maintains a view of local authorities where concerns exist about financial resilience, service delivery or officer/member conduct issues. In appropriate circumstances this may lead to statutory interventions into local authorities or, alternatively, statutory support. Qualified audit opinions are considered a part of this view.

2.5.6 Another team has responsibility for the local audit policy framework, the 2014 Act and the Accounts and Regulations 2015, managing relationships with PSAA, SAAA, NAO, ICAEW, Institute of Chartered Accountants of Scotland (ICAS) and FRC insofar as their activities relate to the local audit framework and logging Public Interest Reports.

2.5.7 In 2014 the team responsible for local audit set up a Local Audit Delivery Board to support implementation of the 2014 Act. In 2018, it became the Local Audit Monitoring

Board, with revised terms of reference and expanded membership. The Board comprises representatives of relevant departments and framework bodies to facilitate sharing of information about the operation of the framework. This Board is a consultative body, that holds meetings in private and has no formal powers or remit.

2.5.8 In viewing these roles from a local authority perspective, it is clear that MHCLG provides a national oversight of the financing of local government, capital and revenue spending, accounting arrangements and financial resilience. This work is substantial and seeks to offer assurance regarding the financial stability of individual local authorities and it includes, within its brief, responsibility for testing adherence to legislation and regulations governing local audit.

2.5.9 The responsibility for regulating local audit sits elsewhere yet MHCLG has a key role in offering assurance about the financial health of local authorities. The intelligence network and information flow relating to accounting and audit reporting on financial sustainability should reach MHCLG in a structured, timely and coordinated fashion. Given the strategic roles that the Department and The Accounting Officer carry it is crucial that systems and procedures are in place to enable this to happen. Clarity, coherence and consistency in fulfilling the Department's role are key to helping to ensure effective local audit.

3. Procurement of local audit

3.1 Statutory framework and eligibility criteria

3.1.1 In order to bid for a local authority audit, both audit firms and every individual responsible for signing off an audit opinion, typically but not always a KAP, needs to be pre-approved either by ICAEW or ICAS. Eligibility criteria are set out in Schedule 5 to the 2014 Act. These criteria stipulate that it is impossible to bid for local authority audits unless both the firm and each nominated KAP has recent experience of undertaking local authority audits. It is difficult for new entrants to enter the local authority market as a consequence of these criteria as audit firms not currently in the market are unable to gain the relative knowledge and expertise that would be required to become a KAP.

3.1.2 Despite the high barriers to entry, since 2016 there has been a 7% increase in the number of KAPs eligible to sign off local authority Audits. Firms active in the market continue to register new KAPs. 39% of KAPs currently registered were not KAPs in 2016, with the firms with a smaller market share being responsible for much of this increase. However, the headline KAP figure is slightly misleading. The number of KAPs has declined by 13% once those who are working for firms who do not currently hold contracts with PSAA are excluded.

Figure 3.1

Number of Key Audit Partners registered with ICAEW

Firm	2016	2020
BDO	5	7
EY	13	16
GT	32	26
Mazars	4	10
KPMG	22	23
Deloitte	6	8
Total KAPs (Firms holding contracts with PSAA)	76*	67*
Cardens	0	1
Moore Stephens	2	0
PWC	12	9
Scott-Moncrieff	0	3
Total KAPs	96	103

** Deloitte did not hold any PSAA contracts in 2016. KMPG does not currently hold any PSAA contracts.*

3.1.3 There is a risk that the Competition and Markets Authority: Statutory Audit Services Market Study[4] recommendation to implement an operational split between the Big Four's audit and non-audit businesses, to ensure maximum focus on audit quality will further reduce the number of KAPs qualified to sign off local authority audits. KAPs may be responsible for a mixture of external audit, internal audit and consultancy engagements. If required to choose between specialisms, there is, of course, no guarantee that they will opt for external audit.

[4] See Annex 5 for a more detailed analysis of the potential impacts of the CMA, Kingman and Brydon recommendations for local audit.

3.2 The 2017 procurement process

3.2.1 As detailed in **Chapter 2**, PSAA took over the administration of the bulk audit contracts let by the Audit Commission in 2014. These ran from 2015-16 to 2017-18. They comprised five lots let on a regional basis. In 2017 PSAA ran a new procurement to contract for local authority audits for the period 2018-19 to 2022-23.

3.2.2 PSAA chose to split lots by market share rather than on a regional basis. The reason for this was a concern that some regions could prove less popular with bidders than others. They also checked for potential conflicts of interest. Five lots comprising between 40% and 5% of the total market were let, each for a period of five years. No firm could win more than one lot. A sixth lot with no guaranteed work was let, with the aim of providing some resilience in the market.

3.2.3 Local authorities were notified of the lot to which they had been allocated and were given the opportunity to request transfer to a different lot; for example, if they were in a shared service arrangement with an authority in a different lot. Seven local authorities asked for their audit to be transferred to a different lot. Five of these requests were accepted.

3.2.4 Of the nine firms registered to undertake local authority audits seven bid for one or more lots. One firm decided not to bid and a second was excluded from the bidding process by PSAA because it felt the firm was too small to have a realistic chance of submitting a competitive bid.

3.2.5 Assessment of audit firms was split 50:50 between price and quality, compared to the final Audit Commission procurement which was done on a price quality ratio of 60:40. The team assessing quality scores was not given sight of the price each firm had bid. In addition, PSAA asked an ex-District Auditor working for the LGA to quality assure the assessors' quality scores. The assessment of quality was based solely on the tender documents submitted. Past performance was not considered.

3.2.6 One of the firms bid at a much higher price point than the other firms. This generated such a low "price" score that it was effectively impossible for its quality score to make up sufficient difference to win a lot.

3.2.7 Although the headline quality price ratio was 50:50, as highlighted in **Figure 3.2**, many of the questions included in the quality score do not directly relate to factors impacting audit quality.

3.2.8 Four firms bid for the largest two lots (including the firm who priced themselves out of the market); and six for the remaining four lots. Each successful firm was eliminated from consideration for each smaller lot, leaving only two firms from which to choose when awarding Lot 5.

3.2.9 After excluding the firm that priced itself out of the market, the firms awarded the five contracts were those with the highest quality scores. The firm with the highest quality score won the largest lot; the second highest quality score the second highest lot; and there was a marginal difference between the quality scores for the other successful firms.

Figure 3.2: Audit Quality Questions – PSAA tender document

Question number	Question	Weighting	Maximum weighted score
1.1 and 1.2	Confirmation of information in SQ Response; and other declarations; Guarantee (if applicable) and completed, unqualified Form of Tender	N/A	N/A
2.1	Identifying and addressing risks and issues and engaging with different stakeholders	0.5	5
2.2	Continuing professional development	0.2	2
3.1	Providing a clearly articulated audit plan to address the risks identified, and arrangements for carrying out the planned work effectively	1	10
3.2	Information assurance	N/A	N/A
4.1	Quality assurance arrangements to ensure that local audits are undertaken to a consistently high standard	0.6	6
5.1	Schedule of staff	N/A	N/A
5.2	Details of resourcing	0.5	5
5.3	Details and role of Contact Partner	0.3	3
6.1	Selection of a team to work on an individual audit	0.5	5
6.2	Arrangements for discharging statutory reporting responsibilities under the Local Audit and Accountability Act 2014, managing authority and public expectations	0.4	4
7.1	Arrangements to ensure a smooth transition for audits of local government bodies transferring between audit firms	0.5	5
8.1	Opportunities to be commenced and completed	0.3	3
8.2	Other economic, social and environmental initiatives to be undertaken	0.2	2
Overall quality score			50
Price	Ranking of Bid Rate %	1	50%
Overall score (quality and price combined)			

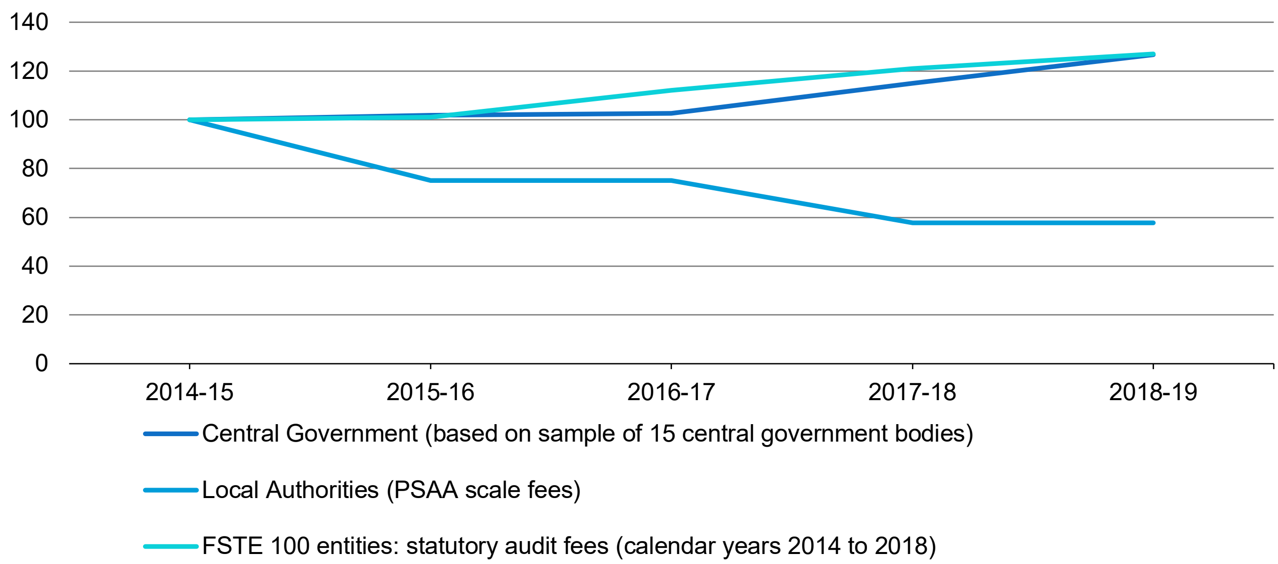
Questions 2.1, 3.1 and 4.1 are direct indicators of quality.

3.2.10 Lot six was designed to provide spare capacity in the market. However, this has not worked as intended, in part because mergers mean that the firm that won Lot 6 no longer exists.

3.2.11 As demonstrated by **Figure 3.3**, audit fees in the local authority sector have dropped significantly at the same time that audit fees in other sectors have significantly risen. As well as the overall external audit fee paid by the sector declining in cash terms it has also dropped as a percentage of net current expenditure of local authorities, from 0.05% in 2014-15 to 0.04% in 2018-19. Within the sector there are further variations with PCCs and Local Authority Pension Funds typically paying much lower audit fees as a percentage of net expenditure than other types of local authorities.

Figure 3.3

Sector by sector comparison of change in audit fees over time



Notes

1 2014/15 base 100

3.3 Translating bids into audit fees paid by LAs

3.3.1 PSAA told the Review that the scale fee paid by individual LAs under the current contracts has been calculated by taking the total annual fee paid to external auditors under the contract and adding PSAA's margin; comparing the total amount paid to the total amount paid under the 2014 contracting process; and applying the percentage reduction in total amount paid equally across all local authority audits.

3.3.2 The Audit Commission adopted the same approach for allocating fees to individual local authorities when it let the 2012 and 2014 contracts. This means that no assessment of the amount it would cost to audit each local authority based on their level of audit risk has been made in the past ten years.

3.3.3 Since 2010, there have been changes to the major powers and duties of local authorities and to the business environment within which they operate. Individual local authorities will have been impacted by these changes to differing extents. As a result, there is no guarantee that the fee paid by each local authority accurately reflects the risk profile or amount of audit work required for their external audit.

3.3.4 88% of local authorities who responded to the Call for Views think that the current procurement process does not drive the right balance between cost reduction, quality of work, volume of external auditors and mix of staff undertaking the work.

3.3.5 Audit fees for those local authorities who have opted out of the PSAA arrangements have changed in a way similar to fees for those who have opted in.

3.4 Fee variations and contract management

3.4.1 When an auditor requests a fee variation, this must be agreed by PSAA[5]. In practice, PSAA may challenge fee variations by asking for more information from the firm but expects the auditor and the local authority to come to an agreement as to the additional fee to be paid. PSAA records and monitors this activity. It may also facilitate a conversation between the auditor and local authority in the case of disagreement.

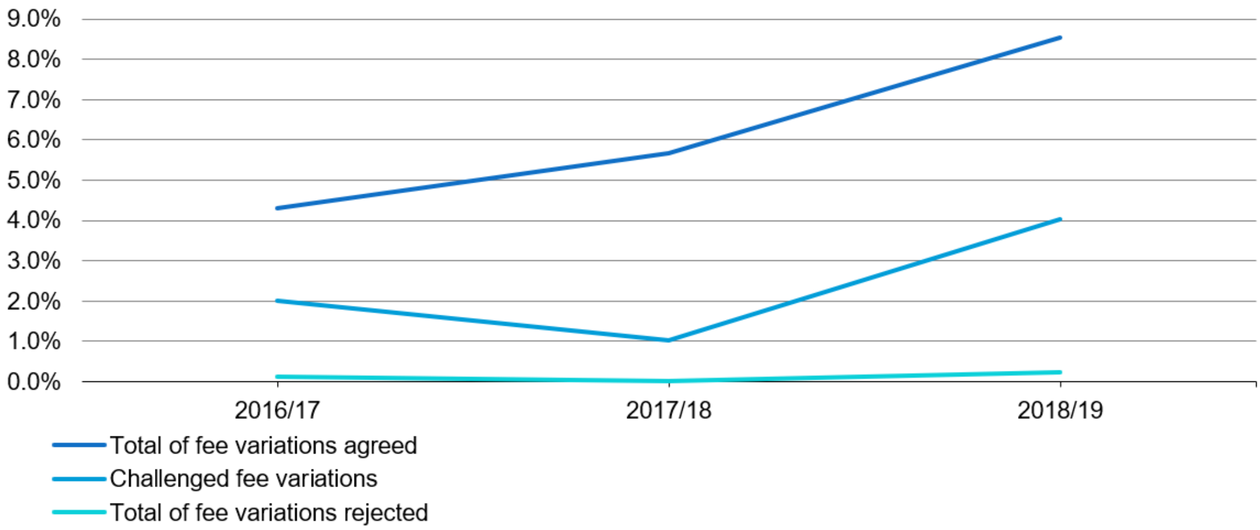
3.4.2 As demonstrated by **Figure 3.4** the number and size of fee variation requests have increased over time. Fee variation requests are often received some months after audits are completed, which means it is difficult to assess the true level of fees paid by the sector. As delayed audits are more likely to generate issues that require more work and thereby attract fee variations, and some firms are not always prompt in submitting fee variations, there are likely to be some requests outstanding relating to 2017-18 and 2018-19 audits.

3.4.3 Audit firms consider the fee variation process to be unsatisfactory. They have raised concerns that the scope to claim fee variations is not sufficient to meet their costs. Increasing the scale fee, to reflect changes in regulatory requirements is for practical purposes not possible under the current arrangements.

3.4.4 The majority of local authorities' representatives who offered a view on fee variations also considered them to be unsatisfactory. A concern, which has been raised by a not insignificant number of authorities, is the fact that fee variation requests are not always supported by any evidence of additional work done. Some local authorities passed examples to the Review of auditors, representing more than one audit firm, refusing to provide evidence to support a requested fee variation.

Figure 3.4

Fee variations as a percentage of total scale fees



Notes

1 Transitional arrangements in 2016-17 & 2017-18, PSAA contract in 2018-19.

2 Some fee variation requests for 2018-19 audits still to be received and agreed.

[5] https://www.psaa.co.uk/wp-content/uploads/2019/12/PSAA-fee-variation-process.pdf

3.4.5 Some local authorities questioned why they have been asked to join a call with a significant number of a firm's technical experts, most of whom do not contribute to the discussion, when they need to resolve technical accounting issues. They have questioned whether the costs of these calls are factored into later fee variation requests.

3.4.6 Fee variations can be submitted at any time which increases uncertainty for local authorities. In addition, some local authorities have claimed that they were led to believe by their auditors that they would refuse to sign off their accounts until they agreed a fee variation.

3.4.7 Finally, some authorities have also claimed that they are being asked to fund the costs of additional audit fieldwork because auditors have not resourced the planned audit visit properly and as a result, need to conduct additional audit testing. It has not been possible to assess whether this is happening or how widespread is the practice.

3.4.8 For the 2019-20 audit cycle, PSAA has taken steps to manage fee variations more proactively. Rather than wait for fee variations to be submitted, PSAA has asked all of the firms active in the market to estimate the additional fee required to ensure that their audit work and audit files meet current quality standards. Four of the firms have suggested that an increase of between 15% to 25% on the scale fee is required with the fifth firm requesting an increase of 100% on the scale fee. PSAA informed local authorities that it expects audit firms to provide fee variation information at the earliest possible opportunity, and that PSAA has emphasised this to the firms in its recent auditor communications. PSAA is currently in the process of reviewing how each firm's standard audit testing programmes have changed over the past three audit cycles to identify whether the increases requested are justified. PSAA will use this work to enable it to provide reassurance to audited bodies that extra work has been validated.

3.4.9 Some local authorities have suggested that PSAA has an incentive to approve fee variations as they are funded through making a margin on audit fees. This is not correct. Because PSAA calculates its margin on a total system cost, it is not possible for local authorities to calculate how much of each audit fee or fee variation is due to PSAA. However, as a not for profit company, PSAA has no incentive to claim more funding than it is entitled to. The company's Articles of Association requires PSAA to return surpluses to the sector. In late 2019, under the transitional arrangement, a distribution of the surplus funds of £3,500,000 (9.3% of the 17-18 scale fee £37.6m) was approved by the Board to be returned to the sector, apportioned between local authorities on a scale fee basis. This might be interpreted as an effective transfer of funds from LAs charged fee variations to those who have not been charged variations.

3.4.10 Some LAs have stated through interviews, that PSAA's role is opaque and that they feel that they have no route to challenge audit fees that they feel are unfair or to raise concerns relating to poor quality or delayed audits. The contract provides no mechanism for individual LAs to complain about the service they receive from their auditors.

3.4.11 PSAA states that its role as defined under statute does not include active contract management and it does not currently have the expertise to do so. However, in the *Local Audit (Appointing Person) Regulations 2015* the additional functions of appointing person include requirements to:

"monitor compliance by a local auditor against the contractual obligations in an audit contract… [and] resolve disputes or complaints from— (aa)local auditors, opted in authorities and local government electors relating to audit contracts and the carrying out of audit work by auditors it has appointed."[6]

3.4.12 During the transitional period implementing the new arrangements (2015-16 to 2017-18), there was a Memorandum of Understanding (MoU) between MHCLG and PSAA, which required PSAA to fulfil its statutory functions. When the MoU expired MHCLG did not renew it.

[6] https://www.legislation.gov.uk/ukdsi/2015/9780111126134

4. Audit performance

4.1 Introduction to local authority audit

4.1.1 Auditors of local authorities provide two audit opinions. These are:

- A financial audit opinion; and
- An opinion on the effectiveness of the systems in place to meet the best value duty (known as the 'value for money' opinion).

Scope of financial audit opinion

4.1.2 The purpose of a financial audit is to form an opinion on a set of financial statements. Financial audits are required to be conducted in accordance with International Standards on Auditing – UK (ISAs). The auditor is required to certify whether the financial statements are free from *material* misstatement and are properly prepared in accordance with the relevant accounting and legislative framework. For local authorities, the relevant accounting framework is the Code of Accounting Practice prepared by CIPFA.

4.1.3 In a local authority context, the audit opinion covers the financial statements, the Collection Fund Account and the Housing Revenue Account. It does not cover the narrative statement or annual governance statement. These are covered by what is known as a 'negative assurance' or 'consistent with' opinion. The auditor is required to read these statements to confirm that there is nothing inconsistent or misleading based on what is reported in the accounts and their understanding of the business. If these statements contain information which is misleading or inconsistent, auditors should insist that the relevant sections are appropriately reworded or removed. If not, no further work is required.

4.1.4 Materiality is a key concept in financial audits. Errors or misstatements are material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions that users take on the basis of the financial statements. Auditors are not required to take account of individual users, but do need to assess them as a group.

4.1.5 Auditors do not test every transaction supporting a set of financial statements. Instead they split the financial statements into groups of transactions with similar characteristics and assess the risks of material misstatement for each. The amount and types of audit testing for each of these areas is informed by this risk assessment.

4.1.6 It therefore follows that the key factors in delivering a quality audit are understanding the needs of the users of the accounts; and undertaking an effective risk assessment informed by a proper awareness of the business.

Scope of value for money opinion

4.1.7 The framework for the value for money opinion is set out in the NAO's Statutory Code of Audit Practice, published in April 2015.[7] ISAs do not apply to VfM audits.

[7] https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Final-Code-of-Audit-Practice.pdf

4.1.8 The 2015 Audit Code requires auditors to:
"undertake sufficient work to be able to satisfy themselves as to whether, in the auditor's view, the audited body has put arrangements in place that support the achievement of value for money. In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period."

4.1.9 The Audit Code goes on to say:
"Ultimately, it is a matter for the auditor's judgement on the extent of work necessary to support their conclusion on value-for-money arrangements".

4.1.10 The Audit Code requires documentation of the overall conclusion, consideration of risk and of the planned response and work done to address significant risks. If there are no significant risks, the Code does not explicitly require documentation of work done.

Changes introduced by the 2020 Code of Audit Practice

4.1.11 In 2020, the C&AG published a new Code of Local Audit Practice. This is effective from the 2020-21 financial year. The main changes made are in respect of the value for money opinion and supporting work and have been broadly welcomed by auditors and those local authorities who have so far expressed a view.

4.1.12 The binary audit opinion on whether appropriate arrangements are in place has been replaced by a commentary on:

- *Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;*
- *Governance: how the body ensures that it makes informed decisions and properly manages its risks; and*
- *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.*

In addition, the updated Code will explicitly require auditors to document clearly the work that they have done to support their findings.

4.1.13 The consultation on the supplementary statutory guidance issued by the NAO to support the new Code closed on 2 September 2020. Once this guidance is finalised auditors will need to consider the factors including the following:

- whether a revised risk assessment is required;
- how to design an approach that moves away from obtaining evidence to support a binary audit opinion, to one that generates information to support a commentary on the arrangements in place.
- whether additional or different types of audit testing will be required, and how to structure and produce the new narrative reports.

Other statutory duties and powers

4.1.14 In addition, auditors of local authorities have other statutory powers and duties. These are:

- The power to issue a Public Interest Report at any time;
- The power to issue statutory recommendations to management, copied to the Secretary of State;
- The power to issue an advisory notice setting out potential illegal expenditure;
- The power to apply to the Courts to have unlawful expenditure disallowed;
- The duty to consider qualifying whistleblowing disclosures; and
- The duty to respond to objections raised by electors or other relevant persons.

The Audit Code includes guidance on the scenarios that might give rise to use of these powers and duties. Use of the powers along with the work required to support reports, recommendations and responses to objections is a matter of judgement.

4.2 Defining audit quality

4.2.1 Audit quality is a key determinant of audit performance and this must be seen, not only as a measure against agreed standards and principles, but also whether the output of an audit is seen to meet the legitimate expectations of council taxpayers and other users of accounts.

4.2.2 Financial audit is fundamental to these requirements to give assurance to the reader that the accounts are properly prepared and fairly reflect the council's financial position and use of resources.

4.2.3 Value for money audit should be designed to provide the reader with assurance that the systems in place for use of resources in an effective and efficient way are adequate and appropriate, and that the local authority plans will deliver financial resilience in the immediate and medium term.

4.2.4 The effectiveness of audit also depends on the usefulness, impact and timeliness of auditor reporting. Consideration of Public Interest Reports and Statutory Recommendations is relevant here. Finally, the effectiveness of audit also depends on the Authority's response to audit recommendations. This is a wider definition than that currently used by regulators. Ultimately, regulators consider a local authority financial audit to be of acceptable quality if the audit opinion is supported by sufficient and appropriate evidence and if the work complies with auditing standards, relevant legislation and the Code of Audit Practice. As VfM audit is not covered by auditing standards, the regulators focus principally on whether the audit complies with the Code of Audit Practice.

4.2.5 Nevertheless, the effectiveness and usefulness of local audit has to be measured alongside the assessment of quality. The Review has considered the extent to which the auditors of local authorities:

- Meet the contract specification;
- Demonstrate sufficient understanding of the local authority environment through identification and testing of key financial audit and value for money risks;

- Deliver audits in a cost-effective way;
- Make balanced and considered recommendations; and
- Issue reports and make recommendations in timely fashion.

4.3 Assessing Audit Quality

Meeting the Contract Specification

4.3.1 The contract between PSAA and audit firms largely follows standard terms and conditions. It requires providers of audit services to deliver audits in accordance with statutory obligations and appropriate professional standards. These are discussed below.

4.3.2 The contract is supplemented with a Statement of Responsibilities published, on the PSAA website, which is intended to set out the engagement between PSAA and the appointed auditors. The contract requires audit firms to familiarise themselves with this statement. In accompanying text on their website, PSAA makes clear that the responsibilities of auditors are derived from statute, principally, the 2014 Act and from the NAO Code of Audit Practice and nothing in the Statement is meant to vary those responsibilities.

Demonstrating an understanding of the local authority environment

4.3.3 Feedback received from interviews with local authorities is that KAPs tend to be knowledgeable, skilled and experienced. However, the amount of time devoted to the audit has become more limited in recent years. Anecdotal evidence on the accessibility of KAPs varies. Local authorities largely stated that the senior partners were brought in to resolve significant issues, so were not often visible during the course of the audit. This matched many audit firms' comments that senior partners were brought in for the specific and more complex issues. Most local authorities commented that this was reasonable, and as expected, but some felt that it was difficult to secure input from their KAP on specific issues. Some local authorities commented that during 2018-19 audits, the visibility of both the audit team and KAP had declined somewhat compared to prior years.

4.3.4 As demonstrated by the responses in **Figure 4.1,** despite valuing KAPs, many local authorities had a negative opinion of the overall knowledge and expertise of their audit teams. The two areas of particular concern were:

- the knowledge and continuity of working level audit staff; and
- whether audit work always covered the most important areas of the accounts from a financial resilience and service user perspective.

4.3.5 There is a question as to whether external audit could make more use of the knowledge and expertise of internal audit in developing sufficient understanding of the local authority. It is usual for the external audit team to meet the Head of Internal Audit as part of the audit planning process, but it is unclear if liaison extends much beyond that. Internal auditors are likely to be much closer to the business than external audit and, in many authorities, a proportion of their work focuses on governance and service delivery matters. This could make internal audit a rich source of knowledge, should the external audit team wish to use it.

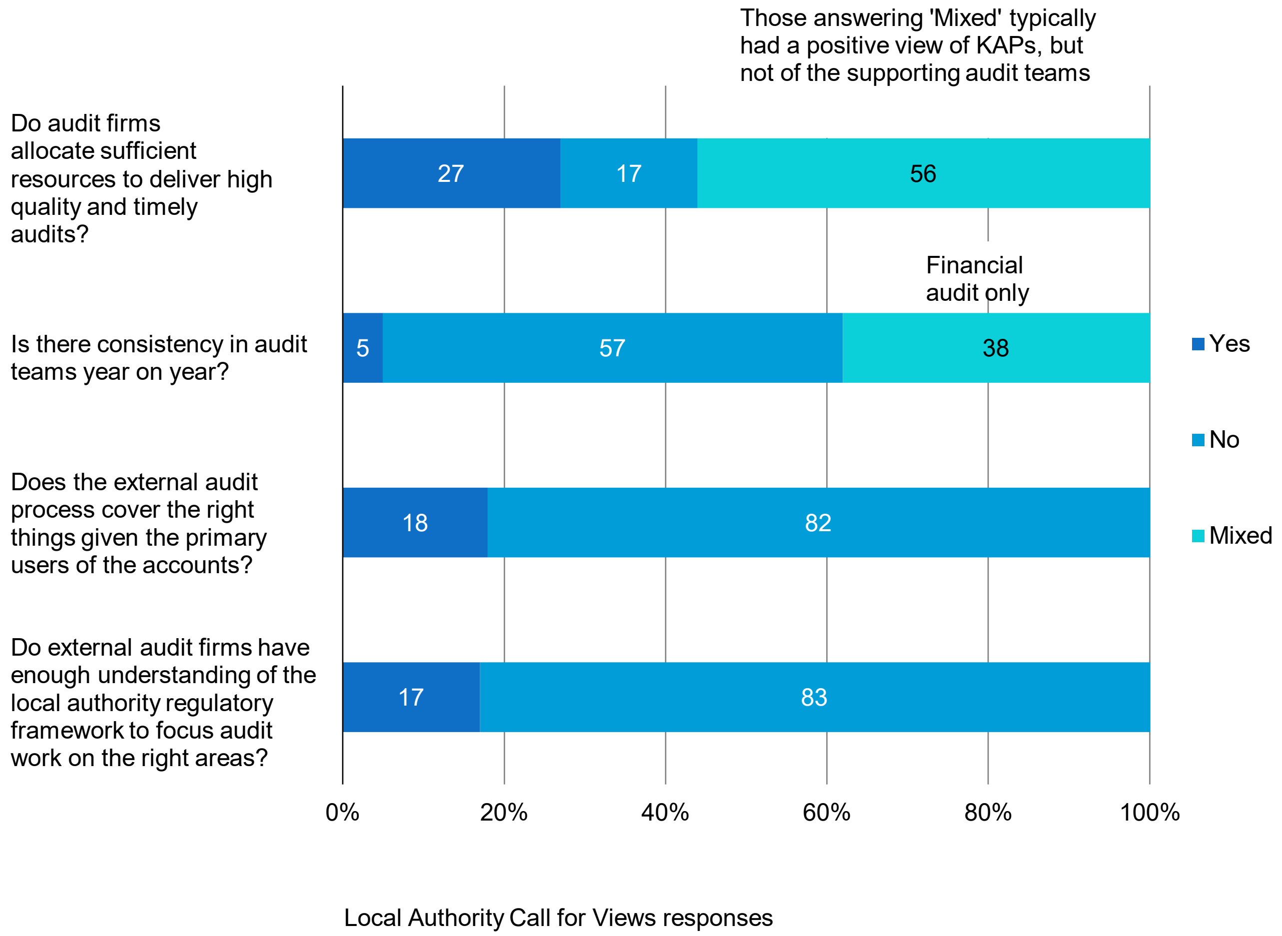
Knowledge, experience and continuity of audit staff

4.3.6 All audit firms active in the local audit market told the Review that they had expert technical teams who provided sector specific training to staff working on local authority audits. Nonetheless, many local authorities reported significant concerns about the knowledge and expertise of staff working on their audit. Issues identified included:

- audit examiners not having a full understanding of how local authorities were funded and how this impacted the accounts;
- a lack of continuity from year to year, or in some cases from week to week, leading to a lack of client knowledge; and
- a lack of understanding of local authority specific financial statements such as the Collection Fund and Housing Revenue Account.

4.3.7 Local authorities also reported the use of audit examiners from other countries to help manage the local audit peak. This is not unique to audits in the local authority sector and can be advantageous as different countries will encounter different audit peaks. However, may local authorities whose audits are staffed in this way reported that such examiners processed very little training in respect of English local government.

Figure 4.1
Opinions on External Audit Quality



4.3.8 Firms agreed that consistency in audit teams could sometimes be compromised by either the difficulty in attracting and retaining quality junior staff or the challenge to retain more experienced staff.

4.3.9 Underpinning the concerns about the quality and continuity of working level audit staff is a concern that there are not enough audit examiners with local authority expertise, and that this is an area in which accountancy trainees no longer wish to specialise.

4.3.10 This is a concern that has developed since 2015. Prior to 2012, the Audit Commission's in-house audit practice, District Audit (DA), was responsible for 70% of the local authority audit market. In its 2012 procurement the Audit Commission outsourced its audit practice. DA staff were TUPE'd[8] to the private sector firms who largely took over responsibility for auditing local authorities. This meant that there was then a plentiful supply of audit examiners with local authority experience. Since 2015, many of those audit examiners have left the external audit profession and have not always been replaced.

4.3.11 A reason for the decline in the number of audit examiners with sector specific expertise is the route taken by auditors to qualify as accountants. Currently, there are five chartered British and Irish professional accountancy bodies that include external audit as a significant element in their qualification. Only one of these bodies (CIPFA) has a mainly public sector focus. All District Audit service trainees would have followed the CIPFA qualification route. Only one of the firms currently active in the market (Grant Thornton) uses the CIPFA qualification route for its public sector audit staff. In addition, audit firms highlight that between 2010 and 2015 the Audit Commission cut back on its recruitment of audit examiners. This means that an increasing number of local authority auditors will not have had the public sector as their main focus whist studying for their accountancy qualification.

4.3.12 In March 2020, PSAA published research it had commissioned on the future of the local audit market.[9] In this research firms raised two main issues that made it difficult for them to attract and retain high quality staff that wanted to specialise in local authority audit:

- **Timetable** - In 2017-18 the target date for completing local authority audits was brought forward from 30 September to 31 July. This reform was requested by many local authorities, who wanted to complete their accounts and audit process as quickly as possible, so as to free up their finance teams to work on other areas. The compression of the audit timetable was mentioned as an issue by every audit firm. Firms raised concerns about the resulting peaks in workload, pressures on staff during the summer months, and knock-on effects when target dates are not met. These pressures contribute to making work unpopular with local audit staff.
- **Fees** – Firms stated generally that the lack of profitability changes the way that local audit work is perceived within the firm. As the contribution that local audit makes to the overall profit of the Partnership is low, specialising in this area is seen by many auditors as having a detrimental impact on career prospects.

[8] TUPE stands for the Transfer of Undertakings (Protection of Employment) Regulations and its purpose is to protect employees if the business in which they are employed changes hands.

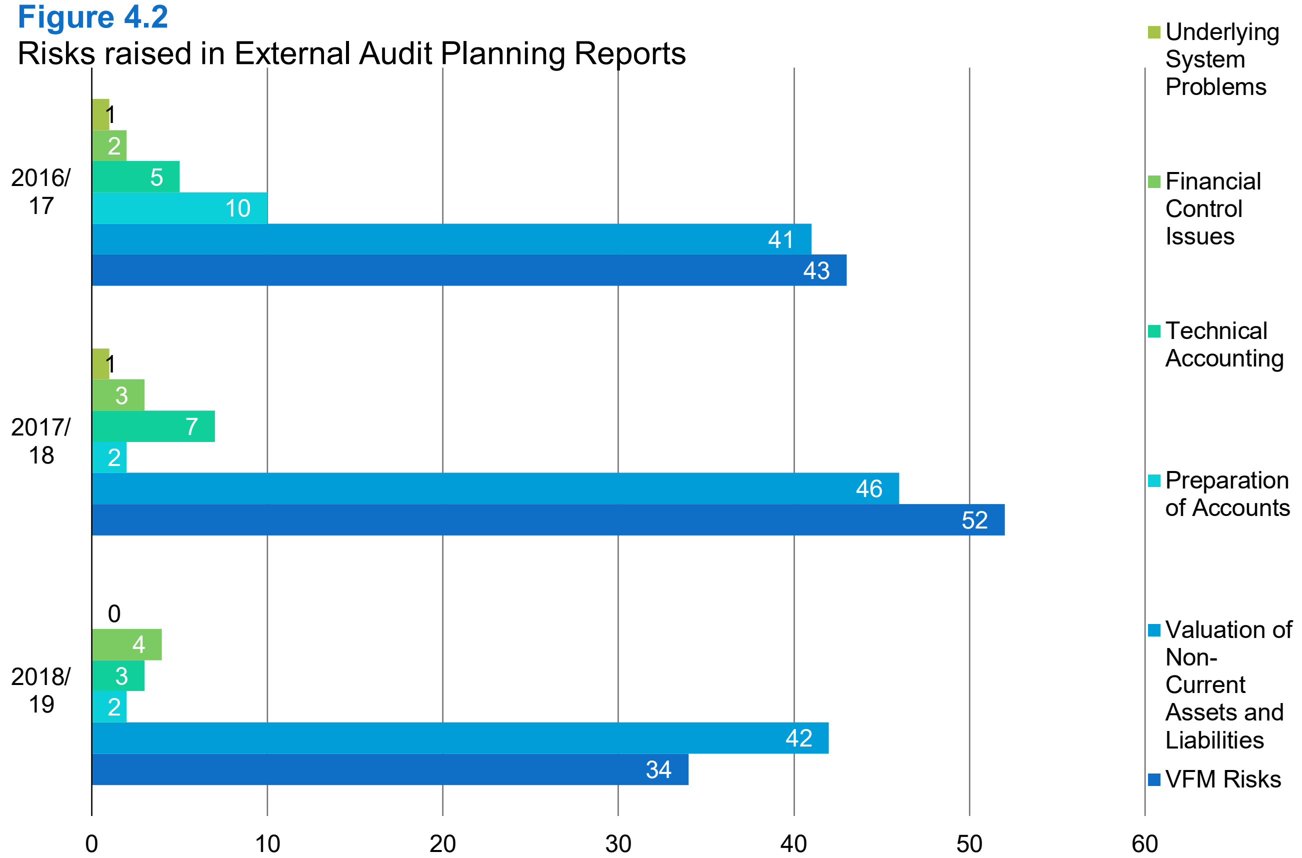
[9] https://www.psaa.co.uk/wp-content/uploads/2020/03/PSAA-Future-Procurement-and-Market-Supply-Options-Review.pdf

Focus of audit work

4.3.13 Many local authorities have raised concerns that auditors spend a significant amount of time focusing on fixed asset and pension valuations, whereas a fuller understanding of the business would lead to more of a focus on major areas of expenditure, together with the level of usable non-ringfenced revenue reserves. The reason for this argument is that most changes to fixed asset and pension values are 'reversed out' of the accounts by a range of statutory adjustments. As a result, in those circumstances, these valuations have no immediate impact on the cost of delivering services or on the financial resilience of a local authority.

Figure 4.2

Risks raised in External Audit Planning Reports



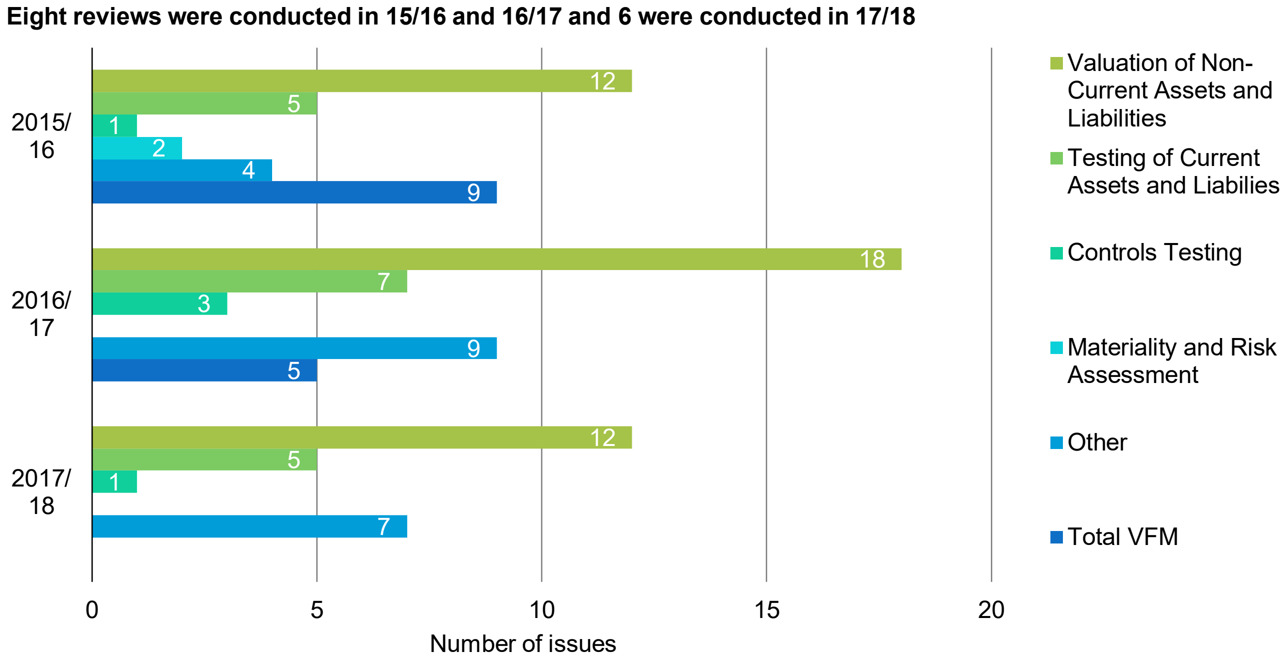
Notes

1 Representative sample of 30 local authorities. Presumed risks excluded

4.3.14 As demonstrated in **Figure 4.2**, valuation of non-current assets and liabilities have been the most common significant financial audit risk category identified in Audit Planning Reports. In addition, irrespective of the risk profile, the amount of detailed testing undertaken on these balances has increased significantly over the past three audit cycles. To manage the risk of regulatory criticism, that more scepticism is needed when assessing non-current assets and liabilities, audit firms are increasingly using their own expert valuers to assess valuations provided by a local authority employed expert. Some audit firms agreed that they would prefer to do less work on asset and pension valuations but explained that these areas of the accounts were given more attention as it was important in the context of securing a positive assessment from the FRC quality assurance processes.

4.3.15 The results of the quality assurance reviews of local authority audit files undertaken between 2015-16 and 2017-18 in **Figure 4.3** demonstrate clear and continuing concerns about the quality of audit work to support fixed asset and pension valuations. The FRC commented that, overall, the local authority audit files it reviewed tended to be of slightly lower quality than the files of corporate sector audits.

Figure 4.3
Issues identified by FRC file reviews conducted on behalf of PSAA



4.3.16 The FRC quality reviews identified far fewer significant issues in VfM audit work. This may be because the current Audit Code gives auditors quite a lot of discretion as to how much work they need to undertake before forming their VfM opinion.

Deliver audits in a cost-effective way

4.3.17 Since 2015, audit fees paid by local authorities have dropped by 42.25% (in cash terms). The decrease in fees has been welcomed by the LGA and by many local authorities. This reduction in fees has been attributed to the following reasons:

- PSAA costs being lower than those of the Audit Commission;
- Improved audit efficiency;
- Reduction in firms' profit expectations; and
- Reduced financial risks for the firms from staff previously TUPEd.

4.3.18 It is difficult to identify the extent to which local authority audits are more efficient than previously. All of the audit firms active in the market have looked to generate efficiencies through making significant investments in digital technology and innovation to equip audit teams with the appropriate tools to deliver a digital audit. However, audit firms note that many local authorities have IT systems that do not lend themselves to the delivery of a digital audit, so some of the anticipated efficiencies have not been realised.

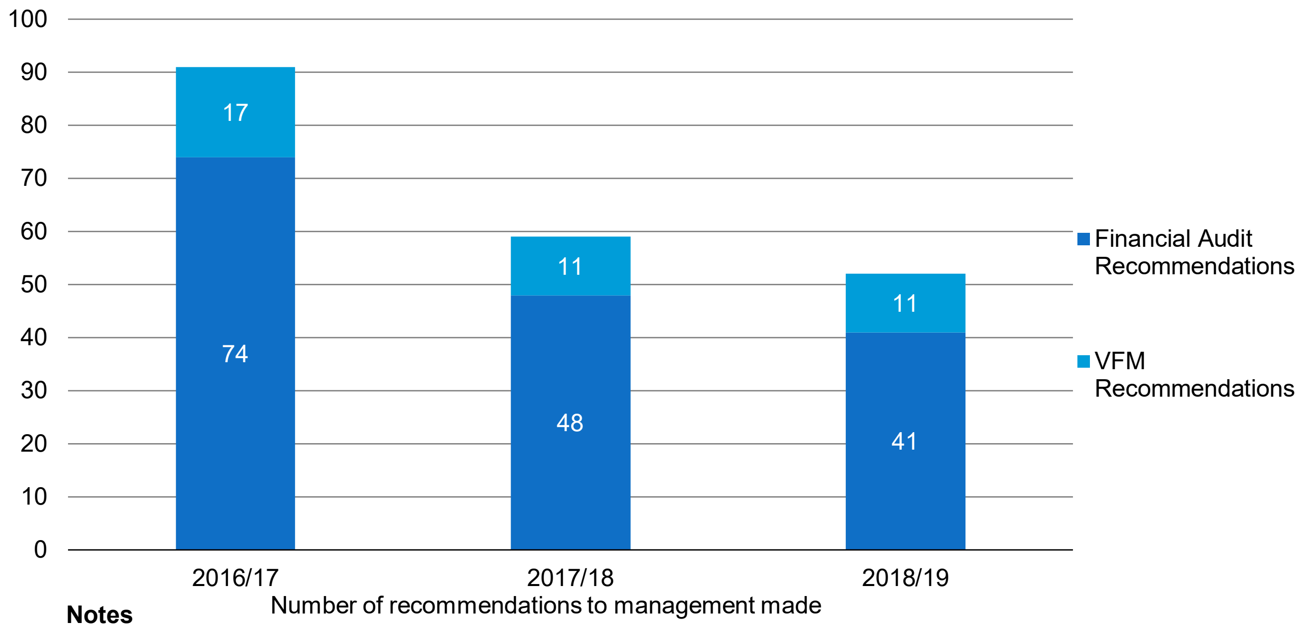
4.3.19 The decrease in fees must be set against the potential impact on quality if audit is considered to be cost effective. Audit firms have raised concerns about whether audit fees are at a sustainable level. One of the registered firms not active in the local authority market said that they had decided not to bid because it was impossible to deliver cost effective and high-quality audits at current fee levels.

4.3.20 Firms have the power to request fee variations where the cost of the work is greater than allowed for by the contract fee. As discussed in **Chapter 3** the fee variation process is an ongoing and increasing source of tension, with auditors concerned that they are not always able to recover legitimate costs. Local authorities are concerned about late notifications and that requested variations are not always supported by evidence of additional work done.

Make sensible recommendations

4.3.21 Auditors can issue recommendations to management through their end of audit communications. These can either be statutory recommendations, which must be copied to the Secretary of State, introduced through the "management letter" recommendations. Eleven statutory recommendations have been issued since 2015.

Figure 4.4
Number of External Audit recommendations given to local authorities



Notes

1 Representative sample of 30 local authorities.

2 Not all audits in 17/18 18/19 have been signed off in this sample.

4.3.22 As demonstrated in **Figure 4.4,** a review of Audit Completion Reports indicates that the number of management letter recommendations issued seems to be declining year on year. The practice on following up management letter recommendations was mixed and Audit Committees were more likely to check progress on implementation of internal audit recommendations rather than external audit recommendations. A majority of the recommendations made relate to technical accounting issues rather than financial control or value for money matters. This is not surprising given the focus of external audit, but it contributes to a perception that the process is not adding as much value as formerly.

Provide useful and timely reports

4.3.23 As demonstrated by **Figure 4.5,** the number of delayed audit opinions has significantly increased over the past three years. For 2018-19, all the audit firms in the market had some outstanding audit opinions as at 30 September 2019, though the extent varied from firm to firm; one firm completed just less than 40% of audits by the deadline while another completed 80%. All firms have made progress in completing these delayed audits although at December 2019, there were still 85 outstanding audit opinions (17.5%); and by July 2020, 42 (8.6%) of 2018-19 audits remained incomplete. These delays are likely to have had a knock-on impact for the 2019-20 timetable.

Figure 4.5

Audit opinions signed off by the statutory deadline for publishing audited accounts

	2018/19	2017/18	2016/17
Opinions issued by the statutory publication deadline	57% *31 July 2019	87% *31 July 2018	95% *30 September 2017
Opinions issued by 30 September	70%	95%	N/A

*statutory deadline for publishing local authority accounts 30 September in 2016-17; and 31 July thereafter.

4.3.24 PSAA asks audit firms to explain the reason for delayed audits. The four most common reasons provided were:

- poor quality accounts/working papers submitted by the local authority;
- potential qualification issues;
- outstanding objections on the accounts; and
- for the first time in 2019-20, having insufficient qualified individuals to deliver all audits at the appropriate time was included as a reason for some of the delays.

4.3.25 Audits are by their nature backwards looking and the increasing delays in signing off local authority audits have an impact on the timeliness of reports. The more material issues that an auditor finds, the greater the risk that the sign off of the audit opinion is delayed. When a judgement needs to be made about modifying an audit opinion, audit firms are required to undertake enhanced quality assurance procedures, and these take time. In addition, some audits will be delayed if a local authority presents poor quality accounts or if there is an outstanding objection. As a result, a number of local authority audits will inevitably be signed off after the reporting deadline.

4.3.26 In recognition of the increased challenges posed by Covid-19, MHCLG has extended the deadline for signing off 2019-20 audits to 30 November 2020. If a majority of audits are not signed off by this date, there could be a significant impact on MHCLG's ability to run the non-domestic rates system effectively. It is too early to say how many local authority audits will make this target date or whether the extension of the deadline will enable audit firms to complete more of the outstanding 2018-19 audits.

4.3.27 Examples of useful and timely auditor reporting through client communications are relatively few. Some local authority Chief Financial Officers commented that they no longer got the useful and informative advice, challenge and support that they had received from KAPs prior to 2015. Audit Planning Reports tend to be presented in February, March or April, which is rather late in the financial year. This means that local authorities get late notification of audit risks. In addition, it is not possible to undertake interim audit work on management controls if the plan is presented in the last month of the financial year and this increases the pressure on the year end peak.

4.3.28 If an Auditor is assessing a significant issue, which they believe needs to be brought to the attention of elected representatives and the public as soon as possible, the have the power to issue a Public Interest Report (PIR). PIRs can be issued at any time. However, only four PIRs have been issued since 2015. Three of these related to matters identified prior to 31 March 2015 and the fourth, issued on 11 August 2020, related to a wholly-owned local authority company.[10] This means that the opportunity to enhance transparency and accountability by sighting key stakeholders on significant issues in a timely fashion is not often used.

4.3.29 Audit firms have not commented on why there is not a greater use of the statutory powers available to them. The position in which auditors find themselves can relate to a situation where intervention in a local authority may be warranted by the use of statutory powers. It is possible that the legal and reputational risks of using these powers may play a part in their thinking as may the difficulty of recovering the costs of the extra work required to support use of these powers.

4.4 Interactions between external audit and relevant stakeholders

4.4.1 The areas of concern that particularly stood out from interviews with local authorities and through the Call for Views were:

- Senior audit staff not being contactable by clients when issues arose;
- Late notification of audit risks;
- Changes to the audit timetable – without justification given;
- Late notification of fee variations with no justification or breakdown of cost given; and
- The auditor's valuation expert overriding asset valuations provided by client experts with equivalent qualifications sometimes with no justification given.

4.4.2 It is important to note that these concerns are not unreciprocated. Auditors raised concerns about LAs not preparing properly prepared draft accounts supported by high quality working papers or not being available to answer audit questions.

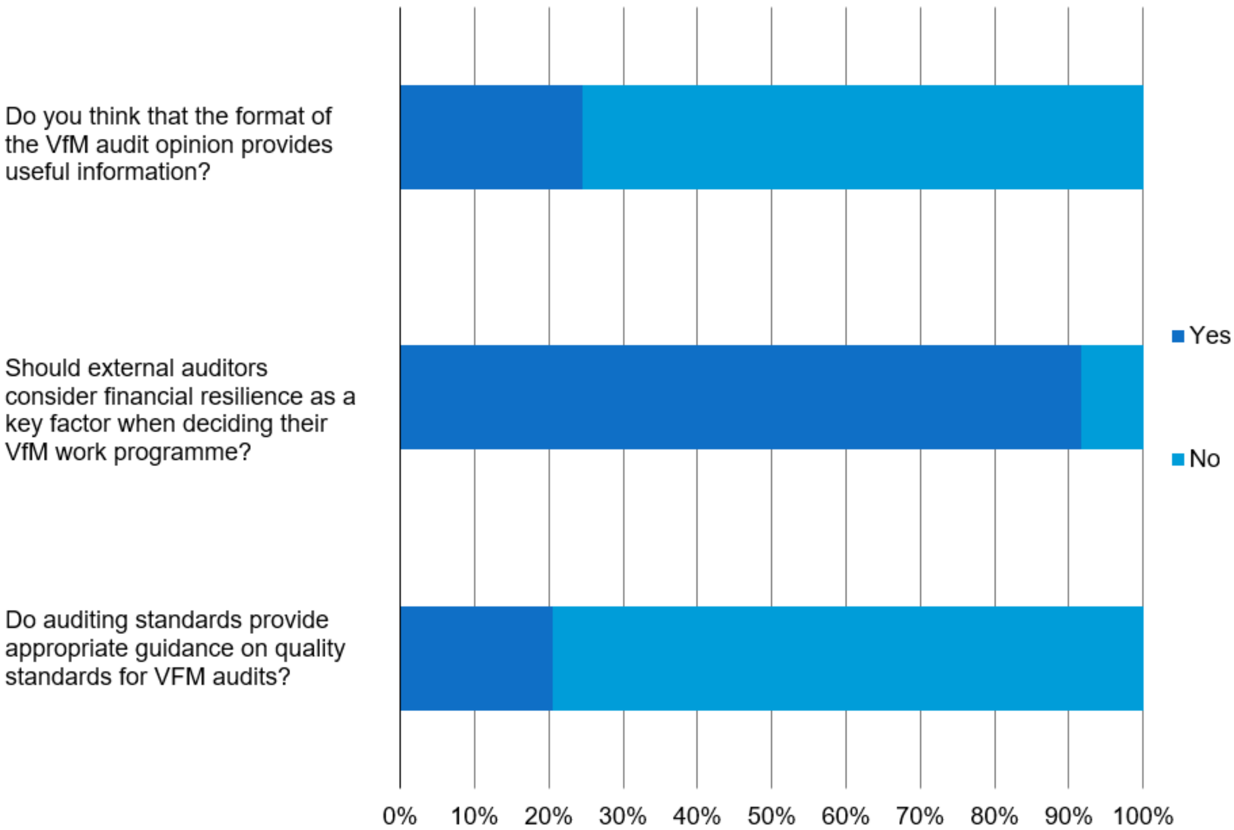
4.5 VfM expectation gap

4.5.1 Whilst audit firms feel that the NAO's new code of practice resolves many of the VfM conclusion shortcomings, some local authorities believe that more significant changes need to be made. There is a large expectation gap between what local authorities

[10] https://www.nottinghamcity.gov.uk/publicinterestreport

expect a VfM opinion should provide and what it actually provides. The VfM conclusion is viewed by many local authorities to be an exercise with limited use to them as it is too retrospective and often states what the local authority often already knows. **Chapter 6** includes a more detailed consideration of the extent to which the VfM opinion covers financial resilience risks.

Figure 4.6
Opinions on the VfM opinion and auditing standards



Notes

1 Data from Local Authority Call for Views responses.

4.5.2 As demonstrated in **Figure 4.6**, 74% of the local authority respondents to the Call for Views think the format of the VfM opinion does not provide useful information. Some of these respondents recognised that the opinion is limited to giving assurance only that processes are in place to secure value for money and therefore that the opinion needs to be expanded to provide useful information. 79% of these respondents do not think the standards provide appropriate guidance on quality standards for VfM audits.

4.5.3 91% of respondents think external audit should be required to assess financial resilience. Although 3% of these respondents felt that financial resilience is already covered to an appropriate amount, most of the other respondents thought that financial resilience should be considered in the medium and long term as part of the value for money audit opinion. This included most audit firm respondents to this question, all of whom stated that the updated NAO Code of Audit Practice, effective from 2020-21, would provide a suitable level of coverage. No local authorities specifically mentioned the NAO Code of Audit Practice in their responses, although this may be due to the fact that the updated Audit Code had not been finalised at the time the Call for Views closed. However, 16% of local authority respondents thought the non-statutory CIPFA Financial Management Code (published Oct 2019) could provide a suitable framework for assessing financial resilience and financial management.

4.6 Summary of audit performance

4.6.1 There is an expectation gap that extends across both the financial and the VfM audit. The coverage of the financial and VfM audits is far narrower than many stakeholders expect.

4.6.2 There are questions about the level of audit performance. In addition, although external auditors may be meeting the contract specification by delivering audits that, for the most part, meet the quality standards set out in ISAs and the Audit Code, an increasing number of audits are not being completed by the statutory deadline for publishing audited accounts.

4.6.3 Audit fees paid by local authorities have reduced, whereas, over the same period, they have increased in other sectors. There is some evidence that the reduction in fees has led to a decline in the number of examiners with appropriate skills, knowledge and expertise. This has had an impact on the timeliness of audits, the usefulness of auditor reporting to management and the quality of interactions between external auditors and local authorities.

4.6.4 Underpinning concerns about audit performance is a question of focus. There is a perception amongst many local authorities that an increasing amount of time is spent auditing fixed asset and pension valuations. It is clear that external audit increasingly has a greater focus on these areas, and that this has been driven by the requirement to meet quality standards and comply with relevant statutory guidance. What is less clear is the extent to which this has led to a reduction of audit work in other areas, but given the reduction in audit fees, it is likely to have had some impact.

4.6.5 It is more difficult to summarise audit performance in relation to the VfM engagement. This is partly because the 2015 Audit Code requires minimal documentation unless significant VfM risks are identified. This makes it impossible to assess whether the external audit assessment of VfM risks is complete in all cases. However, given the squeeze on audit fees and the reduction in the number of audit examiners with appropriate skills, knowledge and expertise, this remains a matter of significant concern.

5. Governance arrangements in place for responding to audit recommendations

5.1 Outline of the different frameworks in operation

5.1.1 The effectiveness of audit must, in part, be determined by the arrangements in place within each body subject to audit for considering and acting upon external audit reports. All local authorities are required to set up Audit Committees or the equivalent with responsibility for considering the annual accounts and receiving internal and external audit plans and reports. The specific arrangements vary between different types of local authorities. However, the purpose of an Audit Committee is to provide independent challenge on behalf of the authority in respect of accountability and risk management arrangements.

Arrangements within PCCs

5.1.2 A PCC is an elected official charged with securing efficient and effective policing of a police area. The policing function is delivered by the constabulary, led in large part by Chief Constables. PCCs are required to set up Joint Audit Committees covering the activities of both the PCC and the constabulary. These arrangements appear to work effectively and the findings and conclusions in the rest of this Chapter do not apply to PCCs.

5.1.3 Some PCCs also have responsibility for overseeing the delivery of Fire and Rescue Authorities, which deliver the fire service, in their local area. In other areas, primarily Shire Counties, the fire service is the responsibility of the County Council.

Arrangements within other types of local authorities

5.1.4 Mayoral Combined Authorities[11] are required by statute to have an Audit Committee, although there is no statutory guidance on the membership or remit. Whilst not a requirement for other types of local authorities, in practice most have set up an Audit Committee or equivalent.

5.1.5 Constitutionally, Audit Committees in local authorities are sub-committees of Full Council. This means that a majority of its members will be elected as a councillor or its equivalent. As highlighted in **Figure 5.1,** membership tends to be based on the political balance of the council and the chair is often, but not always, a member of the ruling group.

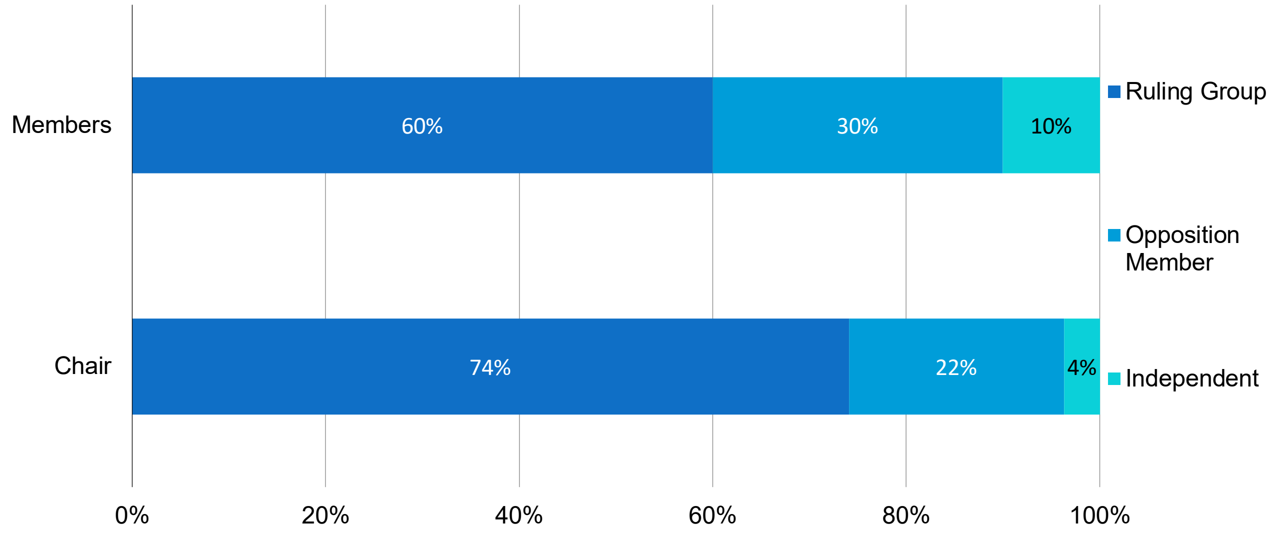
5.1.6 The number of members of Audit Committees varies from four to seventeen, with seven being the most common. This compares to common practice in central government and the private sector, which is to have no more than three or four Audit Committee members. The size of the committee might vary according to the number of councillors an authority has; however, Birmingham City Council, which by expenditure is the largest local authority and has more councillors (99) than any other local authority in England, has eight members on its Audit Committee, whereas the

[11] Combined Authorities are statutory bodies made up of neighbouring local authorities that broadly cover a city-region that have agreed to work together. A Mayoral Combined Authority is where a mayor is the directly elected leader of the combined authority.

Audit Committees of some Shire District Councils have memberships that far exceed this.

Figure 5.1
Composition of audit committees in councils

56% of committees had no independent members



Notes

1 Representative sample of 27 Local Authority Committees (not including FRAs or PCCs).

5.1.7 Local authority accounts are very complex and there appears to be a significant difference between the assurance that external auditors provide and public expectations. Elected members may or may not have relevant skills, expertise or background to fulfil the role of a member of an Audit Committee. Many local authorities provide training for Audit Committee members, but it has not been possible to assess how comprehensive or effective this training is. As a result, it is not possible to conclude whether members are always equipped to provide effective challenge to Auditors or Statutory Officers.

5.1.8 As part of its Audit Quality Reviews of 2018-19 audits, the FRC review teams have met with Audit Committee chairs of 12 selected local authorities. Although the reviews of the related audits are not yet publicly available, a mixed picture was reported, with some chairs being very engaged and informed, but others being less so. As the FRC is responsible only for the quality assurance reviews of the 230 larger local authorities and NHS bodies, the experience provided by their quality reviews may not be fully representative of the sector.

5.1.9 Whilst the vast majority of local authorities interviewed were supportive of the principle of appointing independent members, only about 40% of Audit Committees currently have done so. The reported experience of having independent members on Audit Committees was mixed. In some cases, they provided useful challenge, but some authorities reported that the effectiveness of independent members was hampered by their lack of sector specific knowledge.

5.1.10 A particular challenge for authorities is attracting independent members with the relevant technical experience. This challenge can sometimes be greater depending on an authority's geographical location. Some PCCs have found that the introduction of Joint Audit Committees, which are seen as more prestigious, has made Audit Committee membership more attractive to appropriately qualified independent members, but there is still not an abundance of suitable applicants for vacant positions.

5.1.11 The independent member is often a voluntary position across the local authority sector. This compares to NHS trusts who are more likely to pay independent Audit Committee members, which may make it slightly easier for them to attract applicants with relevant expertise.

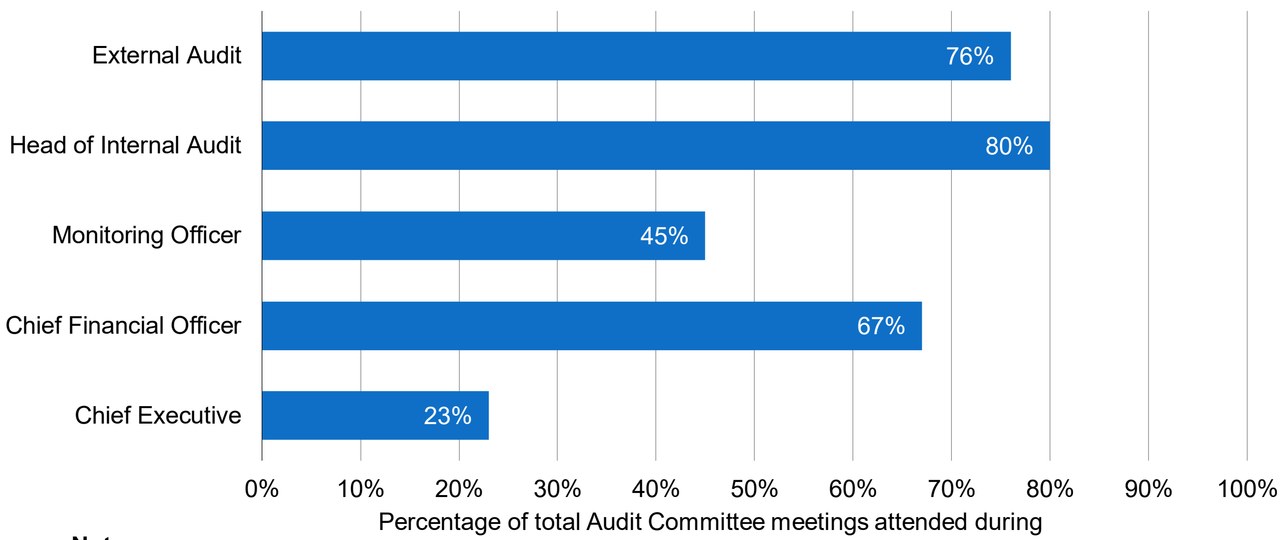
5.1.12 Local authorities have a number of statutory officers, three of whom have responsibilities that may be covered by audit work. They are:

- The **Head of Paid Service** – typically the Chief Executive or Managing Director
- The **Section 151 Officer** – typically the Chief Financial Officer or Finance Director
- The **Monitoring Officer** – typically the Head of Legal Services

5.1.13 As demonstrated by **Figure 5.2** the frequency of attendance of statutory officers at Audit Committee meetings is mixed. Whilst the Chief Financial Officer and Head of Internal Audit attend a majority of meetings, Monitoring Officers attend just under half of the meetings and the Chief Executive attends such meetings less often. Other statutory officers and service heads usually attend Audit Committee meetings if a matter relevant to their service area is discussed.

5.1.14 The Chief Financial Officer is more likely to attend meetings where external audit completion reports are presented. Attendance of the Chief Executive increased by 2% and the Monitoring Officer attendance decreased. This may be reflective of the fact that in local government, the Chief Financial Officer signs the accounts on behalf of the local authority, or it may be indicative of the profile of external audit.

Figure 5.2
Audit Committee attendance: Local Authority Officers and External Audit Representative



Notes

1 Representative sample of 30 local authorities

5.1.15 In local government, representatives of external audit are not expected to attend every Audit Committee meeting. Based on a representative sample, the KAP attended 56% of meetings, rising to 87% of meetings where either external audit papers were tabled or where the final accounts were presented. For the 13% of these meetings where the KAP was not in attendance, external audit was represented by a less senior member of the audit team.

5.2 Scope of audit committees within local government

5.2.1 The scope of Audit Committees also varied between authorities. CIPFA's *Position Statement and supporting guidance on Audit Committees (2013)* says that the Audit Committee should cover:

- The annual governance statement
- The work of internal audit
- Risk management
- Assurance framework and assurance planning
- Value for money and best value
- Countering fraud and corruption
- External audit
- Partnership governance

and may also cover:

- Specific matters at the request of statutory officers or other committees
- Ethical values
- Treasury management

5.2.2 Most of the committees reviewed covered most of the items in the CIPFA position statement. There were two areas which had either minimal or no specific coverage: *partnership governance,* which was considered by only two of the 30 authorities reviewed; and *value for money and best value* which was not considered by any of those 30 authorities. The *CIPFA Survey on Local Authority Audit Committees* (November 2016) also found that Audit Committees were much less likely to consider these two areas. However, the scope of Audit Committees in local authorities is not limited to the areas suggested in the CIPFA guidance.

5.2.3 The scope of committees whose responsibilities included audit varied. The second most common name, after the 'Audit Committee' itself was a name which indicated the combining of audit with the functions of an overview and scrutiny committee. Overview and scrutiny committees are required by statute[12] and are responsible for overseeing and scrutinising the whole range of the Council's functions and responsibilities, as well as other public service providers' work and its impact on the local community. Whilst the functions of these two committees have some synergy, there is a question as to whether it enables the audit responsibilities to be fully addressed.

5.2.4 In one example a local authority had set up an Audit, Resources and Performance Committee. This is a significant concern because the prime purpose of an Audit

[12] Schedule 2, Localism Act 2011

Committee is to review the comprehensiveness and reliability of assurances on governance, risk management, the control environment and the integrity of financial statements and the annual report. The Resources Committee will use financial projections and risk management information to take decisions about use of resources. If the same committee is responsible for using information to take management decisions and providing independent assurance over the reliability of that information, there is no effective segregation of duties. There is also a potential for conflicts of interest.

5.3 Relationship between Audit Committees and Full Council or equivalent

5.3.1 Full Council has a role, ultimately, in responding to audit matters that is beyond receiving Public Interest Reports or qualified audit opinions. Full Council is generally more visible to the public than committees/subcommittees. The Council's public accountability to local taxpayers and service users is best served by having significant matters relating to audit discussed in a transparent and accessible way.

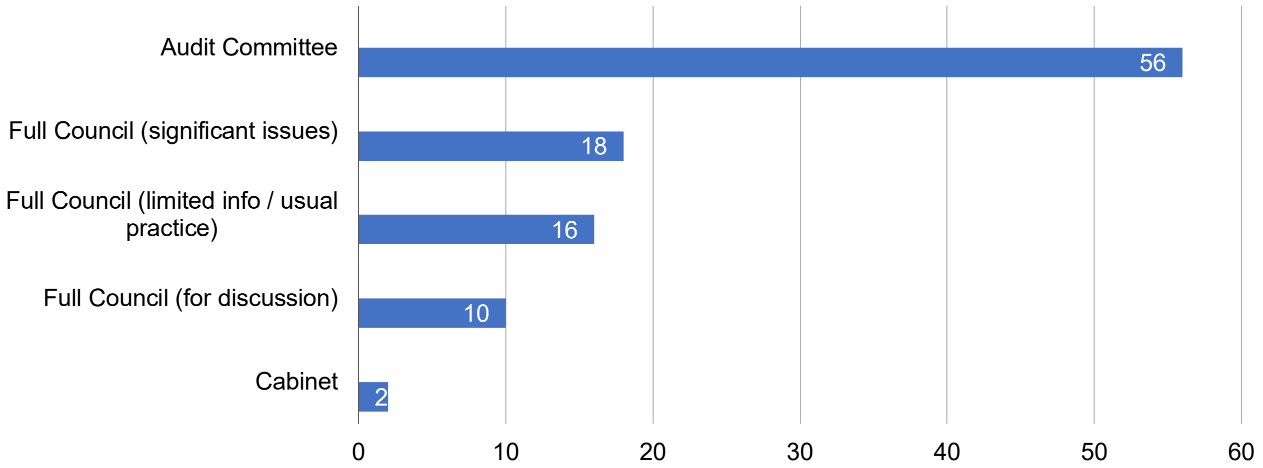
5.3.2 Matters raised at Audit Committee can be referred to Full Council. In addition, the auditor has the power to present some statements, for example an advisory notice that planned expenditure may be unlawful, directly to Full Council.

5.3.3 In practice the auditor tends to present matters to the Audit Committee, which decides if a matter is serious enough to be referred to Full Council. Most local authorities feel that this arrangement is appropriate. It is rare for an Audit Committee to put a substantive item onto the Full Council's agenda. The exception is the Treasury Management Strategy, where some local authorities have a practice of ensuring that it is considered by the Audit Committee before being forwarded to Full Council for approval.

5.3.4 Many local authorities stated that the existing relationship between Audit Committee and Full Council involved either forwarding for information a yearly summary report or meeting minutes and that this was considered to be sufficient. Many also commented that if there were significant recommendations made by the external auditor, such as a Public Interest Report, that then should be a matter for Full Council.

5.3.5 In some cases, some quite serious matters seem not to have been passed onto Full Council. For example, the 'best value' report into Northamptonshire County Council found that when the external auditor reported that appropriate arrangements to deliver best value outcomes were not in place, for the second year in succession, there is no evidence that the Audit Committee forwarded the qualified audit opinion to Full Council.

Figure 5.3
To whom should external auditors present audit reports and findings?



Notes

1 92% of local authorities respondents answered this Call for Views question

5.3.6 If this practice is widespread, there is a significant risk that in many councils, a majority of elected members may not be sighted on serious governance or financial resilience issues. This risk does not fully pertain to PCCs, where the PCC and Chief Constable are expected to attend the Joint Audit Committee and generally do so. There is a question as to whether Audit Committees, including Joint Audit Committees, are sufficiently transparent to local taxpayers and service users. Whilst by default, proceedings of these committees are public, it is not clear that taxpayers and service users are aware that they have a right to attend or to read the papers and the minutes.

5.3.7 As demonstrated in **Figure 5.3** most local authorities felt that external audit reports should be presented to the Audit Committee rather than to Full Council. Reasons given included:

- Full Council only taking items for decision;
- elected members not having the skills, knowledge or experience to understand the report unless they had received Audit Committee training.

5.3.8 Many commented that external audit reports should be reported to Full Council only in exceptional circumstances where there is significant cause for concern. One respondent commented that given the target dates and tight deadlines, there is insufficient time to report to Full Council prior to sign off of the accounts by the external auditors.

Raising the profile of external audit work

5.3.9 The content of the standard suite of external audit reports is mandated by auditing standards. Whilst audit firms have made significant strides in making reports more accessible to clients, much of the required disclosure is highly technical. Given this, it is perhaps understandable that many local authorities do not present such documents to Full Council.

5.3.10 Nevertheless, external auditors may have insights from their work, that could provide assurance to Elected Representatives that their local authority is being run with the best interests of service users and taxpayers in mind. The auditor also has the facility to sight elected representatives on matters that audit work has highlighted as a potential issue.

5.3.11 This suggests that the external auditor should report to Full Council on risks identified and conclusions reached, in a transparent and understandable format. To be of most use, such a report would need to be timely. Given the increase in the number of delayed audits, this report should not necessarily be linked to the certification of the financial accounts as it should be made at the most useful point in the year. Comparatively few local authorities commented on what was the right point in the year to receive audit reports. Two thirds of those who did, expressed a preference for end-September, coming as it does near the start of the following year's annual budget setting planning cycle.

Collating the results of external audit work

5.3.12 Prior to 2015, the Audit Commission published an annual report summarising the results of the audits of local authorities and the NHS. Up to the end of 2017-18 responsibility for preparing this report passed to PSAA. The report summarised the number of audits completed by the statutory deadline and the number of qualified financial audit and value for money opinions, with the latter categorised by theme. It also listed all Public Interest Reports, Statutory Recommendations and Advisory Notices issued in the preceding year. It did not include any details on risks raised by auditors in their Audit Planning Reports or non-statutory recommendations made to local authorities. Just over two thirds of Call for Views respondents think a publication summarising the results of local authority audits adds value.

5.3.13 The responsibility for preparing this report was included in the Memorandum of Understanding between PSAA and MHCLG. When MHCLG decided not to renew the Memorandum of Understanding, PSAA's responsibility for reporting on the results of audit work lapsed. This reinforces the point that no entity currently has the responsibility to collate and report on the results of the work of the external auditors of local authorities and individual NHS bodies.

6 Audit work on the financial resilience of local authorities

6.1 Stakeholders' expectations regarding financial resilience

6.1.1 Reference has been made to the role of external audit in assessing financial resilience and sustainability in local authorities. In England, neither the financial nor the value for money audit includes a specific responsibility to provide an opinion on whether a local authority is financially sustainable.

6.1.2 However, it is legitimate to expect the auditor to examine the ability of the local authority to provide resources sufficient to deliver the statutory services for which it is responsible. It would not be appropriate for this Review to provide a commentary on local government funding, but there are a number of key questions that it would be reasonable to expect the auditor to assess. These could include:

- Has the auditor scrutinised the balance sheet to understand the debt profile of the authority and the level and depletion rate of usable reserves?
- What metrics does the authority use to determine the level of financial risk it faces?
- When the annual budget is approved by Full Council or equivalent, the CFO is required to present a "Section 25" report, providing a view on the reasonableness of financial estimates and the adequacy of reserves. Should the auditor be required to confirm that this report is sound?
- It is good practice for local authorities to prepare a mid-term financial strategy, normally covering a three to five-year period that is presented alongside the budget. Is it reasonable to expect the auditor to consider the assumptions underpinning this strategy or to form a view on its whether it is robust and realistic?
- Local authorities are also required to prepare statutory reports that have implications for financial sustainability and available resources in future years. These include setting a Prudential Borrowing limit, calculating an appropriate provision for repayment of debt (known as "Minimum Revenue Provision"), preparing an Investment Strategy, and potentially preparing a Flexible Use of Capital Receipts Strategy. Is it reasonable to expect the auditor to consider some of these strategies and estimates?

6.1.3 CFOs may have specific expectations of auditors. As previously indicated, many of the CFOs who contacted the Review made it clear that they valued the informal contact and challenge from the KAP. Dialogue between the KAP and the CFO does take place, if not on as wide a scale as it did pre-2015, and there is no doubt this can be beneficial. However, the independence of the auditor must be preserved in the way that advice and guidance may be tendered.

6.2 What does financial resilience mean in a local authority context?

The statutory framework

6.2.1 Financial resilience in a local authority is different to a private sector context. The powers and responsibilities of local authorities along with the financial control framework within which they operate are set by statute.

6.2.2 The services that local authorities are required to provide are set out in legislation along with the accompanying powers and duties. The statutory responsibilities to deliver these services exist even if the local authority's resources may be considered to be insufficient at any given time.

6.2.3 The key financial controls set out in statute are:

- The requirement to calculate an **annual balanced revenue budget** for the upcoming financial year, that must be approved by Full Council or the equivalent. Local authorities are not allowed to run a deficit budget. Instead they are required to calculate a level of Council Tax that equates to the difference between income and expenditure. The increase in the level of Council Tax that can be charged is restricted by a 'referendum principle'. If a local authority wishes to raise Council Tax by more than a percentage specified by Ministers, they are required to put the planned increase to a referendum of local electors. Local authorities can borrow to fund capital investment but are not normally allowed to do so to finance in-year expenditure.
- The CFO's **"Section 25" report** on the robustness of the council's budget estimates and the adequacy of its reserves, which must be presented to Full Council alongside the annual balanced budget.
- The CFO has the power to issue a **"Section 114 notice"** if the CFO believes that the local authority is unable to set or maintain a balanced budget. After a section 114 notice is issued, the local authority may not incur new expenditure commitments, and the Full Council must meet within 21 days to discuss the report. There is no legal provision regarding what action they then must take. There is no procedure in law for a UK local authority to go bankrupt, and none has ever done so.

6.2.4 If a local authority mismanages its budgets over a number of years so that it is unable to recover its financial position, then central government has the choice of intervening under its "best value" powers, providing exceptional financial support, facilitating an offer of leadership and governance support from elsewhere in the sector, or using a mixture of these options.

6.2.5 Intervention on the grounds of lack of financial resilience is very rare. The most recent statutory intervention using best value powers was in Northamptonshire in 2018. Although there have been three other statutory interventions in the intervening years (Doncaster due to pervasive corporate governance failures, Rotherham due to institutional failure in responding to child sexual abuse and Tower Hamlets due to pervasive governance and financial impropriety issues), Northamptonshire was the first statutory intervention primarily due to financial resilience issues since Hackney in 2000.

6.2.6 In both Northamptonshire and Hackney, central government supported the council during the intervention by providing exceptional financial support, primarily by allowing receipts from sale of assets to be used to support revenue expenditure. Northamptonshire was also permitted to raise council tax by 2% more than other authorities for 2019-20 without triggering a referendum.

6.2.7 Whilst this might suggest that financial resilience is not an issue for local authorities, that may not always be the case. Firstly, central government support cannot always be guaranteed and secondly, a local authority experiencing severe financial resilience issues may also be facing governance and service delivery issues, with a consequential impact on those who depend on those services. Furthermore, the impact of financial resilience issues on service delivery is iterative. It must be emphasised here that the system must identify and highlight financial resilience issues at the earliest opportunity in order to avoid negative impact on service. When a service fails, it is likely that that cost of recovery will be greater with a possible consequential impact on financial resilience.

6.2.8 This suggests that in a local authority context, financial resilience means the ability to manage budgets over the medium term whilst continuing to deliver high quality and effective services, that can be accessed by service users. The level of service provided is very important. Local authorities in financial difficulties can seek to cut costs by reducing the level of service. This may be the case for demand led services such as social care where it is more difficult to forecast accurately local demand pressure.

Commercialisation and local authority resilience

6.2.9 One of the most significant sectoral trends since 2015 is the increased commercialisation of local authorities. To simplify, there are two main categories of local authority commercialisation:

- Investment in commercial property, usually through the general fund; and
- Investment in wholly owned companies set up using the "general power of competence". The most common type of wholly owned local authority company is the housing company. Other examples identified include energy companies, recruitment agencies, back office service delivery companies and leisure trusts. PCCs and FRAs do not have a "general power of competence".

6.2.10 The risks commercialisation poses to local authority financial resilience were highlighted in a recent NAO study on *"Local Authority Investment in Commercial Property"*[13] which concluded:

"Buying commercial property can deliver benefits for Local Authorities including both the generation of income and local regeneration. However, as with all investments, there are risks. Income from commercial property is uncertain over the long term and authorities may be taking on high levels of long-term debt with associated debt costs or may become significantly dependent on commercial property income to support services. At the national or regional level, Local Authority activity could have an inflationary effect on the market or crowd out private sector investment."

6.2.11 Although the NAO study focused solely on commercial property, this conclusion is as relevant to investments in wholly owned companies. If a company that is set up using the "general power of competence" gets into difficulty, the parent local authority may ultimately be responsible or may have to write off loans or equity funding, and this can impact financial resilience.

6.2.12 An additional risk with wholly owned companies is a potential lack of transparency. It can be very difficult for a reader to identify a local authority's exposure as a result of

[13] https://www.nao.org.uk/wp-content/uploads/2020/02/Local-authority-investment-in-commercial-property.pdf

investments in or loans to wholly owned companies by looking at the accounts. Unless an investment in, or transactions with, a wholly owned company is material by value, there is no requirement to consolidate the company's income, expenditure, assets or liabilities in the local authority's accounts. Instead, what is required is a disclosure of transactions between the authority and each of its wholly owned companies in what is known as the "Related Parties note". This note is presented less prominently in the annual report and accounts document. In addition, decisions a local authority makes pertaining to its wholly owned companies, including those relating to providing additional finance and awarding contracts, are often held in private on grounds of commercial confidentiality.

Defining local authority financial resilience

6.2.13 CIPFA has attempted to define financial resilience in a local authority context. In *Building Financial Resilience (Jun 2017)*[14]. This publication highlights four pillars of sound financial management and five indicators of financial stress.

Figure 6.1

CIPFA Pillars of Financial Resilience

Pillars of financial resilience	Indicators of financial stress
Getting routine financial management right	Running down reserves
Benchmarking against nearest neighbours – e.g. unit costs, under/overspends by service area, under-recovery of income.	Failure to deliver planned savings
	Shortening medium term financial planning horizons
Clear plans for delivering savings	Increase gaps in saving plans (i.e. where proposals are still to be identified)
Managing reserves over the medium-term financial planning horizon.	Increase unplanned overspends in service delivery departments.

6.2.14 The pillars of financial resilience identified by CIPFA related to process and governance points, so could be covered by the auditor's VfM opinion. Likewise, the indicators of financial stress could be covered by a sector-wide VfM audit framework.

6.2.15 An alternative and more detailed model, mentioned by some local authorities, is the seventeen principles set out in CIPFA's recently published Financial Management Code. Although only three of the seventeen principles are categorised under the heading of sustainability, in practice, all of the principles relate to matters that directly or indirectly contribute to an authority's capacity and capability to deliver sustainable services over the medium term.

6.2.16 A challenge common to both the *Pillars of Financial Resilience* and the *Financial Management Code* is that neither has any statutory basis. Whilst CIPFA requires its members to follow the *Financial Management Code*, compliance cannot be enforced. As a result, auditors may be reluctant to treat non-compliance with either as a matter serious enough on which to report.

[14] https://www.cipfa.org/policy-and-guidance/reports/building-financial-resilience-managing-financial-stress-in-local-authorities

6.2.17 A further challenge with the *Financial Management Code* is that the key principles are fairly detailed. Whilst an auditor could assess compliance with these principles, the costs of doing so in terms of both the auditor and of local authority time could be quite high.

6.2.18 Finally, neither the *Pillars* nor the *Financial Management Code* explicitly cover the impact of commercial activity on a local authority's financial resilience. General fund investments should be considered as part of the audit of financial accounts but wholly owned companies would only be considered if material enough to be consolidated into the accounts.

6.3 Current audit requirements to assess the sustainability and resilience of LAs in England

The Going Concern opinion

6.3.1 An underpinning principle of a financial audit is a 'going concern assumption'. The going concern principle means that readers of a set of accounts are entitled to assume a business will continue in the future, unless there is evidence to the contrary. When an auditor conducts the examination of the accounts, there is an obligation to review its ability to continue as a going concern for the next twelve months.

6.3.2 If the auditor concludes that there is significant doubt that the reporting entity is a going concern, the audit opinion is qualified, and a report explaining the auditor's financial resilience concerns is included with the audit opinion. In addition, if an entity is not a going concern, assets and liabilities must be valued at the amount they can be sold for rather than by assessing their ongoing value to the entity.

6.3.3 This particular way of validating a local authority's financial health has attracted much criticism from respondents. The view of practitioners is that that a local authority cannot face the prospect of bankruptcy/liquidity in the way that a company might.

6.3.4 In addition, local authorities are presumed to be a going concern for the purpose of forming an audit opinion, as the financial reporting frameworks for these bodies dictate a continued service approach, unless there is a clearly expressed Parliamentary intention to discontinue the provision of the services which the entity provides. The NAO has consulted on Supplementary Auditor Guidance, that reinforces this point.

6.3.5 87% of respondents to the Call for Views think the going concern assumption is meaningless in a local authority context. Respondents noted that local authorities would be likely to receive support from Central Government in the wake of a serious event. Many highlighted the example of Northamptonshire remaining a going concern for audit opinion purposes, even when the auditors had issued an advisory notice on what was considered to be an undeliverable budget. as an apparent example of the opinion's flaws. Those who responded that the opinion was meaningful included a majority of audit firms who acknowledged the going concern opinion's flaws and suggested changes but, on the whole, felt that it was still important that this assessment was carried out.

The value for money opinion

6.3.6 The other dimension of audit which could look at financial resilience is through the work required to support what is known as the 'value for money opinion'. The work required to support this opinion is governed by the NAO's Code of Audit Practice ("the Audit Code"). What the auditor is required to do is to form an opinion on the adequacy of the systems in place to support the economy, effectiveness and efficiency of service delivery. Under current practice in England, the auditor may test the adequacy of systems and procedures used to construct the mid-term financial plan but is only required to do so if a significant risk is identified during the audit. The auditor is not required to examine the mid-term financial plan from a sustainability perspective or form a conclusion on the financial resilience of the authority.

6.3.7 The update to the Audit Code, effective from 2020-21, will require auditors to provide a narrative statement on the arrangements in place. The aim of this statement is to provide more useful information to stakeholders, to report in a timelier manner and, through the move away from a binary opinion, encourage auditors to be bolder in highlighting concerns. The updated Audit Code has been broadly welcomed by stakeholders and has the potential to enhance value for money reporting in England.

6.3.8 What the updated Audit Code does not do is specify that auditors consider specific matters or judge local authority systems and performance against specific standards or good practice examples, such as CIPFA's *Pillars of Financial Sustainability* or their *Financial Management Code*. Nor does the updated Audit Code provide any guidance on how to assess whether a value for money risk is material.

Timeliness of the value for money opinion

6.3.9 Less than half of respondents to the Call for Views expressed an opinion on the timing of the VfM opinion. Two thirds of those who expressed an opinion agreed that the statutory reporting deadline of end-September was the right point in the annual cycle to present the VfM opinion, coming as it does near the start of the following year's annual budget setting planning cycle. Many commented that the external audit firms still had the capability to raise any significant VfM concerns outside this process, a process where they were happy with the content.

6.3.10 Those that disagreed included all but one of the audit firms who responded to this question. In addition, many of the local authorities who responded to the Call for Views didn't have strong opinions either way. Some thought that the opinion might be better presented in May, right at the start of the following financial year, but others expressed concern as to whether audit firms would have the capacity to handle a split reporting timetable.

6.3.11 A subsidiary, but still important, factor when considering the timing of the opinion is auditor resourcing. If the full benefits from the revised VfM opinion in the new Audit Code are to be realised, auditors will need to do more work.

6.3.12 Therefore, thinking about how to time the publication of the opinion so that it is of the most use, has the most impact, and can be supported by timely audit work must be a matter for serious consideration.

6.4 Practice in other jurisdictions

6.4.1 Audit requirements in other jurisdictions, for example Scotland, Wales and New Zealand provide alternative models, all of which provide practices that could help bridge the expectation gap between what auditors are required to do and what stakeholders expect them to do to assess financial resilience. The Review has explored New Zealand as it has a different model that is worthy of consideration.

6.4.2 Scotland and Wales have different models of value for money reporting, with Scotland's model requiring the auditor to assess future plans and Wales' model including the option for the auditor to undertake more focussed work on financial resilience as a separate engagement.

6.4.3 In New Zealand, there is no VfM opinion, but instead the financial audit opinion has been extended to cover a large number of pass/fail service delivery and financial resilience metrics. The financial resilience metrics are common to all authorities, allowing comparisons to be made.

6.4.4 Care needs to be taken when assessing the appropriateness of these models. There are currently 32 unitary authorities in Scotland, 22 unitary authorities in Wales and 78 local, regional and unitary councils in New Zealand compared to 343 local authorities in England. It may not be possible to scale-up practices that are appropriate in these jurisdictions to England in a coherent way or to do so at a reasonable cost.

Practice in Scotland

6.4.5 When scoping, planning, performing, and reporting on their 'best value' work, auditors in Scotland are required to consider four audit dimensions. The first of these, financial sustainability, interprets the short term going concern opinion and requires auditors to look *"forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered."*

6.4.6 The results of VfM audits of Scottish local authorities tend to produce quite rich reports, which the Accounts Commission, the public spending watchdog for local government in Scotland, uses to identify and highlight key trends and risks across the sector. For example, the *Local Government in Scotland, Financial Overview Report 2018-19 (Dec 2019)*[15] found that Scottish councils were increasingly drawing down on their revenue reserves; and whilst all councils had medium term financial planning covering the next three to five years, long term financial planning had not improved since the last report.

[15] https://www.audit-scotland.gov.uk/uploads/docs/report/2019/nr_191217_local_government_finance.pdf

Practice in Wales

6.4.7 The value for money audit opinion an auditor of a Welsh local authority is required to provide is the same as that in England; that is an opinion on the "arrangements for securing economy, efficiency and effectiveness in its use of resources". However, the Welsh Code of Audit Practice requires auditors to review significant arrangements in place irrespective of whether material risks have been identified.

6.4.8 Where an auditor identifies notable financial resilience or other value for money concerns, the Auditor General for Wales has the statutory power[16] to publish a separate substantive report. These reports are publicly available on the Wales Audit Office's website and provide an in-depth assessment of the issues identified and the appropriateness of the plans that the local authority has to address these.

Practice in New Zealand

6.4.9 Local authorities in New Zealand are required to report performance in the Annual Report and Accounts against a range of financial prudence benchmarks specified in legislation. The auditor is required to report on the completeness and accuracy of the local authority's disclosures against these benchmarks. As all of the benchmarks have pass/fail thresholds, they lend themselves to a binary audit opinion.

6.4.10 The purpose of this statement is to disclose the Council's financial performance in relation to required benchmarks in order to assess whether the Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings. Although the benchmarks are backwards looking, five-year trend information is presented which helps the user of the accounts to understand how effective the local authority is in managing its financial resilience.

6.5 The audit of financial resilience – a new model for England?

Introduction

6.5.1 There is a significant gap between the reasonable expectations of many stakeholders and what the auditor is required to do when assessing the financial stability and resilience of local authorities.

6.5.2 To help bridge the expectation gap, the scope of audit should include a substantive test of a local authority's financial resilience and sustainability. Care and attention will need to be taken to define how the auditor should address historical, current and future financial sustainability issues, so that the engagement does not become overly burdensome or provide false comfort to stakeholders. In addition, expanding the scope of the audit will increase costs, and there needs to be a balance between those costs and the potential benefits of additional audit coverage and reporting.

6.5.3 However, cost should not be a deterrent in and of itself. The expansion of the opinion to encompass financial resilience and sustainability would, potentially, provide comfort to the authority and to council taxpayers that the finances are in good order. This

[16] under Section 17 of the Public Audit (Wales) Act 2004 and section 18 of the Local Government Wales Measure 2009

would represent a genuine demonstration of public accountability both from a local authority and from an audit perspective.

Form of the opinion

6.5.4 The revised narrative opinion proposed in the new NAO code should lead to a significant enhancement in the usefulness of auditor reporting. The 2020 Audit Code sets out three reporting criteria (para 3.10)[17]:

- Financial sustainability: *how the body plans and manages its resources to ensure it can continue to deliver its services;*
- Governance: *how the body ensures that it makes informed decisions and properly manages its risks; and*
- 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.*

6.5.5 These criteria are not dissimilar to the four reporting pillars in the Scottish model. The pillar that auditors of English local authorities are not explicitly required to report on is financial management. It is unclear why this has been omitted but a possible reason is that an auditor would normally be expected to review material financial management controls as part of financial audit work.

6.5.6 The reporting requirements contained within the 2020 Audit Code will take time to settle down and embed and there will be a role for the regulator in identifying and promoting good practice. However, if practice develops as the NAO intends, the new reports should provide more useful information to stakeholders.

Work required to support an assessment of financial resilience

6.5.7 The 2020 Audit Code requires auditors to do less work to assess financial resilience than is required in either Scotland or Wales.

6.5.8 Specifically, auditors in England will not be required to test whether the body is planning effectively to continue to deliver its services or the way in which they would be delivered over the medium or longer time horizon as in Scotland. Nor will auditors be requested to review the design of significant arrangements to secure value for money, and, where appropriate given the assessment of risk, test the operating effectiveness of those arrangements as in Wales.

6.5.9 In addition to the factors mentioned in the Code, auditors could use the indicators of financial stress in the CIPFA publication, *Pillars of Financial Resilience*, as a key element of the risk assessment.

6.5.10 To support such an assessment the auditor could be required to critically assess and, in cases where significant risks are identified, test the CFO's Section 25 report along with any other statutory reports or management estimates that have an impact on medium or long term financial resilience. This testing could include an assessment

[17] https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf

of whether there are clear plans for delivering savings, the usage rate for non-ringfenced revenue reserves and whether the local authority benchmarks its costs against nearest neighbours and takes appropriate action in response to variances, as set out in accordance with CIPFA's *Pillars of Financial Resilience*.

6.5.11 In addition, the auditor could explicitly be required to assess whether the local authority has complied in practice, and in spirit, with statutory guidance that it is required to "have regard to".

6.5.12 CIPFA's *Financial Management Code* is another model that provides a set of standards against which auditors could assess value for money and financial resilience. However, it is too detailed to assess without a considerable amount of additional audit work. Nevertheless, the principles in the *Financial Management Code* would enhance the consistency of local authority financial management. MHCLG could take the opportunity to give it statutory status when the opportunity arises and require local authorities to report on their compliance with it in their Annual Governance Statement. Since auditors are required to read the Annual Governance Statement to ensure it is consistent with their knowledge of the business this, combined with the enhanced resilience testing recommended, would require auditors to report material breaches.

6.5.13 Consideration has also been given to whether it would be appropriate to require a specific investigation. A more detailed report would enable specific VfM or financial resilience issues to be identified, as in the Welsh model. This is not recommended, as this element of the Welsh model is not applicable due to scale.

7. Financial reporting in local government

7.1 The purpose of financial reporting in the local authority sector

7.1.1 Financial reports provide information to people who seek to understand the performance of an entity. As most of the money that local authorities receive is provided from general or local taxation, it is reasonable to expect people outside the body who are interested in a local authority's financial performance to want to know how the money being managed is being spent. This includes knowing whether the local authority is performing effectively to achieve what was intended with this money.

7.1.2 Local taxpayers and service users do not have the power to require a local authority to produce bespoke financial information for them. Instead, they have to rely on the financial statements. They can inspect the financial statements and the underlying accounting records for a 30-day period that must comprise the first ten days in June. This means that to be relevant the information produced in local authority financial statements must meet the accountability and/or decision-making needs of users and be sufficiently transparent and understandable to allow them to ask appropriate questions.

7.2 Introduction to the framework

7.2.1 When producing financial reports, local authorities are required to have regard to the Statutory Code of Local Authority Accounting Practice ("the Accounting Code"), issued by the CIPFA. The Accounting Code is based on private sector accounting standards other than where they have been adapted for the specific circumstances of local authorities or where these are overridden by specific statutory requirements. As set out in **Figure 7.1**, Government retains the power to use secondary legislation either to override normal accounting practices or to require local authorities to include additional disclosures in their accounts.

Figure 7.1
Hierarchy of the Local Authority Accounting Framework

Primary Legislation	**Local Government Act 2003** Allows SoS to make provision about accounting practices that local authorities must follow.
Secondary Legislation	**Capital Finance and Accounting Regulations 2003** Gives CIPFA the power to produce a statutory accounting code. Introduces statutory overrides to private sector accounting practices; which must be reflected in the accounting code.
Statutory Code of Practice	**CIPFA Accounting Code of Practice** Statutory code setting out proper practices for local authority accounting in England.

7.2.2 When implementing, adapting or interpreting accounting standards, the Code seeks to maintain consistency with other parts of the UK public sector. Preparation of the Code is overseen by the CIPFA/LASAAC Accounting Code Board, which comprises representatives of all the key stakeholder groups. MHCLG has observer status on this Board.

7.2.3 This Accounting Code board does not act in isolation. Its decisions are reported to the Financial Reporting Advisory Board (FRAB), which advises HM Treasury on public sector accounting. In practice, both the annual update to the Accounting Code and any amendments or adaptations to accounting standards for the local authority sector need to be considered at FRAB as well as at the CIPFA/LASAAC Board.

7.2.4 The Accounting Code applies to Principal Councils, PCCs, Chief Constables, FRAs, the GLA, Mayoral Combined Authorities, Passenger Transport Executives and National Park authorities in England. It also applies to similar authorities in Wales, Scotland and Northern Ireland, although the legislative framework for these authorities is different and they are outside the scope of this Review. The Code does not normally apply to subsidiary companies consolidated into local authority accounts. Such companies use the applicable private sector accounting framework.

7.2.5 The Accounting Code is updated annually, and a new edition is published each financial year. Purchasing the 2019-20 Code from CIPFA costs £340 (hard copy) or £710 (online copy). CIPFA's sales numbers demonstrate that at least one third of local authorities do not purchase an Accounting Code in any given year.

7.2.6 The Accounting Code does not apply to smaller authorities, for example Parish Councils, Ports Authorities or Independent Drainage Boards with gross income or expenditure of less than £6.5m per annum (which is currently all but one of them). The accounting and governance framework for these authorities is set by an organisation called the Joint Panel on Accountability and Governance (JPAG), which comprises representatives of all of the key stakeholder groups. Smaller Parish Councils fill in a simplified financial return on a receipts and payments basis. Further discussion of smaller authorities is included in **Chapter 8**.

7.3 Format of local authority accounts

7.3.1 Local authority accounts are very lengthy compared to accounts in other sectors, typically numbering in excess of 50 pages for shire districts and more than 80 for upper and single tier local authorities. They have more primary statements than central government and private sector accounts. **Figure 7.2** shows the primary statements and supplementary accounts that the user can expect to find in a set of local authority accounts.

7.3.2 Local authority accounts are arguably more complex and more challenging for a service user to understand than accounts produced by other parts of the public sector. This is primarily because there is a difference between the budget analysis of information for council tax purposes and the statutory basis of year end accounts.

Figure 7.2

Local Authority Accounts – Primary Statements and Supplementary Accounts

Statement	Purpose
Comprehensive Income and Expenditure Statement (CIES)	Summary of the resources generated and consumed by the council on an accruals basis. Shows gross and net expenditure by service area and other income and expenditure incurred by the council.
Movement in Reserves Statement (MIRS)*	Shows how the movement in reserves in the Balance Sheet is reconciled to the CIES deficit and what adjustments are required to be charged to the general fund balance for Council Tax setting purposes.
Balance Sheet	Sets out the Council's financial position at the year end.
Expenditure and Funding Analysis (EFA)*	Summarises the annual expenditure used and funded by the Council together with the adjustments between the funding and accounting basis to reconcile with the CIES.
Cashflow Statement	Summarises the inflows and outflows of cash for revenue and capital transactions during the year.
Collection Fund Account* • Billing authorities	Agent's statement that reflects the statutory obligation for billing authorities to maintain an account showing collection of Council Tax and National Non-Domestic Rates (NNDR) and the distribution of these taxes to precepting authorities.
Housing Revenue Account (HRA)* • LAs with social housing stock	Local authorities are not allowed to cross subsidise provision of social housing from general taxation or vice versa. The HRA shows the major elements of expenditure on social housing and how these costs are met.

** Statements unique to local authority accounts*

7.3.3 Local authorities calculate their annual council tax requirement through setting a "balanced budget". The balanced budget calculation that local authorities are required to make is specified in primary legislation and is undertaken on a receipts and payments basis. Following the adoption of accruals accounting[18] by the local authority sector and as IFRS have continued to develop, successive governments have sought to protect council taxpayers from accruals movements that do not have an immediate impact on the costs of service delivery. They have done this through introducing statutory overrides.

7.3.4 The most significant of these statutory overrides relates to depreciation. Local authorities are required to charge depreciation on assets in the same way as any other entity. They then reverse out the depreciation charge in the Movement in Reserves statement (MIRS) and replace it with a prudent provision for the debt taken out to acquire assets (Minimum Revenue Provision).

[18] Accruals accounting is a form of accounting where you recognise the economic cost of assets and liabilities over the period when benefits accrue. For example, if you are using accruals accounting and buy a car that you expect will last five years you would split the purchase cost of that car over five years. By comparison if you are accounting on a receipts and payments basis you would recognise the full cost of the car in the year you pay for it.

7.3.5 The adjustments process has two consequences. Firstly it substantially increases the length of local authority accounts as the financial statements report some transactions on both an accruals basis (through the CIES) and a funding basis (through the EFA and MIRS) and include notes reconciling the two; and secondly, unlike for financial statements produced by other sectors, neither the CIES nor the Balance Sheet shows the true financial position of a local authority. To understand that position it is necessary to understand how the outturn reported in these statements reconciles to the basis on which the balanced budget calculation is made.

7.3.6 In addition to the statements in **Figure 7.2**, those local authorities who are also "administering authorities" for local authority pension funds are required to publish full Pension Fund accounts in the same document as their local authority accounts. The Pension Fund accounts are audited as a separate audit engagement. This further lengthens the document and means that the audited accounts cannot be published as final until both the local authority audit and the pension fund audit have been completed. The sector has asked MHCLG to look at decoupling the local authority and pension fund accounts. However, it is not possible to do this without primary legislation.

7.4 Usefulness, understandability and transparency of local authority accounts

7.4.1 The Annual Accounts that each local authority must prepare are prescribed in detail and relevant standards must be observed in the preparation of the statutory accounts and financial report. IFRS cover both the public and private sectors so auditors seek to adhere to those principles when auditing local authority accounts. There is widespread agreement that the resultant accounts are not transparent or easily understandable.

7.4.2 Local government practitioners argue that the extent and nature of asset valuations, very relevant in a commercial setting, undertaken by auditors, have limited significance in local government where assets are more often than not critical to service delivery and "market value" is not a consideration. Time allocated to the asset valuation process for property and pensions, it is agreed, is considerable and increases the cost of audit as well as, in some cases, leading to delays in the audit being finalised. Underlying this point is the question of whether IFRS should continue to be a key element of local authority statutory accounts.

7.4.3 An issue related to the concern in local government about the complex local authority accounting arrangements is the capacity of the external auditor to test and validate technically intricate accounting treatment without a familiarity with local authority finance and accounting. Such an assertion by local government is not universal but it is a concern of many. However, the audit community, whilst recognising that there has been depletion in the number of auditors who served in the District Audit Service, is confident it has necessary skills and resources to fulfil the role.

7.4.4 As highlighted in **Chapter 4**, there is evidence of market stress in the supply of appropriately experienced and qualified local authority auditors. Some auditors have also argued that local government itself does not always have accounting staff with the technical expertise to complete the final accounts without guidance and support from external audit.

7.4.5 That the local authority accounts are very complex is not in dispute. There is wide acknowledgment from all stakeholder groups that the annual financial statement of accounts is understandable only to those with the necessary technical and professional knowledge of local authority accounts. When asked whether local authority accounts allow the user to understand an authority's financial performance and its financial resilience, 93% of respondents said no.

7.4.6 Whilst some local authority respondents argued that the understandability of the accounts is not an issue, because service users and taxpayers can take assurance from the fact that they are prepared and audited to internationally recognised standards, it is questionable whether this is a defensible position.

7.4.7 The lack of transparency and understandability of local authority accounts raises a fundamental and serious challenge in terms of transparency and public accountability. Potential users extend beyond councils, government and auditors. Key stakeholders include council taxpayers/service users, the general public, academia, the media and local authority partners and contractors. Without an appropriate level of transparency these users may not have the information to challenge their local authority effectively. The rigour underpinning local authority accounting and auditing may not be at issue but the accounts, as currently structured and presented, do not enable the public to understand how local authorities are stewarding public funds.

7.5 Options for reform

7.5.1 There are three broad options for enhancing the transparency and usefulness of local authority financial statements, so that they better serve the needs of a wider group of stakeholders. These are:

- Review of IFRS as a basis for the preparation of local authority accounts.
- Expansion and standardisation of the current narrative statement.
- Introduction of a new summary statement presented alongside the IFRS accounts.

7.5.2 The underlying purpose of all three options is to strengthen financial transparency and accountability by providing a simplified presentation that is more relevant to stakeholders. All options have costs associated with them but these need to be set against the benefits of that increased transparency.

Review basis on which accounts are prepared

7.5.3 CIPFA could be asked to review the basis of accounts, with the aim of updating the Accounting Code so that the transactions presented in the annual financial statements are prepared on the same basis as the annual budget approved by Full Council.

7.5.4 If followed to its logical conclusion, this would allow local authorities to prepare simplified accounts that could be easily reconciled to the annual budget. If accounts are presented on a funding basis, the reconciliations between the funding and accounting basis would no longer be required. In addition, many of the lengthier notes to a set of financial statements, such as the financial instruments disclosures, are mainly required to support IFRS disclosures and could be removed or simplified. This would lead to much shorter documents.

7.5.5 There are some issues that would have to be addressed with this recommendation. Firstly, designing and implementing a new accounting framework would be challenging. CIPFA could go back to the pre-2010 near cash accounting framework, but it is questionable whether this would be appropriate. Many local authorities are far more commercial in their operations and have far more leveraged balance sheets than in 2010, so removing much of the accounting for long term assets and liabilities could present a misleading picture of financial resilience to service users. It could lead to local authorities to leveraging their balance sheet yet further, storing up potential financial problems for future years.

7.5.6 Secondly, there is the perception risk of such a step. There could be a perceived disconnect if local authorities reverted to cash accounting at the same point that some are becoming more commercial, taking on more debt to invest in assets acquired solely or partially to generate a return.

7.5.7 Thirdly, moving away from IFRS accounting would create consistency problems between various parts of the public sector. The Accounting Code applies to Scotland, Wales and Northern Ireland as well as to England. If English local government moved to a near cash accounting framework, the other UK jurisdictions would face the decision of mirroring that move or else the Accounting Codes would need to diverge. In addition, the results of UK local government bodies are consolidated into the Whole of Government Accounts, which are prepared on an IFRS basis. If English local authority accounts moved to a near-cash accounting basis, those authorities would in practice be required to maintain financial records and prepare accounts on two bases: on a near-cash basis for their own accounts and an IFRS basis for consolidation into WGA. This would impose considerable additional cost.

7.5.8 Finally, the UK public sector is held up as applying a gold standard of accounting, primarily because it is one of the few to apply IFRS fully. If part of the sector moved away from this it could generate considerable reputational risk. As a result, HM Treasury and FRAB may well oppose any significant modification of the English local authority accounting framework.

Expansion and standardisation of the narrative statement

7.5.9 The framework for local authority annual reports and accounts is unusual in that, although local authorities are required to prepare an annual report, it does not include any mandatory disclosures. In 2015 CIPFA launched the “Telling the Story” initiative, which encouraged local authorities to use the annual report to accurately reflect financial and service performance. Some local authorities have produced innovative and informative annual reports following the launch of this initiative, but performance varies, with other authorities making minimal disclosures. In addition, because “Telling the Story” does not include mandated standards or disclosures it is not consistent across authorities.

7.5.10 By comparison, the UK Central Government Financial Reporting Manual (the “FReM”) requires all central government reporting entities to prepare a Performance Report and an Accountability Report, both of which are based on Companies Act requirements as adapted for the public sector and contain mandated disclosures.

7.5.11 A similar approach could be adopted for local authority accounts. In this model, local authorities could be required to include a Performance Report in their annual report and accounts containing a reconciliation between the approved budget and year-end service expenditure, along with explanations for significant variances and the impact of the variances on revenue reserves, prepared on a budget setting basis whilst being reconcilable to the statutory accounts. Potentially this could be supplemented with standardised service delivery metrics and an explanation of longer-term risks and mitigations linked to key financial management strategies such as the Mid-Term Financial Plan, as appropriate.

7.5.12 The proposed Performance Report could be a transparent element of a local authority’s Annual Report and Accounts, which discloses what the local authority planned to spend on each major service area, what it actually spent, where there were significant variances between the two what the reasons were, and what impact that has had on the reserves available to support the following year’s expenditure. With the addition of service delivery metrics, the Report could also start to give an indication of what service users and taxpayers have got for their money. If the financial information and performance metrics are prepared to common standards, this could start to bring a degree of comparability between authorities, which could promote improvements in the effectiveness and efficiency of service delivery.

7.5.13 Finally, if the reconciliation between budget and outturn is presented in the Annual Report, it may be possible to remove or reduce the MIRS, the EFA and supporting disclosures. This could offset the increased work required to produce the new Performance Report.

7.5.14 There are some challenges with this approach:

- it would mean extending the scope of the audit engagement, particularly if the auditors are required to form an opinion on non-financial information.
- if non-financial service delivery metrics are subject to audit they will need to be prepared and disclosed on a consistent basis. It will be necessary to identify appropriate metrics across a range of service areas, a process that could take time. In addition, including metrics for all of the services that a local authority provides would require very lengthy disclosures.
- if included in a long Annual Report and Accounts document, there is no guarantee that this statement would be any more visible to the general public than the current financial statements are.
- there is a risk that some local authorities use the narrative element of such a statement to present an overly positive view of their achievements and finances.

Introduction of a new summary statement

7.5.15 A variation in part, and a replacement of the enhanced narrative statement, is to leave the current local authority accounts largely unaltered and instead require the production of Summarised Accounts, prepared on the budget setting basis. As with the enhanced narrative statement, the Summarised Accounts would need to be reconcilable to the Statutory Accounts and be subject to audit to have credibility.

7.5.16 Statutory Guidance would need to be developed to set out the form and content of the Summarised Accounts. Potentially they could contain:

- A statement of service information and costs prepared in a standard format and to a standardised framework. The most appropriate framework would probably be the statutory Service Reporting Code of Practice (SERCoP).
- Comparison between budget setting information and outturn performance.
- A degree of detail to encompass all key service expenditure heads; where appropriate this could be extended to present unit cost information. A simplified balance sheet, including some form of assurance relating to non-ringfenced revenue reserves and debt levels and borrowing plans, with the latter linked to the Prudential Framework disclosures, could also be produced.
- A brief narrative. This could be limited to a financial commentary comprising explanations of significant variances between budget and outturn along with an assessment of the impact on medium term financial sustainability. It may also be possible to include a brief description of outcomes though this would need to be linked back to the objectives set when the annual budget was approved.

7.5.17 The aim of this document would be to present a statement aimed at the local community rather than as a basis for compiling national statistics. Because of differences between local authorities, comparability would be difficult and potentially misleading. Local authorities could be asked to think about a range of communication methods to reach their local communities more effectively.

7.5.18 The summary accounts would be a vehicle to increase transparency. As this would be a short stand-alone document, it would be much more accessible to taxpayers and service users.

7.5.19 Local authorities would have to reconcile outturn between the funding basis and IFRS accounting basis. However, the value of disclosing these reconciliations could be reassessed, potentially allowing the MIRS, the EFA and supporting disclosures to be discontinued. This could allow the statutory financial statements to be prepared on an IFRS basis without statutory adjustments.

7.5.20 Finally, consideration would need to be given as to the level of audit required for the Simplified Statements, and the agreed procedures that auditors would be required to undertake to provide assurance over reconciliations between the IFRS Financial Statements and the Simplified Financial Statements, that are not disclosed in either.

8. Smaller authorities

8.1 Introduction

8.1.1 Smaller authorities are defined in the 2014 Act as an authority where the higher of gross annual income or expenditure does not exceed £6.5 million for three years (or one or two if the authority has not existed for three years). Currently there are just under 10,000 smaller bodies, only one of which has to prepare a full set of IFRS compliant accounts and undergo a full audit.

8.1.2 There are different types of smaller authority with a varied range of responsibilities and powers:

- Local councils including Parish, Town, Village and Community Councils and parish meetings. Some common responsibilities can include, but are not limited to, commons and open spaces, car parks, lighting, footpaths, leisure and sports facilities, litter bins, and tourism activities. Some of these services are delivered on behalf of the unitary and district councils.
- IDBs which are responsible for managing water levels including managing flood risks and land drainage.
- Other smaller authorities such as charter trustees, port health authorities, conservation bodies and crematorium boards.

Smaller authorities are financed primarily through a precept which is collected as part of council tax by the unitary or district council. They can also apply for grants and awards.

8.1.3 Governance arrangements depend on the type and size of the authority. All local authorities are required to have a clerk; however, for small authorities, this could be their only employee or may be a volunteer or part-time worker. Roughly two-thirds of smaller authorities have a single employee, and some don't have any employees. The clerk is analogous, in part, to a CFO in a principal authority, as there is a requirement to give guidance to councillors, in many cases carrying out the role of the Finance Officer. Smaller authorities must publish the statement of accounts together with any certificate or opinion provided by the local auditor[19].

8.2 Scale of audit

8.2.1 Smaller authorities are not required to produce IFRS based accounts but instead produce a simplified statement of account on a receipts and payments basis. Some larger Parish Councils present accruals-based accounts alongside this, although these are unaudited. As set out in **Figure 8.1**, smaller authorities are either exempt from audit or undergo a 'limited assurance engagement'. As the name suggests, this provides less assurance than a full-scale audit.

8.2.2 While most authorities with an income or expenditure of up to £25,000 are exempt from audit, a request can be made for a 'limited assurance engagement' from SAAA who will then appoint an auditor to undertake this work. More than 100 bodies have chosen to do this.

[19] The Accounts and Audit Regulations 2015
https://www.legislation.gov.uk/uksi/2015/234/pdfs/uksi_20150234_en.pdf

Figure 8.1

Table of audit thresholds and associated requirements for smaller authorities [20]

Level of income or spending	Form of external assurance to be provided from 2017-18 onwards	% of smaller authorities in each band
More than £6.5 million.	'Full audit' under international auditing standards.	0.01%
Up to £6.5 million but more than £200,000 (accounts on income and expenditure basis)	Limited assurance engagement but may opt for 'full audit'.	11%
Up to £200,000 but more than £25,000 (accounts can be on either receipts and payments or income and expenditure basis)	Limited assurance engagement but may opt for 'full audit'.	31%
Gross income or gross expenditure up to £25,000	Exempt from audit and limited assurance engagement in most cases, subject to the authority certifying that it is exempt. Work by an auditor may still be needed in certain circumstances – notably if there are objections to the accounts.	58%
No financial transactions and no accounts	Exempt from audit and limited assurance engagement in most cases, subject to the authority certifying that it is exempt.	

8.2.3 Smaller authorities are also required to undertake an internal audit to evaluate the effectiveness of its risk management, control and governance processes[21]. Quality of internal audit staff is said by some respondents to be variable, which has the potential to cause issues for the external audit.

8.2.4 One of the trends in recent years has been the transfer of assets and associated running costs to Parish Councils. If smaller authorities are given more responsibility, or if the spending of smaller authorities were to change to where many such authorities approach the £6.5 million threshold, the current accountability arrangements may no longer be appropriate. The assurance levels may need to be reviewed by MHCLG. This is especially pertinent as smaller authorities are not bound

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[20] NAO AGN02 Specified Procedures for Assurance Engagements at Smaller Authorities https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Auditor-Guidance-Note-02-Specified-Procedures-for-Assurance-Engagements-at-Smaller-Authorities.pdf

[21] The Accounts and Audit Regulations 5(1) 2015https://www.legislation.gov.uk/uksi/2015/234/made#:~:text=5.,internal%20auditing%20standards%20or%20guidance.

by council tax referendum rules[22] and can raise their precept by the amount they consider necessary.

8.2.5 In 2020, one IDB met the threshold for preparing full statutory accounts. Available evidence suggests that this is the first occasion of this happening. The cause of the IDB's increase in income and expenditure was the capital grants it received and, as such, the requirements for a full code audit may be temporary. PSAA and the Association of Drainage Authorities (ADA) have worked with the authority to find a new auditor as the previously appointed auditor does not qualify under the statutory framework to undertake full audits. This also resulted in an increased audit fee, from less than £5,000 to £40,000. Producing full IFRS accounts will considerably increase the amount of internal work required by the IDB and this is likely to represent a challenge to its available skills and infrastructure.

8.3 Procurement of audit

8.3.1 Prior to 2017, smaller authorities were included in the audit contracts let by the Audit Commission in 2014 that were taken over by PSAA through the transitional arrangements. SAAA was designated as an appointing person under legislation[23] by the Secretary of State to take over this role from 2017-18. SAAA is an independent, not for profit company. SAAA was set up by the National Association of Local Councils (NALC), Society of Local Council Clerks (SLCC) and the Association of Drainage Authorities (ADA). Although smaller authorities have the same power to appoint their own auditors as principal authorities, in practice, all smaller authorities opted in to SAAA's procurement. SAAA has appointed external auditors for a 5-year period from 1 April 2017.

8.3.2 SAAA's procurement comprised 17 equally sized lots. Other than for IDBs, which were grouped together, lots were geographically based. The SAAA procurement was based on price once a supplier had met a minimum quality threshold. There were five firms that met this threshold. The result of this exercise was that 15 were awarded to a single audit firm and two other firms won one lot each. This met SAAA's declared objective of having a minimum of three firms in the market. Of the three firms, two had previously held contracts with PSAA and one re-joined the market. With regard to the quality and price ration for appointing auditors, SAAA believes that once a certain threshold is reached, it is very difficult to differentiate between firms on the basis of quality.

Fee scale

8.3.3 SAAA's fee scale is based on 15 bands of income or expenditure (whichever is higher). Audit Commission and then PSAA, through the transitional arrangements, also used this fee scale. Exempt authorities do not pay an audit fee. Authorities with income or expenditure of between £25,000 and £50,000 pay an audit fee of £200. Fees rise in stages up to a maximum of £3,600 in cases where income or expenditure is more than £5 million but less than £6.5 million.

[22] The Local Authorities (Conduct of Referendums) (Council Tax Increases) (England) Regulations 2012 https://www.legislation.gov.uk/ukdsi/2012/9780111519035/regulation/3

[23] The Local Audit (Smaller Authorities) Regulations 2015 https://www.legislation.gov.uk/ukdsi/2015/9780111126103

8.3.4 The scale fees paid by smaller authorities for their audit have remained unchanged for the past 12 years. There have been savings for those smaller authorities that, from 2017, could declare themselves as exempt and, therefore, did not have to pay for an audit.

8.3.5 This audit fee model relies on larger authorities supplementing the cost of audit work for smaller authorities. As there are 15 bands of fees, there may be councils receiving the same level of audit work whilst paying different amounts. Although this may offer the most efficient method of payment to ensure audit is affordable for all smaller authorities, the banding system may warrant review.

8.3.6 Overall, smaller authorities seem content with the level of audit fees they pay. The only area of concern raised related to capital grant funding. Two Parish Councils raised concerns that the impact of the rising scale fee could be a deterrent for local authorities investing in future capital schemes in the local community.

Fee variations

8.3.7 Smaller authorities may be subject to variations to the scale fees set out above if additional work is needed. Some of this work is costed as a fixed supplement of the fee scale and some is charged at fixed hourly rates. SAAA agreed a maximum hourly rate for additional work and this is published on their website. Examples of where fee variations may be charged include the auditor considering objections to the accounts from local electors, and where special investigations are undertaken.

Quality

8.3.8 There is no indication that the smaller authority audit market is encountering delayed audit opinions, as is the case for larger authorities. SAAA use trackers completed by the firms to collate and analyse key management information to track and report on the management, delivery and the outcomes of limited assurance reviews. SAAA also reviews the underlying data quality and system interfaces on a light touch risk basis.

8.3.9 In carrying out its quality assurance role, as set out in the Appointing Person Legislation, SAAA review and test the firms' internal quality assurance processes and contract compliance systems (quality aspects) to ensure the delivery of good quality reviews. An overall rating for both quality of limited assurance review work and contract management, compliance and data quality is provided. The findings of this process are reported to each firm and to SAAA's Board. They do not publish these findings, though they maintain the right to do so.

8.3.10 A very small number of smaller authorities responded to the Call for Views; therefore, it must be stressed that the following comments are not necessarily reflective of the sector. One Parish Council commented that the arrangement with SAAA made it feel that the auditor didn't consider the council to be its customer. Similar feedback has been received concerning PSAA's role. It also commented that it felt the quality of their audit was very poor and that it added no value. This may be in part due to the framework of limited assurance audit for smaller authorities and a resulting 'expectation gap'. The Review is unable to corroborate whether this is a commonly held view.

8.3.11 Two other Parish Councils questioned whether auditors provided the right level of assurance. One commented that larger Parish Councils should be held to the same standards for financial reporting, transparency and accountability as those applied to principal authorities of equivalent size. The council linked this to the fact that some councils are playing an increasingly significant role in their communities. It is true that there are currently three smaller authorities that have an annual income or expenditure of over £5 million which is similar to the smallest Category 1 authority which is subject to a full audit. However, there are not many Category 1 authorities that are this small. The other respondent was specifically concerned about governance and financial transparency within the council and the lack of clarity on spending.

8.4 Accountability

8.4.1 In addition to producing a financial return, most smaller authorities are subject to transparency requirements. There are two Transparency Codes; authorities with an income or expenditure of £200,000 or more are included in the same mandatory Transparency Code[24] as principal authorities. Exempt authorities are subject to a specific smaller authority Transparency Code[25], made mandatory in April 2015, that:

"will enable local electors and ratepayers to access relevant information about the authorities' accounts and governance".

8.4.2 Authorities with income and expenditure under £200,000 but above £25,000 are expected to follow the same requirements but it is not mandatory. As these authorities are subject to audit, the transparency code was not considered to be applicable. Such difference in approach may warrant further attention. However, Commitment 8 in the governments UK National Action Plan for Open Government[26], sets out the government's plan for local transparency which includes MHCLG developing proposals to:

"help and encourage councils to publish all the information they can".

Objections

8.4.3 Local objections can be made to an item of expenditure in a smaller authority's finance return. It is very difficult to ascertain how many objections to the accounts smaller authorities receive, as the auditor is required to respond, by statute, only to the objector. As a result, most objections are never made public, the exceptions being if an objector choses to publish a response or the investigation leads to a Public Interest Report. However, one authority reported over 100 objections in a single year. NALC commented that several authorities at the smaller end of the income and expenditure level are consistently subject to objections, sometimes by the same individual or group of objectors.

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[24] Local Government Transparency Code 2015
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/408386/150227_PUBLICATION_Final_LGTC_2015.pdf

[25] Transparency Code for Smaller Authorities
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/388541/Transparency_Code_for_Smaller_Authorities.pdf

[26] 2019-2021 UK National Action Plan for Open Government
https://www.opengovernment.org.uk/resource/uk-national-action-plan-for-open-government-2019-2021/

8.4.4 The auditor is responsible for reviewing all objections that meet the statutory requirement. In deciding whether to investigate, the auditor has to review the objection, which will result in a cost to the authority (not exceeding the maximum hourly rates as specified by SAAA) even if they do not subsequently pursue an investigation.

8.4.5 The auditor can refuse to investigate an objection[27] if:

- the cost of dealing with the complaint would be disproportionate to the underlying sum;
- the objection is frivolous or vexatious; or
- it is a repeat of a complaint made in a prior year of account.

8.4.6 A number of smaller authorities receive repeat or vexatious complaints. Where an authority receives such a complaint, it can choose to terminate communication with the complainant. However, if that individual raises an objection, an auditor must consider it to see if it is something to be pursued. This work incurs a supplement to the scale fee as set out by the SAAA. Given the size of many smaller authorities, objections can be proportionately very costly, both in terms of additional fees paid to auditor firms and in terms of resources that the authority requires to support, appropriately, the objection process. As with larger authorities, outstanding objections can cause a delay in issuing the audit opinion

8.4.7 The objections regime does provide a solid basis of accountability and ensures the auditor investigates potential issues further, to supplement the 'limited assurance' audit. There may be cases where the system is misused. Consideration should be given to provide more support to auditors to enable them to identify repeat or vexatious objectors in a more efficient manner.

Public Interest Reports

8.4.8 External auditors have a duty under the 2014 Act to consider whether to issue a report where there has been a significant matter identified that needs to be addressed in the interests of the public. There are more PIRs issued for smaller authorities than there are for larger authorities. SAAA publishes reports from the 17/18 financial year on their website, and previous financial years are available on the archived PSAA website.

Figure 8.2

Smaller Authorities - Reasons why a PIR was issued

	16/17	17/18	19/20
Failure to produce an annual return (for 16/17) or an AGAR (from 17/8 onwards)	16	22	23
Criteria submitted for exemption not all satisfied	N/A	0	8
Other	6	1	0
Total	22	23	31

The "other" category includes issues relating to governance, fraud, employment law, and non-compliance with VAT regulations.

[27] NAO Local Authority accounts: A guide to your rights https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Council-accounts-a-guide-to-your-rights.pdf

8.4.9 One authority had a PIR issued for all three years for failure to produce an annual return or annual governance and accountability returns (AGAR), and a further seven authorities had a PIR issued in two of the three years for the same reason. Failure to produce an AGAR from 2017/18 triggers a statutory recommendation to the authority from the external auditor that it should submit an approved AGAR within 42 days. A public interest report is then issued if the authority fails to do so.

8.4.10 Out of the six PIRs issued in 16/17 that were *not* due to a failure to produce an annual return, four of them related to work carried out by auditors in response to objections raised by a local elector. In one authority's case, it received objections on a multitude of issues with one issue (ineffective internal audit and other governance failings) receiving a number of objections.

8.4.11 If a smaller authority chooses not to engage with external audit recommendations or PIRs, there is no mechanism, other than through local elections, to hold smaller authorities to account. The LGSCO investigates complaints against larger local authorities, but this does not extend to Parish Councils. If MHCLG wishes to devolve more powers to smaller authorities or smaller authorities increase their spending considerably, MHCLG should consider further accountability arrangements for smaller authorities.

8.5 Financial Reporting in Smaller Authorities

8.5.1 Smaller authorities that are able to declare that they have had had no financial transactions in the year of account do not need to prepare accounts. Instead they can send a declaration that they are exempt to their auditor.

8.5.2 Smaller authorities that cannot declare themselves exempt have to prepare an Annual Governance and Accountability Return (AGAR). The AGAR which is freely available, is updated and produced by SAAA and approved by the SAAA board. The cost of its production is met by SAAA.

8.5.3 JPAG is responsible for issuing proper practices about the governance and accounts of smaller authorities. Its membership consists of sector representatives from the National Association of Local Councils, the Society of Local Council Clerks and the Association of Drainage Authorities, together with stakeholder partners representing MHCLG, the Department of Environment, Food and Rural Affairs, CIPFA, the NAO and a representative of the external audit firms appointed to smaller authorities.

8.5.4 The AGAR has a number of sections. In order these are:

a. Guidance notes on how to complete the template and what information needs to be published on the authority's website.
b. The Annual Internal Audit Report.
c. Section 1: The Governance Statement.
d. Section 2: The Accounting Statement, which is prepared on a receipts and payments basis.
e. The External Auditor Report and Certificate.

8.5.5 Each non-exempt smaller authority is required to complete parts b, c, and d of the AGAR and send it together with a bank reconciliation and an explanation of any variances between the budget and the outturn to the auditor. The template itself is quite short, but fairly busy, with detailed guidance included in each section.

8.5.6 Under the Accounts and Audit Regulations 2015, authorities must publish the following information on a publicly accessible website. Before 1 July, smaller authorities must publish:

- Notice of the period for the exercise of public rights and a declaration that the accounting statements are as yet unaudited;
- Section 1 - Annual Governance Statement, approved and signed; and
- Section 2 - Accounting Statements, approved and signed.

8.5.7 Not later than 30 September, smaller authorities must publish:

- Notice of conclusion of the audit;
- The External Auditor Report and Certificate: and
- Sections 1 and 2 of AGAR including any amendments as a result of the limited assurance review.

9. Conclusions

9.1 During the course of this Review it has become increasingly apparent that the current local audit arrangements fail to deliver, in full, policy objectives underpinning the 2014 Act. As a result, the overriding concern must be a lack of coherence and public accountability within the existing system. For local audit to be wholly effective it must provide a service which is robust, relevant, and timely; it must demonstrate the right balance between price and quality; and be transparent to public scrutiny. The evidence is compelling to suggest that the current audit service does not meet those standards.

Key Factors Determining the Outcomes of The Review

9.2 In reaching the outcome and recommendations for this Review the following key factors have been taken into account:

- providing clarity of purpose in local audit;
- giving emphasis to performance and accountability in local audit framework;
- maintaining and improving the stability of the local audit market;
- reaffirming the importance of the auditing and accounting staff having the requisite skills, training and experience to fulfil their roles;
- improving and strengthening the governance arrangements underpinning effective local audit;
- developing coherence and coordination in the procurement and effective delivery of audit performance within a clear and consistent accountability framework;
- engaging key stakeholders in regular dialogue as an aid to maintaining an effective local audit service; and
- providing transparency in financial and external audit reporting to reinforce public accountability.

Local Audit

9.3 As currently configured the local audit market is vulnerable, due in no small part to the under-resourcing of audit work required to be undertaken within the contract sum. In addressing this weakness, a fundamental review of the fee structure is necessary. Evidence suggests that audit fees are at least 25% lower than is required to fulfil current local audit requirements effectively. Concerns reported about variable levels of knowledge and experience of local government finance and accounting demonstrated by auditors must also be addressed. The skills and competencies of auditors must also be paramount if the full extent of audit requirements are to be delivered satisfactorily. The current audit deadline of 31 July is viewed as unrealistic and in the light of the evidence presented by the Call for Views, there is a compelling argument to change this date to 30 September. The procurement arrangements must acknowledge these factors and it is essential that the audit performance regime offers assurance to the public that true accountability has been served.

9.4 Attention has been given to whether the existing local audit framework might be improved to achieve these objectives. The roles and responsibilities of all relevant bodies should be reviewed to respond to the concerns expressed in this report. However, the key challenge is the underlying weakness of the current arrangements where there is no coordination and regulation of local audit activity. This is a role best discharged by a single overarching body.

9.5 A single body would embrace all aspects of local audit incorporating procurement, contract management, the code of local audit practice, accountability for performance, oversight and regulation. Clarity of purpose, consistency and public accountability would be essential features of this approach and the expertise and skills of those currently providing these services would be harnessed and maintained in the new body.

9.6 The Review has highlighted a potential weakness in the way in which audit outcomes are considered and presented to both the local authority and the public. The ability of Audit Committees, which mostly lack independent, technically qualified members, to consider, effectively, audit reports has been challenged in responses to the call for views. In addition, transparency and accountability of audit reports, from a public perspective is lacking and there is considerable scope for the Key Audit Partner to present a report on the principal issues arising from the audit to Full Council at least annually.

9.7 The situation facing PCCs and FRAs is many ways similar to those for principal councils in that audit quality and price are in need of review. Governance here, however, is somewhat different in terms of reporting lines and public accountability as these are currently more transparent than those applying in Principal Authorities.

9.8 Parish Councils, Meetings, IDBs and other smaller authorities operate on a much smaller scale and procurement/contractor arrangements are overseen by SAAA where no serious concerns have been identified. However, there is scope here to improve public reporting of local audit outcomes and attention should be given to 'turnover' thresholds in order to ensure a proportionate level of resource is utilised in fulfilling audit requirements.

9.9 An area that has generated considerable comment is the perceived gap between the reasonable expectations of many stakeholders and what auditors are required to do relating to the financial stability and resilience of local authorities. There is a compelling argument to extend the scope of audit to include a substantive test of financial resilience and sustainability. The scope of this audit needs to be clearly defined and focused to ensure there is a balance between cost and the potential benefits of such additional audit coverage and reporting. This would represent a genuine demonstration of public accountability.

9.10 The new NAO code includes a revised narrative audit opinion and sets out three reporting criteria relating to financial sustainability, governance and improving economy, efficiency, and effectiveness. This approach, once fully established, will provide a very important statement to stakeholders regarding a local authority's financial health. In effecting this scrutiny of financial sustainability, the auditor would also undertake an assessment of the risks identified in the CFO's annual Section 25 report of the budget. This could be further assisted by a review of the local authority's observance of CIPFA's Financial Management Code which provides a set of statements including value for money and financial resilience. To ensure that the Auditor's work is genuinely transparent and accessible to local taxpayers an Auditor's Report should be presented to the first Full Council meeting after 30 September every year, irrespective of whether the financial accounts have been certified.

Transparency of Financial Reporting

9.11 This report has highlighted the inability of the general public to understand the annual statutory accounts presented by local authorities. The technical complexity of the accounts means that service users/council taxpayers have little or no opportunity to comprehend what is being said or to challenge expenditure and income relating to a specific service and how the local authority has performed.

9.12 Three options have been explained in this report as a possible response to this problem. A review of the existing IFRS based accounts could be undertaken, but, given the requirement to observe international reporting standards, it may not yield the simplicity in presentation and terminology that is sought here. An alternative detailed in this report would entail adapting the existing narrative report produced by local authorities as an addendum to the statutory accounts where discretion would be afforded to each local authority regarding style, content and presentation. The third and final option relates to a new simplified statement of service information and costs as a means of enabling each local authority to communicate, in a standardised format, the key information relating to the budget and council tax setting compared to actual financial performance. If transparency and consistency of financial reporting are to be achieved this last option best meets these objectives although the experience developed in the production of narrative reports may be beneficial in its design.

9.13 A draft of a simplified statement is included as an annex to this report which incorporates the key features of simplicity and transparency. Observance of IFRS based accounts remains an important ingredient in ensuring proper accountability for financial performance, so the current statutory accounts should still be produced. This requirement is underpinned by a Code of Accounting Practice produced by CIPFA. Many local authorities have not purchased the most recent copy of the Accounting Code. Consideration should be given to this being freely available, given its importance in the construction of statutory accounts.

10. List of Annexes

1. What are auditors required to do?
2. Roles and duties of Statutory Officers
3. Functions of the Office of Local Audit and Regulation
4. Illustrative Simplified Financial Statements
    a. District Council
    b. Fire and Rescue Authority
    c. Police and Crime Commissioner
    d. Unitary Authority
5. Potential impact of recommendations made by other reviews of audit
6. Approach of other state auditors to performance audit
7. Terms of Reference
8. Call for Views respondents

Appendix – Glossary of Key Terms, Acronyms and Abbreviations

ACCA – Association of Chartered Certified Accountants
Professional accounting body offering the Chartered Certified Accountant qualification

Accounting Officer
Normally the Permanent Secretary of a government department who is personally responsible for the regularity and propriety of expenditure, robust evaluation of different mechanisms for delivering policy objectives, value for money, the management of risk, and accurate accounting for the use of resources

Accounts and Audit Regulations 2015
Statutory Instrument that sets the deadlines for publishing unaudited local authority accounts for inspection and for publishing audited local authority accounts; requires local authorities to have an internal audit; and details the information that must be included in local authority annual report and accounts.

Adverse Opinion
An audit opinion - a conclusion that an authority's accounts are not true and fair/proper arrangements to secure the economy, effectiveness and efficiency of service delivery are not in place.

AGN – Auditor Guidance Notes
Guidance produced by the National Audit Office to support external auditors in their work and to facilitate consistency of approach between auditors of the same types of entity. These have the same status as the NAO Audit Code of Practice

ALB – Arm's Length Body
A body which has a role in the processes of national government but is not a government department or part of one, and which accordingly operates to a greater or lesser extent at arm's length from ministers.

Annual Audit Letter – also known as Audit Completion Report or ISA260 Report
The annual audit letter summarises key findings from the auditor's yearly audit; often includes management recommendations.

AQR – Audit Quality Review team
The part of the Financial Reporting Council that monitors the quality of the audit work of statutory auditors and audit firms in the UK that audit Public Interest Entities (PIEs). Since 2018-19 AQR has been responsible for the quality assurance of larger local authority audits.

ARGA – Audit, Reporting and Governance Authority
A planned independent regulatory body to replace the Financial Reporting Council. This was recommended by Sir John Kingman in his review of the Financial Reporting Council and supported by Sir Donald Brydon in his review into the quality and effectiveness of audit

Audit Commission
A now disbanded independent public corporation that had the responsibility for appointing auditors to a range of local public bodies in England. They set the standards for auditors and had oversight their work

Audit Scotland
The body responsible for supporting the Auditor General for Scotland in providing independent assurance to the people of Scotland that public money is spent properly, efficiently and effectively.

BEIS – Department for Business, Energy & Industrial Strategy
Has policy responsibility for statutory audit, including taking forward the recommendations made by the Kingman and Brydon reviews.

Best Value
A local authority should make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. Under the Duty of best value, therefore, authorities should consider overall value, including economic, environmental and social value, when reviewing service provision. Central government may use its best value powers to intervene in a local authority in exceptional cases where that best value duty has not been met.

Brydon Review
Independent Review into the Quality and Effectiveness of PIE Audits led by Sir Donald Brydon (published December 2019).

C&AG – Comptroller and Auditor General
An independent officer of the House of Commons who leads and is supported by the National Audit Office. Has the statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively and with economy. Responsible for preparing, maintaining, and developing the Code of Audit Practice for local authority auditors (the Audit Code).

Capital Finance and Accounting Regulations 2003 (as amended)
Regulations governing local authority capital finance and investment. Include the statutory overrides to GAAP that local authorities in England are required to apply.

Category 1 Authority
A relevant authority that either: (a) is not a smaller authority; or (b) is a smaller authority that has chosen to prepare its accounts for the purpose of a full audit in accordance with regulation 8 of the Smaller Authorities Regulations. All local authorities with income or expenditure of more than £6.5m are Category 1 authorities. The Council of the Isles of Scilly and Shire Districts with income and expenditure of less than £6.5m are also Category 1 authorities.

Category 2 Authority
A relevant authority that is a smaller authority (that is a parish council, parish meeting or internal drainage board) and has annual income and expenditure of less than £6.5m

CFO – Local Authority Chief Financial Officer / Head of Finance (also referred to as the S151 Officer)
A local authority officer, who has statutory responsibility for the proper conduct of that local authority's financial affairs.

CIAA – Chartered Institute of Internal Auditors
A representative body of internal auditors

CIPFA – Chartered Institute of Public Finance and Accountancy
A professional public finance accountancy body. Maintains four statutory codes that local authorities are required to 'have regard to'.

Clean opinion – also known as an "unqualified opinion"
An audit opinion – that the accounts are true and fair, free from material misstatement and have been properly prepared in accordance with the applicable accounting framework.

Code of Audit Practice
The "Audit Code" sets out what local auditors are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. The Comptroller and Auditor General is responsible for the preparation, publication and maintenance of the Code of Audit Practice.

Code of Practice on Local Authority Accounting
Public sector organisations responsible for locally delivered services are required by legislation to prepare their accounts in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code)

CIPFA/LASAAC
A partnership between CIPFA (England, Northern Ireland and Wales) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC). Responsible for preparing, maintaining, developing and issuing the Accounting Code.

CMA – Competition and Markets Authority
A non-ministerial government department responsible for strengthening business competition and preventing and reducing anti-competitive activities

CMA Markets Study - Audit
The CMA carried out a study into the statutory audit market, to see if the market is working as well as it should. (published October 2018)

County councils – also known as Shire Counties
Upper tier authority responsible for services across the whole of a county such as: education; transport; planning; social care.

CQC – Care Quality Commission
An executive non-departmental public body responsible for monitoring, inspecting and regulating health and social care services.

DHSC – Department for Health and Social Care

District Audit Service
Set up in 1844, and originally part of HMT, was the Audit Commission's in-house audit practice until all local authority audits were outsourced for the 2012-13 financial year. Most staff working in the DAS at that time transferred to the private sector accountancy firms who took on responsibility for local authority audits.

District Council – also known as Shire District
Lower tier authority, responsible for services over a smaller area than county councils such as: rubbish collection; recycling; Council Tax collections; housing; planning applications

EFA - Expenditure and Funding Analysis
Summarises the annual expenditure used and funded by the Council together with the adjustments between the funding and accounting basis to reconcile with the CIES

Except for opinion
An audit opinion - a conclusion that in all material respects the accounts are true and fair/proper arrangements are in place except for the matters detailed in the audit certificate and report OR a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether one or more material items in the accounts are true and fair/a material element of proper arrangements are in place

Financial Reporting
Financial reporting uses financial statements to disclose financial data that indicates the financial health of an entity over during a specific period of time. These reports provide information to people who wish to understand the performance of an entity

FRA – Fire and Rescue Authority
A supervisory body which ensures that a local fire service performs efficiently and in the best interest of the public and community it serves. FRAs can be part of a another type of local authority or can be stand-alone entities.

FRAB – Financial Reporting Advisory Board
The role of the board is to ensure that government financial reporting meets the best possible standards of financial reporting by following Generally Accepted Accounting Practice as far as possible.

FRC - Financial Reporting Council
An independent regulatory body which regulates auditors, accountants and actuaries and sets the UK's Corporate Governance and Stewardship Codes. Currently transforming into a new body the Audit, Reporting and Governance Authority.

FReM - UK Central Government Financial Reporting Manual
The technical accounting guide to the preparation of financial statements, prepared after consultation with the Financial Reporting Advisory Board. It complements guidance on the handling of public funds published separately by the relevant authorities in England and Wales, Scotland and Northern Ireland

General Fund
The main revenue account that local authorities are required to maintain. The majority of income goes into the general fund account and most service expenditure is funded from it.

General Power of Competence
*Introduced by the Localism Act 2011 and took effect in February 2012. In simple terms, it gives councils the **power** to do anything an individual can do provided it is not prohibited by other legislation. Most wholly-owned local authority companies are set up under the General Power of Competence.*

Generally Accepted Accounting Practice/Principles (GAAP)
A collection of commonly-followed accounting rules and standards for financial reporting. The acronym is pronounced "gap." GAAP specifications include definitions of concepts and principles, as well as industry-specific rules.

Going Concern Test
An element of the audit report certifying that readers of a set of accounts are entitled to assume a business will continue in the future, unless there is evidence to the contrary. Going concern reporting is very specifically about ensuring that the correct accounting basis is being used, not about confirming whether an authority is running out of resources.

Greater London Authority (GLA)
A type of local authority. The GLA regional authority, with powers over transport, policing, economic development, and fire and emergency planning in Greater London. The GLA is unique in the British devolved and local government system, in terms of structure elections and selection of powers.

Head of Paid Service
The Head of Paid Service has statutory responsibility for the management and coordination of the employees appointed by the Council. Although the roles are separate, frequently the Chief Executive or Managing Director of a local authority.

HMICFRS - Her Majesty's Inspectorate of Constabulary and Fire & Rescue Services
Inspectorate responsible for independently assessing the effectiveness and efficiency of police forces and fire & rescue services.

HMT – Her Majesty's Treasury

HOFMCP - Home Office Financial Management Code of Practice
The financial management code of practice provides clarity around the financial governance arrangements within policing

Housing Revenue Account
Legislation prohibits social housing expenditure from being subsidised by general fund expenditure and vice versa. Therefore, local authorities with social housing stock are required to maintain a separate "housing revenue account", which must be self-financing.

ICAEW - Institute of Chartered Accountants of England and Wales
A professional membership organisation that promotes, develops and supports chartered accountants and students in the UK, Wales and globally. Responsible for maintaining the register of firms and KAPs qualified to sign off audits of local authority accounts.

ICAS - Institute of Chartered Accountants of Scotland
A professional membership organisation that promotes, develops and supports chartered accountants and students in Scotland.

IFRS – International Financial Reporting Standard (set by the International Accounting Standards Board)
A public interest organisation which has developed and maintains a single set of globally accepted accounting standards.

Internal Drainage Board
A type of local authority which is established in areas of special drainage need in England and Wales with permissive powers to undertake work to secure clean water drainage and water level management within drainage districts. The area of an IDB is not determined by county or metropolitan council boundaries, but by water catchment areas within a given region.

ISA - International Standards on Auditing
Standards for audits of financial statements, which include objectives for the auditor, together with requirements and related application and other explanatory material. ISAs(UK) are issued by the FRC.

KAP – Key Audit Partner
A senior member of staff within an audit firm who is registered to sign off a set of local authority accounts. Does not need to be a partner in the firm.

Kingman Review
Independent Review of the Financial Reporting Council led by Sir John Kingman (published December 2018). Included commentary and recommendations for local audit.

KPI – Key Performance Indicator
A performance measurement which helps evaluate the success of an organisation or of a particular activity in which it engages.

LGA – Local Government Association
The national membership body for local authorities.

LGSCO – Local Government and Social Care Ombudsman
A service that investigates complaints from the public about councils, registered adult social care providers and other select bodies providing public services in England

Limitation in Scope
An audit opinion - a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether the accounts are true and fair and/or proper arrangements are in place to deliver economy, efficiency and effective services.

Local Audit and Accountability Act 2014
Abolished the Audit Commission and established the current arrangements for the audit and accountability of the local public audit system

Local Audit Delivery Board
Consultative board chaired by MHCLG, which compromises of representatives of relevant departments and framework bodies to facilitate sharing of information about the operation of the local authority accounting framework. Meetings are held in private and it has no formal powers or remit.

Local Government Act 2000
An Act to make provision with respect to the functions and procedures of local authorities

London Borough
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide. Some services, like fire, police and public transport, are provided through the Greater London Authority.

Mayoral Combined Authority
A type of local authority created in areas where they are considered likely to improve transport, economic development and regeneration. MCAs are led by metro mayors who make decisions about policy and spending in conjunction with council leaders from each constituent council. Both the metro mayor and each of the council leaders have a single vote and must approve or oppose decisions.

Metropolitan borough – also known as Metropolitan District
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide. Some services, like fire, police and public transport, are provided through 'joint authorities

MHCLG – Ministry of Housing, Communities and Local Government
The government department with policy responsibility for the local audit framework.

MIRS - Movement in Reserves Statement
Shows how the movement in reserves in the Balance Sheet is reconciled to the CIES deficit and what adjustments are required to be charged to the general fund balance for Council Tax setting purposes

Monitoring Officer
A local government officer with three main roles: to report on matters he or she believes are, or are likely to be, illegal or amount to maladministration; to be responsible for matters relating to the conduct of councillors and officers; and. to be responsible for the operation of the council's constitution.

NAO – National Audit Office
The UK's independent public spending watchdog. The NAO support Parliament in holding government to account and they work to improve public services through their audits. They are led by the Comptroller and Auditor General

NHSI(E) – NHS England and NHS Improvement
The umbrella body for the NHS in England. From 1 April 2019, NHS England and NHS Improvement have worked together as a new single organisation to better support the NHS to deliver improved care for patients.

Ofsted - Office for Standards in Education
Office for Standards in Education, Children's Services and Skills. Inspect services providing education and skills for learners of all ages. Also inspects and regulate services that care for children and young people including those delivered by local authorities.

Parish Council – can also be known as community councils
A civil local authority found in England and is the lowest tier of local government. They are elected corporate bodies, have variable tax raising powers. Responsibilities of parish council's vary considerably but can include allotments, bus shelters, burials and maintenance of common land and rights of way.

Parish Meeting
A meeting to which all the electors in a civil parish are entitled to attend. In some cases, where a parish or group of parishes has fewer than 200 electors, the parish meeting can take on the role of a parish council, with statutory powers, and electing a chairman and clerk to act on the meeting's behalf.

PCC – Police and Crime Commissioner
An elected official in England and Wales charged with securing efficient and effective policing of a police area. Commissioners replaced the now-abolished police authorities.

PIE – Public Interest Entity
A listed company or an entity with listed debt. Under EU Law, entities are designated by Member States and are usually defined as having undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

PIR – Public Interest Report
When an Auditor considers there to be a matter that is sufficiently important enough to be publicly brought to the notice of the council or the public they can make a report in the public interest.

PSAA - Public Sector Audit Appointments Ltd
Public Sector Audit Appointments is a company limited by guarantee wholly owned by the Local Government Association. PSAA are specified as an appointing person for local authority under provisions of the Local Audit and Accountability Act 2014. The functions of PSAA are specified in statute.

Qualified Audit Opinion
When an external auditor concludes that financial records have not been maintained in accordance with the Generally Accepted Accounting Principles. There are three types of qualified opinion; an except for; adverse; and limitation in scope opinion

SAAA - Smaller Authorities' Audit Appointments Ltd
The sector-led limited company appointed as the specified person to procure and appoint external auditors to smaller authorities and to manage the ongoing smaller authority audit contracts.

SERCoP - Service Reporting Code of Practice
A statutory code that sets out the proper practices with regard to consistent financial reporting for services; all local authorities in the UK are expected to adopt its mandatory requirements and recommendations and use them when reporting statistical data to central government.

Smaller Authorities - parish, community and town councils and internal drainage boards
These operate at a level below district and borough councils and in some cases, unitary authorities. They sometimes deliver additional services on behalf of the district council.

SOLACE – Society of Local Authority Chief Executives
Members' network for local government and public sector professionals throughout the UK

TUPE - Transfer of Undertakings (Protection of Employment)
Regulations to protect employees if the business in which they are employed changes hands. The two types of transfer protected by TUPE regulations are business transfer and service provision changes

Unitary Authorities
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide.

Unqualified Audit Opinion
When an external auditor concludes that the financial statements of an entity present fairly its affairs in all material aspects

VfM Conclusion – Value for Money Conclusion
A requirement that external auditors undertake sufficient work to be able to satisfy themselves as to whether the audited body has put arrangements in place that support the achievement of value for money. In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period

Welsh Audit Office
The Wales Audit Office provides staff and other resources for the Auditor General's work, and monitors and advises the Auditor General for Wales.

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Annex 1 – What are auditors required to do?

Financial Audit

A financial audit is the examination of the financial statements of a local authority - as presented in the annual report and accounts - by someone independent of that organisation.

The purpose of a financial audit is to form a view on whether the financial statements:

- give a true and fair view of the financial position and of the Authority at the end of the financial year (31 March), and of the Authority's expenditure and income for the year then ended;
- have been prepared properly in accordance with the statutory accounting code; and
- have been prepared in accordance with the requirements of relevant legislation

The scope of the financial audit opinion is defined in *International Standards in Auditing (UK)*.[1] ISAs require the auditor to form an opinion on *"whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework." (ISA 200)* For Local Authority accounts the applicable financial reporting framework is CIPFA's Statutory Code of Accounting Practice.

In doing so they *"require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error." (ibid)* Reasonable assurance is defined as a high but not absolute level of assurance. In practice, audit firms will use statistical procedures to design audit tests that provide 95% confidence that the financial statements are free from material misstatement.

The final key concept for a financial audit is materiality. ISAs state that *"misstatements including omissions are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements." ISA 320.* Matters can be material due to value, nature or context.

ISAs require the auditor to make "*judgments about matters that are material to users of the financial statements … based on a consideration of the common financial information needs of users as a group." (ibid)* They do not require consideration of the effects of misstatements on *specific* users.

If a local authority has wholly owned subsidiary companies that are material to the operations of the authority, the authority is required to prepare group accounts. When an authority prepares group accounts, the financial audit covers the finances of both the authority and the group. It does not cover the finances of the subsidiary companies, which will be audited separately.

Once auditors have completed their work, they present an audit completion report to the client explaining what they have done, and issue an audit certificate providing their opinion on accounts.

[1] https://www.frc.org.uk/getattachment/34c335dd-d191-462c-9214-e59a31c33349/ISA-(UK)-200_Revised-June-2016_Updated-January-2020_final-With-Covers.pdf

Value for money audit

A value for money audit is a risk-based examination by an independent person to enable that person to form a view on whether an authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

International Standards on Auditing (UK) do not apply to value for money audits. The Statutory Code of Audit Practice requires the auditor to form a judgement on the nature and amount of work required to support the audit opinion.

Audit opinions

Both the financial audit and value for money audit opinions can be **clean** or **qualified**.

A **clean opinion** means that the auditor has concluded that in all **material** respects the accounts are true and fair/the authority has proper arrangements in place.

There are three types of qualified opinion:

- an **except for** opinion – which is a conclusion that in all material respects the accounts are true and fair/proper arrangements are in place except for the matters detailed in the audit certificate and report OR a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether one or more material items in the accounts are true and fair/a material element of proper arrangements are in place.
- an **adverse** opinion – which is a conclusion that the accounts are not true and fair/proper arrangements are not in place.
- a **limitation in scope** opinion – which is a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether the accounts are true and fair/proper arrangements are in place.

The updated Code of Audit Practice, effective from 2020-21, replaces the binary value for money opinion with a requirement to produce a narrative certificate and report.

How is a financial audit conducted?

- The local authority prepares its annual report and accounts.
- Auditors start their examination by gaining an understanding of the local authority's activities to gain an understanding of the economic, service delivery, leadership and pollical issues that might have affected it during the reporting period.
- For each major area of activity listed in the accounts, the auditors identify and assess any risks which could have a **material** impact on the financial position or financial performance of the local authority. They may test some of the measures (called internal controls) that the organisation has put in place to mitigate those risks.
- Based on the risks and controls identified, auditors consider what management has done to ensure the financial statements are accurate and examine supporting evidence, normally using a mixture of analytical procedures and sample testing.
- Auditors then make a judgement as to whether the annual report and accounts taken as a whole presents a true and fair view of the financial results and position of the organisation and its cash flows.

How is a value for money audit conducted?

- The local authority prepares its annual governance statement.

- Auditors start their examination by reading the statement. They would normally consider the Chief Financial Officer's "Section 25 report" setting out the reasonableness of assumptions and adequacy of financial reserves supporting the budget along with the mid-term financial strategy or equivalent. They may also consider reports issued by other inspectorates. However, none of these processes are mandated by standards or statutory guidance.
- If auditors identify a risk of a **material weakness** of the systems in place to support the delivery of value for money outcomes, they will undertake testing to assess that risk.
- Auditors the make a judgement on whether the authority has put proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources.

What is materiality?

- Materiality is a key concept when preparing and auditing financial statements.
- A matter is considered to be material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the main users of a set of financial statements make on the basis of those financial statements.
- Auditors are required to assess materiality at the start of an audit engagement and to keep it under review throughout the audit.[2]
- If errors are identified in a set of financial statements and not amended by the local authority, the auditor is required to assess whether they are individually or cumulatively material when forming the audit opinion.[3]

What don't auditors currently do?

- Audit other information provided to elected members or central government, such as the balanced budget, the single data list data returns or the mid-term financial strategy or equivalent.
- Form a view on whether a local authority has delivered value for money. A local authority may have appropriate systems in place but still not deliver value for money outcomes.
- Check every figure in the financial report – audits are based on selective testing only.
- Look at every transaction carried out by the organisation.
- Provide assurance over whether government grants have been spent on appropriate purposes.
- Judge the appropriateness of the organisation's business activities or strategies or decisions made by elected members or statutory officers
- Test the adequacy of all or even any of an organisation's internal controls.
- Undertake specific procedures to detect or prevent fraud.

What can't auditors do?

- Predict the future – A financial audit relates to a specific past accounting period. It does not judge what may happen in the future, and so cannot provide assurance that the organisation will continue in business indefinitely.

Can external auditors rely on the work of internal audit?[4]

- The interface between internal and external audit is governed by *ISA (UK & Ireland) 610 Using the work of internal auditors.*

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[2] ISA(UK)320 - materiality in performing and planning an audit
[3] ISA(UK)450 - evaluation of misstatements identified during an audit
[4] ISA(UK)610 - using the work of internal auditors

- Key elements of the ISA are as follows:
    - The use of internal auditors to provide direct assistance is prohibited for audits conducted in accordance with UK auditing standards.
    - The external auditor can choose to place reliance on the work of internal audit should its planned testing cover relevant areas. To do so the external auditor is required to assess (a) the extent to which the internal audit function's organisational status and relevant policies and procedures support the objectivity of the internal auditors; (b) the level of competence of the internal audit function; and (c) whether the internal audit function applies a systematic and disciplined approach, including quality control.
    - Assuming the assessment of internal audit's organisational structure and quality control procedures indicates that it can be relied upon, the external auditor is required perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether: (a) the work of the function had been properly planned, performed, supervised, reviewed and documented; (b) sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and (c) conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed.
- In practice, the quality control procedures set out in ISA610 are onerous, and it is considered to be more efficient for the external auditor to undertake additional testing rather than rely on the work of internal audit.

- As with all auditing standards, ISA 610 does not apply to the value for money audit. However, the Review is not aware of any instances where external audit has placed reliance on the work of internal audit when forming their value for money opinion.

Concerns about the financial audit framework raised by the Brydon Review

- Although focused on corporate audit, the Brydon Review raised some concerns about the current financial audit framework that are as relevant to local authority audits. Key amongst these are:
    - the growing challenge in using 'true and fair' as a descriptor of financial reporting given that corporate accounting increasingly involves the use of estimates and judgments. Together with the fact that the audit intends to provide assurance that the company accounts are free of material misstatements, it is difficult to see how either directors or the auditor can communicate effectively that modern company accounts are 'true' in accordance with any reasonable person's understanding of the word (para 2.3.1. & chapter 11)
    - All entities are required to keep adequate accounting records and auditors have statutory responsibilities in relation to these. However, auditors demonstrated lack of understanding of what was expected of them regarding accounting records, beyond establishing their adequacy to prepare the financial statements (chapter 12)
    - The confusion and expectation gap between the reality and the expectations of performance of auditors in their duties to assess the risk of and identify material fraud (chapter 14).
- An assessment of the impact of the Brydon Review recommendations on local authority audit is included at Annex 5.

Annex 2 - Roles and duties of Statutory Officers

Every relevant local authority, namely:

- County Councils;
- County Borough Councils;
- District Councils;
- London Borough Council;
- The common Council of the City of London;
- The Council of the Isles of Scilly;
- The Greater London Authority; and
- Standalone Fire and Rescue Authorities

must have the following statutory officers who are each responsible for elements of governance within the authority. This is specified in the Local Government and Housing Act 1989 (Section 21) - https://www.legislation.gov.uk/ukpga/1989/42/section/21

For Police and Crime Commissioners, the requirement to appoint a Chief Executive and Chief Finance Officer (S151 Officer) is set out in Paragraph 6, Schedule 1 of the Police Reform and Social Responsibility Act 2011 - https://www.legislation.gov.uk/ukpga/2011/13/schedule/1/paragraph/6/enacted. The Chief Executive is designated as the Monitoring Officer for the purposes of section 5(1) of the Local Government and Housing Act 1989 with responsibility for ensuring the legality of the action of the PCC and the PCC's staff. See paragraph 202 of Schedule 16 of the 2011 Act, which amends section 5 of the 1989 Act - https://www.legislation.gov.uk/ukpga/2011/13/schedule/16/paragraph/202/enacted.

In respect of the Combined Authority Mayor for Greater Manchester, the Combined Authority is required by section 73 of the Local Government Act 1985 to appoint a Chief Finance Officer to be responsible for the proper administration of the Combined Authority's affairs - https://www.legislation.gov.uk/ukpga/1985/51/section/73. Section 5 of the Local Government and Housing Act 1989 also requires the Combined Authority to appoint a Monitoring Officer - https://www.legislation.gov.uk/ukpga/1989/42/section/5.

Chief Executive:

It is the role of the Chief Executive, also known as the Head of Paid Service, to ensure that all the authority's functions are properly co-ordinated as well as organising staff and appointing appropriate management.

Local Government and Housing Act 1989 - https://www.legislation.gov.uk/ukpga/1989/42/section/4

Section 151 Officer:

Section 151 of the Local Government Act 1972 requires local authorities to make arrangements for the proper administration of their financial affairs and appoint a S151 Officer, also known as a Chief Financial Officer (CFO), to have responsibility for those arrangements.

As such, the CFO must lead on a local authority's financial functions and ensure they are fit for purpose. CFOs must be professionally qualified and suitably experienced.

In correspondence with the Local Government Finance Act 1988 the CFO must be a member of one of the following bodies in order to qualify as a responsible officer:

(a) the Institute of Chartered Accountants in England and Wales,
(b) the Institute of Chartered Accountants of Scotland,
(c) the Chartered Association of Certified Accountants,
(d) the Chartered Institute of Public Finance and Accountancy,
(e) the Institute of Chartered Accountants in Ireland,
(f) the Chartered Institute of Management Accountants, and
(g) any other body of accountants established in the United Kingdom and for the time being approved by the Secretary of State for the purposes of this section.

Local Government Act 1972 - https://www.legislation.gov.uk/ukpga/1972/70/section/151

Local Government Finance Act 1988 - https://www.legislation.gov.uk/ukpga/1988/41/section/113

Monitoring Officer:

It is the role of the Monitoring Officer to report on matters they believe to be illegal or amount to maladministration, to be responsible for matters relating to the conduct of councillors and officers and, to be responsible for the operation of the council's constitution. They are often, but not always, the head of legal services in a local authority.

Local Government and Housing Act 1989 - https://www.legislation.gov.uk/ukpga/1989/42/section/5

Annex 3 – Functions of the Office of Local Audit Regulation

Classification

1. To have credibility with local authorities, audit practitioners and other regulators and professional institute, OLAR will need to have a considerable level of professional and technical expertise. This suggests it will need to be constituted as a **non-departmental public body** with the following characteristics.

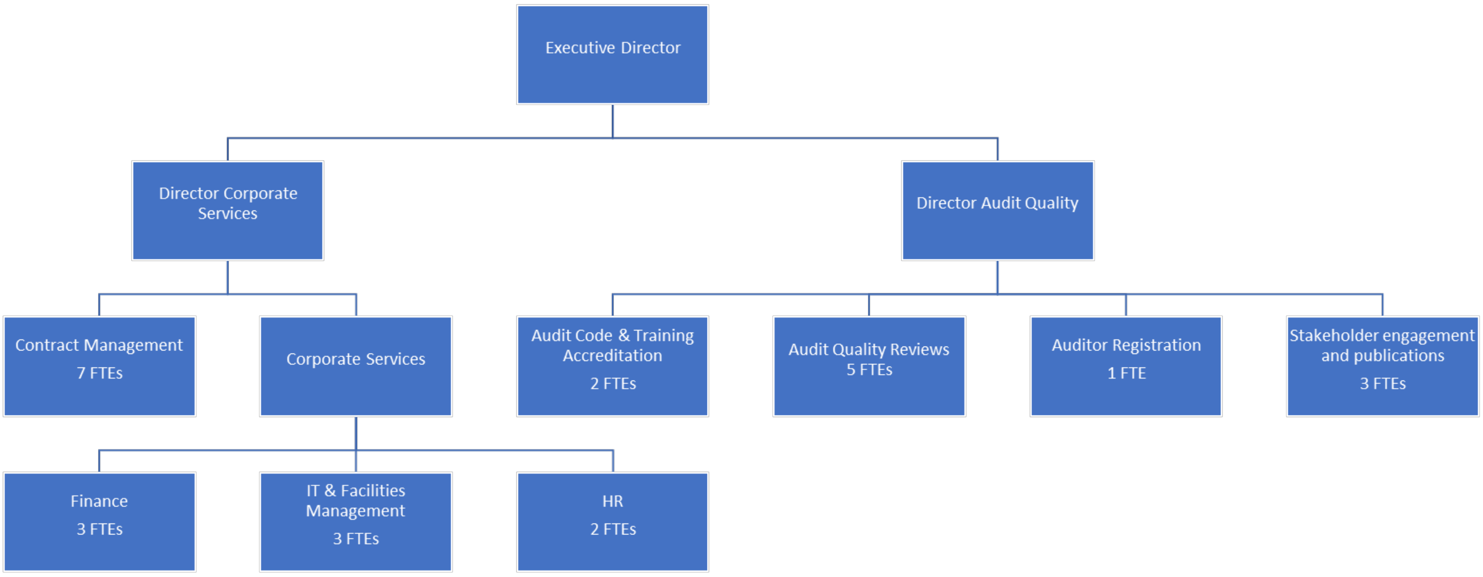
Oversight / Accountability	MHCLG sets strategic framework, minister accountable to Parliament
Sources of Income	Included in MHCLG estimate: could be funded through grant-in-aid and/or a levy on audit fees
Legal position	Established and sponsored by Dept. with own separate legal personality, outside of the Crown
Duration	Permanent
Appointments	Ministers consulted on appointment of Executive Director
Staffing	Public servants
Accounting	Produce own accounts, consolidated within MHCLG

Functions

2. OLAR should be responsible for the following:
    a. **Letting the new framework contracts.** The contract management team should draw on the resource of the government commercial function to support them in moving from a standard framework contract to a contract that allows for more dynamic market management.
    b. **Active contract management.** Including resolving disputes between auditors and local authorities, agreeing fee variations and actively managing the local audit market to ensure that there are sufficient suppliers of audit services.
    c. **Code of audit practice.** OLAR should take over the functions of the audit code team currently undertaken by the NAO on behalf of the C&AG. This includes issuing Auditor Guidance Notes, considering how wider changes to auditing standards and the audit profession should be implemented in the local government sector, convening the local auditor forum and laying the next update to the Local Audit Code of Practice in Parliament
    d. **Undertaking audit quality reviews.** OLAR should take over responsibility for AQRs from the FRC and ICAEW. The AQR process should include an assessment of the skills, knowledge and expertise of audit teams. The OLAR AQR team will be required to publish the results of its reviews.
    e. **Sanctioning firms that do not deliver audits to appropriate level of quality.**
    f. **Maintaining the register of firms/KAPs qualified to undertake local authority audits.**
    g. **Producing publications summarising the results of local audit work.** The three publications envisaged are the summary report on the results of audit work previously published by PSAA and two new publications, one summarising the financial audit and value for money risks identified by external auditors and the other summarising recommendations made to the sector.

3. The exact structure and staffing for OLAR will be for the first Executive Director to determine. However, what is envisioned, as per the OLAR Organisational Structure diagram below, is a small body with no more than 30-35 staff.

OLAR: Organisational Structure



Governance

4. OLAR is recommended to have an executive management board of three:
    a. Executive Director (Accounting Officer)
    b. Director of Audit Quality
    c. Director of Corporate Services (including contracting and contract management)

5. The executive management board should be supported by a non-executive Advisory Panel comprised of representatives appointed by ARGA and by MHCLG, Home Office and HM Treasury (as the departments with relevant policy interests in local authority audit).

Costing of the new body

6. OLAR has been costed assuming that TUPE will apply where appropriate and that its head office will be in a Government Property Hub outside London. The estimated cost of the new regulator is about **£5m per annum** (see table below). Both accommodation costs and IT and facilities management costs will vary depending on the location chosen and whether OLAR chooses to operate HR and facilities management in house. In addition, set-up costs may be higher, due to the need to recruit appropriately skilled and experienced staff.

OLAR - Estimated annual running costs	**RDEL £'000**	**CDEL £'000**
Staff costs	2,500	
Accommodation cost	500	
Other operating costs	1,500	
Leases (share of build cost)		150
Software		350
New body costs p.a.	**4,500**	**500**

7. MHCLG will need to retain a small appropriately qualified and experienced team to provide the interface between OLAR and other stewardship functions carried out by the department. The reports that OLAR produces summarising the risks considered and issued identified by external auditors, along with the information produced by the enhanced value for money reporting proposed by the 2020 Audit Code as enhanced by the recommendations in this report, should provide a rich source of evidence to support MHCLG's system stewardship activity.

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Annex 4a – Illustrative Simplified Financial Statement: District Council

1. Financial Performance Statement

We have a responsibility to feed back to you, as a local resident or tax payer, on how we spend and manage Golden Sands District Council's resources.

This financial performance statement compares the budget (what we planned to spend) at the start of the year with what we actually spent and explains the changes. If we have

ANNEX 4A – ILLUSTRATIVE SIMPLIFIED FINANCIAL STATEMENT: DISTRICT COUNCIL

Financial Performance Statement

over or under spent, we have explained why.

This financial performance statement provides an analysis of the council's financial performance and position over the last 12 months.

As well as our annual expenditure, this statement also includes information about our longer-term financial sustainability. This is important so that you know the resources we have available to provide services into the future. The summary shows you what we own

goldensandsdc.gov.uk
[Email address]

and what we owe and what we have put aside to make sure we can deliver services beyond this year.

You can have confidence in the figures in this report because we have to follow regulations and standards in compiling them, and the information from our accounts is independently audited.

This information is consistent with that reported in the council's audited accounts. A full set of the Golden Sands District Council's Statement of Accounts for 2019/20 is available from the Council's website.

About the Council

Golden Sands is a medium-sized coastal district council and this means we have responsibility for delivering services such as housing, planning, car parking, council tax and business rates collection, leisure, environmental health and refuse collection.

To deliver these and other services, working with other organisations is important as it helps us to achieve more with our resources. We work closely with our neighbouring authorities in areas such as coastal defences and economic regeneration.

Where the council gets its money from

A local council gets money from three main sources: council tax, business rates and grants from the government. We also receive locally generated income from activities such as leisure services, planning and car parking.

We have to make sure that when we set the budget for the year, we can afford to pay for the services we offer. This includes any plans we make where we need to include longer-term commitments. A council must balance its budget each year, and setting council tax is an important part of this process.

Our total funding is £63.9m, and this must support the services for a population of over 120,000.

2. Analysis of Financial Performance

Table 1 below shows what Golden Sands District Council planned to spend (its budget) against what we actually spent in the year.

Where a service generates income such as fees and charges, that income will be included as well. The difference between expenditure and income is known as net spend.

The net spend (expenditure less income) can be compared to the budget, and the difference between the two is shown in the final column. The positive figures are those where we have spent less than planned and the negative figures are where we have spent more than planned.

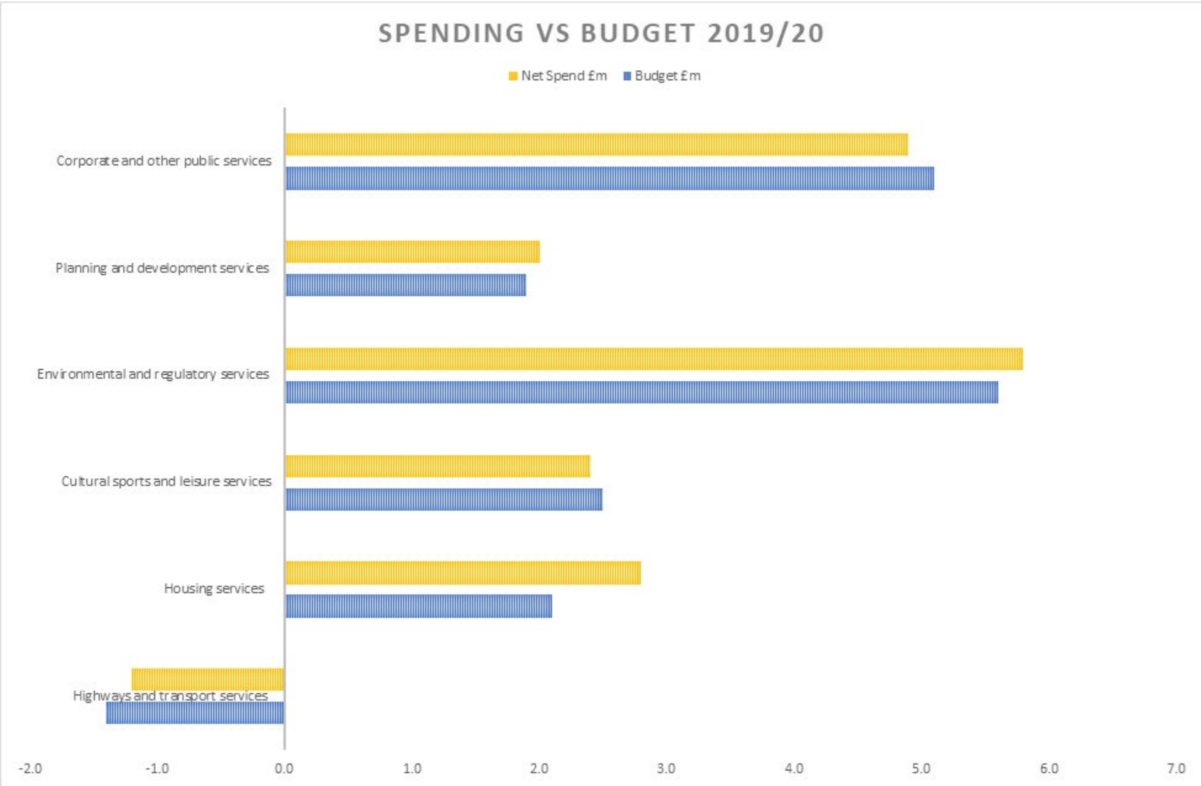
The differences from the budget are explained in Table 2 below.

Table 1 - Golden Sands Council Budget - what we planned to spend against what we finally spent

Service	Budget (What we planned to spend)	Net Spending (What we actually spent)	Difference from Budget
	£m	£m	£m
Highways and transport services	-1.4	-1.2	-0.2
Housing services (excluding HRA – see section 3)	2.1	2.8	-0.7
Cultural, sports and leisure services	2.5	2.4	0.1
Environmental and regulatory services	5.6	5.8	-0.2
Planning and development services	1.9	2.0	-0.1
Corporate and other services to the public	5.1	4.9	0.2
Total service expenditure and income	***15.8***	***16.7***	***-0.9***
Housing Benefits	30.0	30.5	-0.5
Precepts and levies	2.1	2.1	0.0
Trading services	-0.7	-0.5	-0.2
Financing costs (costs relating to financing debt)	2.9	2.6	0.3
Net taxation and grant income (excluding council tax income)	-38.8	-42.0	3.2
Total expenditure and income	***11.3***	***9.4***	***1.9***
Transfers to / from (-) reserves	-1.5	0.4	-1.9
Council tax requirement *(Our income without council tax is not enough to pay for the services we deliver - this is the amount we need to raise to cover that gap)*	***9.8***	***9.8***	***0.0***

The differences between what we planned to spend against what we have actually spent are demonstrated by the graph below.

Graph1 Golden Sands District Council service analysis - budget against spend



What were the differences?

Table 2 – Explanations for the significant differences between what we budgeted for and what we spent

The net underspend of £1.9m is due to the following significant variations:		
	Explanation	**Difference £m**
Highways and transport services	Reduced car parking income across the district compared to what was expected	-0.2
Housing services	Increased costs of temporary accommodation due to rise in homelessness	-0.7
Housing Benefits	Increase in number of housing benefit cases	-0.5
Financing Costs	Savings in costs due to lower interest rates and reduced debt repayments	0.3
Net grant income	COVID grants received from Government at the year-end in advance of spending need	3.2
	Other spending differences (net)	-0.2
	Total differences between budget and spend	**1.9**

3. Housing Revenue Account

As the landlord account for the authority, the Housing Revenue Account (HRA) accounts for all services to tenants and leaseholders, and is the account that holds the rent we collect.

The HRA is a separate account to the general budget and the Council is not allowed to subsidise the HRA by making contributions from the General Fund. This means that the HRA must break even in its own right.

Table 3 shows the spending on HRA services to council tenants in the year and how that compared to the HRA budgeted figures. Significant differences to the budget are explained in table 5.

Table 3: Analysis of HRA budget against actual spending

Housing Revenue Account	Budget (What we planned to spend)	Net Spend (What we actually spent)	Difference from Budget
	£m	**£m**	**£m**
Rent income	16.3	15.9	0.4
Other income	1.4	1.5	-0.1
Total Income	**17.7**	**17.4**	**0.3**
Repairs and maintenance	5.1	4.4	0.7
Managing the stock	4.6	4.6	0.0
Rents, rates and taxes	0.2	0.2	0.0
Capital financing and interest charges	6.7	6.1	0.6
Set aside for stock improvements	1.7	1.7	0.0
Total Expenditure	**18.3**	**17.0**	**1.3**
Surplus (-) / Deficit	***0.6***	***-0.4***	***1.0***

Table 4 shows the level of reserves that the council holds to support the future provision of council housing and manage future risks.

Table 4 – HRA Reserves

Housing Revenue Account Reserves	Opening Balance	Closing balance
	£m	**£m**
HRA Reserves	10.7	11.1

Table 5 – Explanations for the significant differences between what we budgeted for and what we spent

The net underspend of £1.0m is due to the following significant variations:		
Service category	**Explanation**	**Difference £m**
Dwelling Rents	Reduced rent income due to higher than expected Right to Buy sales to tenants	-0.4
Repairs and Maintenance	Fewer responsive repairs than anticipated	0.7
Capital financing and interest charges	HRA share of savings in corporate interest costs	0.6
	Other spending differences (net)	0.1
	Total differences between budget and spend	**1.0**

4. The Council's Financial Position

Golden Sands District Council uses your money to provide necessary local services. The summary financial position below (also known as the balance sheet) represents a summary, or 'snapshot,' of the financial position at a single point in time, which for councils is 31 March. Each year the council sets out what it owns and how much is owed, and the resources it has left to support the provision of future services on the 31 March.

Below we show the council's financial position at the year-end, which is a summary of the balance sheet in the council's audited accounts. This information supports the assessment of whether or not the council has a sustainable financial position and is able to support and maintain services on an on-going basis. The net financial position helps inform future financial planning and sustain the services we deliver.

Summary Financial Position

	£m
What we own and are owed *(held as 'assets')*	302.5
What we owe *(held as 'liabilities')*	-112.5
Net Financial Position *(assets less liabilities)*	190.0
The net financial position is held in reserves as follows:	
General reserves available to the council	37.5
Other Reserves held for statutory and/or specific purposes	152.5
Total Reserves	190.0

Financial Sustainability - The ability to plan for the future

We have to plan for the long term to ensure that we can continue to deliver our services in future years and be able to deal with any unexpected events. As a result, it is important that our financial standing (or sustainability) is robust.

Golden Sands District Council has a fully developed five-year financial plan, which includes looking at risks and future demands on services. These risks will include things like the impact of changes to national welfare schemes on services such as homelessness support, and the ongoing uncertainties surrounding the future core funding of local authority services generally under the Government's comprehensive spending review.

The recent impact of the COVID-19 pandemic is also a key area where the risks to the council (through extra costs and reduced income) and the impact of government support schemes are being closely monitored as part of the council's financial planning processes.

More about our Reserves

Table 6 sets out a breakdown of the council's general reserves.

Table 6 – General Reserves

	Amount held at 31 March £m
Earmarked reserves (reserves intended to fund specific projects or other council commitments)	10.4
Unallocated reserves (reserves held to support future service provision and manage risk)	27.1
Total general reserves	**37.5**

Council Subsidiaries, Associates and Joint Ventures

The council does not own, or part own, any companies, but has produced group accounts in respect of its relationship with Sandy Shores Direct Services. This is due to the council's ability to participate in the operating decisions of the company through its representation on the board. The company relies on the provision of refuse and maintenance services on behalf of the council as its core business.

The inclusion of Sandy Shores Direct Services in the council's Statement of Accounts has the following impact on the financial position of the council:

Subsidiaries, Associates and Joint Ventures	£m
What we own and are owed *(held an 'assets')*	0.4
What we owe *(held as 'liabilities')*	-
Net Financial Position *(assets less liabilities)*	**0.4**
The net financial position is held in reserves as follows:	
General Reserves available for future spend	-
Other Reserves held for statutory and/or specific purposes	0.4
Total Reserves	**0.4**

Raising debt to finance council investment

Councils can borrow to invest in property and infrastructure that supports the delivery of services, but they must ensure that they can pay this amount back. The Council has an underlying need to borrow to finance these assets (this includes leases of assets) of £115.8m. The council must set aside a prudent amount of resources each year so it can pay back its borrowing, and this must be affordable when compared to its annual income.

We compare what it is costing to cover our borrowing costs for these assets against the funding we receive from council tax, business rates and grants (our income streams) to show you what proportion of income is required to fund the council's investments.

Table 7 - Borrowing costs as a proportion of income

2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual	Actual	Actual	Forecast	Forecast	Forecast
0.8%	0.8%	0.9%	1.0%	1.0%	1.0%

You can find more detail on these balance sheet items in the Golden Sands District Council's Statement of Accounts.

Investments in Commercial Properties

Since 2017, the council has invested in three income-generating commercial properties within the district at a total cost of £4m to help balance its budget and compensate for reductions in general grants from the government. The investment was part financed from asset sale proceeds (£2.4m) with the £1.6million balance funded through borrowing.

Commercial rates of return on investments for these types of property locally are around 2.5%, however in 2019/20 the council only budgeted for assumed returns of 1.5%. The actual return on that investment was 1.8%, exceeding the target. Whilst COVID-19 has impacted on commercial income for local authorities since the end of the 2019/20 financial year, the council anticipates an overall return no lower than that budgeted for the current year.

5. Golden Sands Financial Performance Data 1 April 2019 to 31 March 2020

Table 8 - Golden Sands District Council performance information

The table below provides performance information for our key services, identifying the costs incurred by the authority (using the information in Table 1) and measuring that on a cost per head of population basis.

Cost Type	Cost per person £
Highways and transport services	-9.76
Housing Services	22.76
Cultural, sports and leisure services	19.51
Environmental and regulatory services	47.15
Planning and development services	16.26
Corporate and other services to the public	39.84

[Note the above extract is indicative only and the detail of what could/should be set out in an accountability statement will form a significant element of future consultation.]

AUDIT CERTIFICATE

Audit certificate to be developed. There is an expectation that this statement will be subject to external audit from 2021/22

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Annex 5 – Potential impact of recommendations made by other reviews of audit

In the past three years, three independent reviews have been published on elements of the statutory audit framework. Whilst the Kingman Review made specific recommendations regarding the local audit framework, the CMA Study and the Brydon Review were solely focussed on the audit of Public Interest Entities (listed companies or entities with listed debt). In addition, BEIS ministers have yet to decide whether/how to take forward all recommendations made by these reviews.

Given that local authority audit is delivered by assurance practices that undertake both public and private sector audits and conducted in accordance with a common set of quality standards, some of the recommendations made by these reviews may be relevant to the future of local audit.

This Appendix lists relevant recommendations made by all three reports and comments on how this Review has addressed them and/or how they may impact on the future of local authority audit.

Independent Review of the Financial Reporting Council (Kingman Review) – Dec 2018 https://www.gov.uk/government/publications/financial-reporting-council-review-2018	
Recommendation (local authority audit only)	**Review Conclusions**
Recommendation 76: The Review recommends that the arrangements for local audit need to be fundamentally rethought to ensure that they: • Deliver robust assessment and scrutiny of the quality of all local audit work, with individual reports shared with audit committees and published; • Establish a more appropriate threshold for enforcement action; and, • Bring together in one place all the relevant responsibilities, so a single regulatory body can take an overview.	This Review concurs with and has expanded on this recommendation.
Recommendation 77: Such a role (regarding local audit) could be taken on by the FRC or its successor body, but the Review recommends that it would be much better undertaken by a separate body that has (or could develop) a deeper expertise in the local audit world. That body should have a different and much more focused remit than the former Audit Commission. It should have a clear objective to secure quality, and should set the relevant standards, inspect the quality of relevant audit work and oversee the relevant	This Review concurs with and has expanded on this recommendation. This Review has considered whether the FRC would be an appropriate body to take on this role but has concluded that the regulator of local audit would be better as a separate body, that could focus on developing a deep expertise in local audit and which embraces the audit process from beginning to end, by including procurement and sector-wide reporting as well as quality.

professional bodies. It should also take on responsibility for appointing auditors for local bodies and agreeing fees.	
Recommendation 78: In the same spirit, the Government should review whether the arrangements now in place for other public sector audits, such as Foundation Trusts, are genuinely robust and effective. It is very unlikely that they are.	The audit of public sector bodies other than those classified as local authorities is outside the scope of this Review.
Recommendation 79: Just as the Review recommends public disclosure of AQR findings and gradings in relation to the private sector, the Review recommends that the new regulator's individual AQR reviews in relation to the NAO should be shared with the relevant audit committee and Parliament, and should be published.	This Review concurs with this recommendation. The Review recommends that the new regulator has a specific remit to publish the results of its audit quality reviews and be required to share them with Parliament.
Recommendation 82: The Review also recommends that responsibility for the local audit "Code of Audit Practice" should be moved to the same body that monitors the quality of local audit work.	This Review concurs with this recommendation.

Competition and Markets Authority: Statutory Audit Services Market Study - Apr 2019
https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit_final_report_02.pdf

Recommendation	Review conclusions
Robust regulatory oversight of the committees that run the selection process for audited companies, and oversee the audit, to make them more accountable and ensure that they prioritise quality.	This Review recommends that a new local audit regulator be responsible for procuring audit services for the sector and overseeing the work of those auditors with a specific remit to prioritise quality.
Mandatory joint audit, to increase the capacity of challenger firms, to increase choice in the market and thereby drive up audit quality.	The number of small number of firms active in the local authority audit market is of concern. However, audit practitioners and local authorities do not believe that joint audit is an appropriate solution for local government bodies.

	The Review recommends that the new regulator have a specific mandate to increase the number of practitioners in the local authority audit market through more active market management and that the statutory barriers to entry for new firms are removed.
An operational split between the Big Four's audit and non-audit businesses, to ensure maximum focus on audit quality.	CMA's declared aim in making this proposal is to enhance audit quality and end the practice of audit fees being subsidised by non-audit work. If this split does occur and the CMA's assertion that a subsidy does exist is proved true, then audit fees may go up across all sectors including local government.
A five-year review of progress by the regulator.	The Review recommends that the new regulator be overseen by an advisory committee comprising representatives of all key stakeholders and that it will be responsible for reporting on the effectiveness of its activities both to the panel and to Parliament. It will also be subject to triennial reviews as part of standard central government processes.

Assess, Assure, Inform: improving audit quality and effectiveness (Brydon Review) - Dec 2019 https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review	
That the Audit, Reporting and Governance Authority (ARGA) together with auditors and the Plain English Campaign produce an appropriately concise guide to audit, explaining clearly what the different elements of an audit report mean as redefined in this Report, and what, just as importantly, they do not mean.	This Review believes that a concise plain-English guide to audit would be as valuable a reference to local authority audit as it is to public interest entity audit.
That auditing should provide information that is useful to present and potential investors, lenders, creditors and other users in making rational investment, credit and other decisions and assessments about the company.	The stakeholders in local government are different. However, this Review agrees that the purpose of an audit is to provide useful information that enables key stakeholders to make decisions and assessments about an entity. The recommendations about extending the scope of the value for money opinion and requiring the auditor to present it to

	full council aim to achieve this for local authorities.
That auditors should be free to include original information, materially useful to a wide range of users, in their audit report and at the AGM, and not be confined to commenting on that which has already been stated by directors.	The changes that the new Audit Code makes to the value for money opinion along with the further enhancements to that opinion recommended by this review should require the auditor to include original information in their reports.
That ARGA acts as the midwife to create a new profession of corporate auditing, establishing the necessary professional body, to encompass today's auditors and others with appropriate education and authorisation. ARGA would be the statutory supervisory body for that profession.	This recommendation has the potential to have a significant impact on the sustainability of the local authority and indeed the wider public sector audit market. Depending on how this recommendation is developed, Government and the local authority audit regulator may need to consider whether the proposed corporate audit profession would continue to generate skills that are transferrable for public sector audit. If not, and it develops as suggested by Brydon, there is a risk that local audit market could come under even more stress. If skills are transferrable, consideration will need to be given to how to ensure that members of the new corporate audit profession retain the skills, knowledge and expertise to deliver high quality local authority audits.
That an auditor's authorisation to carry out audits in particular areas of activity should flow from tailored qualifications which they have achieved.	This recommendation aligns to the Review recommendation that the current procedures to accredit firms and KAPs to carry out local authority audits be replaced by a qualification based on accredited training. Consideration should be given as to whether the local authority audit accredited training be treated as a tailored qualification as suggested by the Brydon Review.

That the Principles of Corporate Auditing should be established to form an overarching framework governing the behaviour of corporate auditors, and that standards and rules should sit within this framework.	The Regulator recommended by this review will need to consider whether the Principles of Corporate Auditing should also apply to audits under its remit, and if so whether they should be adapted. When making this assessment, the key considerations should include quality and market sustainability.
That the development of a specific auditor qualification, including education and training, should become a high priority for ARGA over the coming years.	If public sector audit remains part of a wider corporate audit profession, consideration will need to be given as to how to integrate local authority audit training into the ARGA led audit qualification.
That ARGA develops an agreed definition of professional judgment which builds on ISA(UK) 200.	Once developed, this definition is likely to apply equally to audits in all sectors.
That if the auditor considers there are other risks of similar or greater significance to those reported by the directors, based on its knowledge of the company, the auditor should report this fact.	Consideration will need to be given as to whether equivalent risk reporting should be introduced for local audit. The recommendation in this Review that the value for money opinion to be presented to the budget setting council or equivalent will facilitate such reporting.
That the Companies Act and ISA (UK) 700 be amended to replace “true and fair” with “present fairly, in all material respects”.	If this amendment is made for public interest entity audits, consideration will need to be given as to whether it should be replicated for local authority audits.
That the Government review the Companies Act to see if it could be improved to give more clarity as to what is meant by “adequate accounting records”. Given the complex requirements modern accounting creates, either through law or regulation, there should be an obligation for auditors to assess that the directors have maintained accounting records to a standard beyond the minimum level necessary for an audit to be performed. In doing so, the objective should be a High-Quality Audit as defined in this Report.	If the Companies Act is amended, consideration will need to be given as to whether this clarification should apply to the accounting records maintained by local authorities.
That ARGA promptly develop guidance for auditors around their responsibilities in relation to accounting records	The new local authority audit regulator will need to decide whether to implement or adapt this guidance.

That ARGA amends ISA (UK) 240 to make clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways.	The FRC is consulting on an update to ISA (UK) 240, to start to address this recommendation. The new regulator will need to consider what application guidance will be required to help auditors of local authorities to apply the updated ISA.
That training in both forensic accounting and fraud awareness be part of the formal qualification and continuous learning process to practise as a financial statements auditor. In developing qualifications for auditors of other areas of activity, parallel training should be established.	If local audit remains part of the same profession as corporate audit, the local audit regulator will need to consider whether to mandate this training to practise as a local authority financial statements auditor.
That the auditor's report state explicitly the work performed to conclude whether the directors' statement regarding the actions they have taken to prevent and detect material fraud is appropriate. Furthermore, the auditors should state what steps they have taken to assess the effectiveness of the relevant controls and to detect any such fraud.	If this becomes mandated practice in corporate audit, the local audit regulator will need to consider the extent to which it is applicable for local authority audit.
That there should be an obligation on the auditors to report to both the audit committee and the shareholders on the extent to which their work has been influenced and informed (or not) by any external signals which might imply enhanced risk in the company whose financial statements are being audited. That ARGA should develop a menu of possible signals [regarding enhanced risk] and the auditors should report against the relevant parts of that menu.	The menu of enhanced signals developed by ARGA may or may not be applicable to local authority audit. If a menu of external signals is developed by ARGA and adopted for local authority audit, Government and the local authority audit regulator will need to give consideration as to whether something similar would be beneficial for local authority auditors.
That the auditor explain in each of the two succeeding audit reports what procedures have been undertaken and what conclusions reached in relation to those matters [KAMs or identified deficiencies]; the auditor should also highlight what actions have been taken by the company in response to deficiencies identified in the prior year's audit.	Consideration will need to be given as to whether this recommendation should be replicated for local authority audits.
That, in the audit report, auditors should explain the reasons for the necessity and basis of any sampling techniques used in conducting the audit.	Consideration will need to be given as to whether this recommendation should be replicated for local authority audits.

That individual statutory audit reports detail the number of hours spent in conducting the audit by grade of auditor.	Consideration will need to be given as to whether this recommendation should be replicated for local authority audits.
That audit committee minutes be published with a time-lag of 12-18 months and with approved redactions.	The minutes of audit committees or equivalent in local authorities are already published, typically with a lag of less than a month.

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Reflections from the Redmond review – guiding principles for reform

Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting

Published on the 8th September 2020, Sir Tony Redmond's findings and recommendations from his independent review provides a significant opportunity to shape the future sustainability of local government financial reporting and auditing. We believe this will help ensure audit continues to meet the evolving needs of local authorities, the public, and the public interest.

Guiding principles for reform

We believe reforms should be guided by the following principles:

- Reforms should enhance, or at least should not create risks to, the quality of financial reporting and external audit.
- The importance of the multidisciplinary audit firm model, to enable local auditors to respond efficiently and effectively to the increased reporting complexity, risks and financial resilience pressures we have seen facing the public sector pre and post Covid-19.
- There should not be a two-tier system of generally accepted accounting and auditing standards between the public and corporate sectors.
- To be effective and sustainable, reforms need to focus on the public sector financial reporting and external audit ecosystem as a whole.

Our view of what a public sector financial reporting and external audit ecosystem comprises is set out on the next page. Each part of the ecosystem has a critical role to secure sustainable reforms, and each has specific issues, challenges and solutions. Only by addressing all of these elements together, will any subsequent reforms become truly effective and long term.

Reflections from the Redmond review – our view on the ecosystem

Page 134

Reflections from the Redmond review – our initial views

Taking our guiding principles, we broadly welcome the Redmond review and proposals, in particular:

Quality of financial reporting and external audit

- The recognition that all stakeholders in the ecosystem have a role to play to improve accountability, transparency and sustainability. This includes improving the effectiveness of Audit Committees, strengthening the training skills, capacity capability and attractiveness of the public sector finance and audit professions.
- His conclusion that the current procurement and fee structure does not support sustainable audit quality. We have provided you with our perspectives on how baseline audit fees need to change to take account of your risk profile, complexity as well as the regulatory and professional context which drive our audits.

Reforming the public sector financial reporting and external audit ecosystem

- Establishing the Office for Local Audit Regulation (OLAR), which provides a “system leader” and will bring clarity to the existing framework for local authority audit.
- The importance of MHCLG establishing a liaison committee of all key stakeholders to oversee reforms. To begin with MHCLG should take urgent action to implement primary legislation to establish OLAR, revise the timetable for financial reporting and revisit the procurement and fee structure for public sector audit.

Multidisciplinary audit firm model

- The importance of the auditors work to critically assess the financial resilience and viability of public sector bodies and his proposals on how this assessment could be enhanced within the NAOs code of audit practice.

Safeguarding professional accounting and auditing standards

- The need for CIPFA/LASAAC to revisit the accounting code and introduce summarised accounts. We agree that there is a need for more proportionality in the Code which also sets out the expectations of practitioners and auditors and how this could be applied in areas such as pensions and asset valuations. However, we believe that any future proposals on the accounting code should not create a two-tier system.

What are we doing in the meantime?

1. Planning for a 30 September financial reporting target date for 2020/2021 accounts, integrated with our NHS work.
2. Implementing the new NAO code and changes to our VFM conclusion work and reporting for 2020/2021 audits. We will also work with the NAO and other audit suppliers on any refinements to how auditors assess financial resilience.
3. Continuing to engage with and influence MHCLG, NAO, PSAA CIPFA/LASAAC, FRC and other key stakeholders on the actions required to implement the Redmond proposals as swiftly as possible and how these effectively align to the broader package of audit reforms which BIES will consult on later this year.

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Agenda Item 4

Stevenage Borough Council
Audit Committee

17 November 2020
Shared Internal Audit Service –
Progress Report

Recommendation

Members are recommended to:

a) Note the Internal Audit Progress Report
b) Approve Amendments to the Internal Audit Plan as at 30th October 2020
c) Note the Status of Critical and High Priority Recommendations

Contents

1 Introduction and Background
1.1 Purpose
1.2 Background

2 Audit Plan Update
2.1 Delivery of Audit Plan and Key Findings
2.4 Audit Plan Changes
2.9 Critical and High Priority Recommendations
2.11 Performance Management

Appendices:

A Progress against the 2020/21 Audit Plan
B Implementation Status of Critical and High Priority Recommendations
C Audit Plan Items (April 2020 to March 2021) - Indicative start dates agreed with management
D Assurance Definitions / Priority Levels

1 Introduction and Background

Purpose of Report

1.1 To provide Members with:

a) The progress made by the Shared Internal Audit Service (SIAS) in delivering the Council's 2020/21 Internal Audit Plan as at 30th October 2020.
b) The findings for the period 1 April 2020 to 30th October 2020.
c) The changes required to the approved Internal Audit Plan.
d) The implementation status of previously agreed audit recommendations.
e) An update on performance management information as at 30th October 2020.

Background

1.2 Internal Audit's Annual Plan for 2020/21 was approved by the Audit Committee at its meeting on 9 June 2020. The Audit Committee receive periodic updates against the Internal Audit Plan.

1.3 The work of Internal Audit is required to be reported to a Member Body so that the Council has an opportunity to review and monitor an essential component of corporate governance and gain assurance that its internal audit function is fulfilling its statutory obligations. It is considered good practice that progress reports also include proposed changes to the agreed Annual Internal Audit Plan.

2 Audit Plan Update

Delivery of Audit Plan and Key Audit Findings

2.1 As at 30th October 2020, 36% of the 2020/21 Audit Plan days have been delivered (the calculation excludes contingency days that have not yet been allocated).

2.2 The following final reports have been issued since the last Progress Report to the Audit Committee:

Audit Title	Date of Issue	Assurance Level	Number of Recommendations
Procurement Activity	Sept 2020	Good	None
Garage Lettings	Sept 2020	Satisfactory	Four Medium priority
Void Management	Oct 2020	Satisfactory	One Medium, one Low/Advisory priority

2.3 The table below summarises the position regarding 2020/21 projects as at 30th October 2020. Appendix A provides a status update on each individual project within the 2020/21 Internal Audit Plan.

Status	No. of Audits at this Stage	% of Total Audits
Final Report Issued	3	9%
Draft Report Issued	4	11%
In Fieldwork/Quality Review	7	20%
In Planning/Terms of Reference Issued	6	17%
Allocated	11	32%
Not Yet Allocated	0	0%
Cancelled	4	11%
Total	35	100%

Proposed Audit Plan Changes

2.4 At the start of the new financial year, Council resources were focused on maintaining services and responding to the COVID-19 pandemic. As a result, no internal audits were started in April, May or June (a delay in starting to deliver the 2020/21 Audit Plans was experienced across all SIAS partners). As part of the gradual return to Audit Plan delivery at this Council, 20 audits are now complete or in progress at the time of writing this report and it is anticipated that further audits will commence during quarters 3 and 4.

2.5 Contact was maintained with the Strategic Director – S151 during the above period and a decision made by management to delay some audits to later in the year and, as a result of the loss of available time within the year, an assessment made on those audits that are either no longer required or not seen as a priority.

2.6 For the reasons outlined above, the following Audit Plan changes were agreed with management and are highlighted to the Committee:

Cancellations

a) On-Street Parking (10 days) – audit intended for quarter 1 but it was not considered a priority as traffic movements and parking had significantly declined due to COVID-19 restrictions.
b) Community Safety (10 days) – audit intended for quarter 1 but it was not considered a priority as staff were engaged in the pandemic response.
c) Play Service (6 days) – audit intended for quarter 1 but it was not considered a priority whilst the Play Service was closed due to COVID-19 restrictions.
d) Community Development (Youth Council) (6 days) – audit intended for quarter 2 but it was not considered a priority due to COVID-19 restrictions.

Amendments

e) The Shared Learning (2 days) and Joint Review provisions (3 days) will not be used in 2020/21 (across all SIAS partners). The time has been reallocated to the Ad-hoc Advice provision and used for some miscellaneous contract audit work.

2.7 The impact of the above changes is a total reduction of 32 days in the 2020/21 Internal Audit Plan as originally approved by Committee in June 2020.

2.8 It has also been necessary to re-profile the remaining audits in-line with service capacity. This has resulted several audits being deferred to quarters 3 and 4. This is shown at Appendix C. The position will be reviewed as the year progresses and any further changes reported to Committee.

Critical and High Priority Recommendations

2.9 Members will be aware that a Final Audit Report is issued when it has been agreed (“signed off”) by management; this includes an agreement to implement the recommendations that have been made.

2.10 The schedule attached at Appendix B details any outstanding Critical and High priority audit recommendations.

Performance Management

2.11 The 2020/21 annual performance indicators were approved at the SIAS Board meeting in March 2020.

2.12 The actual performance for Stevenage Borough Council against the targets that can be monitored in year is set out in the table below:

Performance Indicator	Annual Target	Profiled Target	Actual to 30 October 2020
1. Planned Days – percentage of actual billable days against planned chargeable days completed	95%	38% (118/312 days) Note (1)	36% (113/312 days)
2. Planned Projects – percentage of actual completed projects to draft report stage against planned completed projects	95%	29% (9/31 projects)	23% (7/31 projects)
3. Client Satisfaction – percentage of client satisfaction questionnaires returned at ‘satisfactory’ level	100%	100%	100% (4 received) Note (2)

4. Number of Critical and High Priority Audit Recommendations agreed	95%	95%	No High priority recommendations have been made

Note (1) - this reflects the delay in starting to deliver the 2020/21 Internal Audit Plan.
Note (2) - the 4 received so far in 2020/21 relate to 2019/20 audits.

2020/21 SIAS Audit Plan

AUDITABLE AREA	LEVEL OF ASSURANCE	RECS				AUDIT PLAN DAYS	LEAD AUDITOR ASSIGNED	BILLABLE DAYS COMPLETED	STATUS/COMMENT
		C	H	M	LA				
Key Financial Systems – 74 days									
Main Accounting System						8	Yes	0	Allocated
Debtors						8	Yes	0.5	In Planning
Creditors						8	Yes	0.5	In Planning
Treasury Management						6	Yes	0	Allocated
Payroll						10	Yes	0	Allocated
Council Tax						6	Yes	2.0	In Fieldwork
Business Rates						6	Yes	1.5	In Fieldwork
Housing Benefits						6	Yes	1.5	In Fieldwork
Housing Rents						8	Yes	0	Allocated
Cash & Banking						8	Yes	2.5	TOR Issued
Operational Audits – 122 days									
Climate Change & Sustainability						7	Yes	6.5	Draft Report
Matters Identified by SAFS – follow up						5	Yes	4.5	Draft Report
Community Development						0	N/A	0	Cancelled
Community Safety						0	N/A	0	Cancelled
Compliant Homes						10	Yes	7	In Fieldwork
Digitalisation Programme						10	Yes	0	Allocated
Garage Lettings	Satisfactory	0	0	4	0	10	Yes	10	Final Report
Homelessness & Housing Advice						10	Yes	0	Allocated
Housing Allocations						10	Yes	0	Allocated
Housing Repairs						10	Yes	9.5	Draft Report
Leasehold Properties						10	Yes	0	Allocated

AUDITABLE AREA	LEVEL OF ASSURANCE	RECS				AUDIT PLAN DAYS	LEAD AUDITOR ASSIGNED	BILLABLE DAYS COMPLETED	STATUS/COMMENT
		C	H	M	LA				
Licensing						10	Yes	2.5	TOR Issued
On-Street Parking						0	N/A	0	Cancelled
Play Service						0	N/A	0	Cancelled
Statutory Compliance – GF Property						10	Yes	7	In Fieldwork
Tree Management						10	Yes	5.5	In Fieldwork
Void Management	Satisfactory	0	0	1	1	10	Yes	10	Final Report
Procurement, Contract Management and Project Management – 33 days									
Partnerships/Shared Services						10	Yes	0.5	In Planning
Procurement Activity	Good	0	0	0	0	5	Yes	5	Final Report
Regeneration – SG1						10	Yes	1	In Planning
Stevenage Bus Interchange						8	Yes	1	In Fieldwork
Risk Management and Governance – 12 days									
Risk Management						6	Yes	0	Allocated
Corporate Governance						6	Yes	0	Allocated
IT Audits – 12 days									
Payment Card Industry Compliance						6	Yes	5.5	Draft Report
Hardware Acquisition, Movement & Disposal						6	Yes	0	Allocated
Shared Learning and Joint Reviews – 0 days									
Joint Reviews						0	N/A	0	Cancelled
Shared Learning						0	N/A	0	Cancelled

AUDITABLE AREA	LEVEL OF ASSURANCE	RECS				AUDIT PLAN DAYS	LEAD AUDITOR ASSIGNED	BILLABLE DAYS COMPLETED	STATUS/COMMENT
		C	H	M	LA				
Ad Hoc Advice – 7 days									
Advice						7	Yes	4	In Progress
Completion of 19/20 Projects – 5 days									
Various						5	Yes	3	Complete
Contingency – 6 days									
Contingency						6	N/A	0	Through Year
Strategic Support – 47 days									
Head of Internal Audit Opinion 2019/20						3	Yes	3	Complete
Audit Committee						12	Yes	4.5	Through Year
Client Liaison						8	Yes	2.5	Through Year
Liaison with External Audit						1	Yes	1	Through Year
Plan Monitoring						12	Yes	6	Through Year
SIAS Development						5	Yes	5	In Progress
2021/22 Audit Planning						6	Yes	0	Allocated
SBC TOTAL		**0**	**0**	**5**	**1**	**318**		**113**	

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
1	Facilities Management 2019/20	Procedure manual. We recommend that a procedure manual is written for Facilities Management activities. The manual should include the statutory responsibilities and routine compliance checks carried out by the Facilities Management Team.	Recommendation accepted.	Facilities Manager.	Starting 31st October 2019 - Completion 31st January 2020 Starting 31st October 2019 - Completion February 2020 Training ongoing currently.	February 2020. This is a new addition and the management response opposite is therefore the latest comment. October 2020. The Facilities Management manual has been written and includes all statutory routine compliance checks carried out by the FM team and associated method statements and risk assessments form part of the manual.	Implemented.
2	Facilities Management 2019/20	Procurement. We recommend the Facilities Manager ensure compliance with Contract Standing Orders by completing an Award Notification Form (ANF) when a new contract is awarded so the details of the contract can be input into the Council’s central contracts register. Where contracts are running that are not currently on the	Recommendation accepted.	Facilities Manager.	Starting End January 2020- Completion April 2020.	February 2020. This is a new addition and the management response opposite is therefore the latest comment. October 2020. In Place - with the merge of the Facilities Management Team and the Compliance	Implemented.

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
		contracts register the Facilities Manager should seek help from Corporate Procurement to see if any files that have been worked on by procurement are available to help fill in any missing information, where there is no record the Facilities Manager should consider whether a re-procurement is necessary. The Facilities Manager should retain a reference copy of all live contracts in the facilities folders and provide Corporate Procurement with a copy for the contracts database. We further recommend that the Facilities Manager attends the next Contract Management Training course offered by Corporate Procurement to help manage the existing contracts.				Team (plus a move in directorate to Finance and Estates) no new contracts have been awarded but the team are aware ANFs are required if there are new contracts awarded. The procurement process for all compliance contracts will be followed going forward	
3	Facilities Management 2019/20	<u>Contract review.</u> We recommend a full review of all Facilities Management contracts is carried out in line with the Contract Procurement	Recommendation accepted.	Facilities Manager.	Meeting procurement 1/11/19 for overview. Completion of review April 2020.	<u>February 2020.</u> This is a new addition and the management response opposite is therefore the latest	Implemented.

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
		Rules.			Continuous Improvement Action plan to be in place for completion April 2020.	comment. October 2020. In place - the Electrical and Mechanical Compliance Contract has been taken in house after a long run of outsourcing to single contractors. Therefore, there was a need to ensure a smooth transition at short notice. Procurement waivers are in place for our trusted contractors and full procurement of long-term contracts are required. FM and Architects are working together to secure contracts for electrical compliance, water compliance and fire compliance along with contracts for building fabric maintenance.	
4	Cyber Security follow up (2018/19).	Network access control. Management should establish a network access control to block	The Council has created a Security & Network Team who has been tasked to look at security /	ICT Strategic Partnership Manager.	Network Tools July 2019. Intune October 2019.	July 2019. This is a new addition and the management	Partially implemented – continue to monitor.

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
		unknown or unauthorised devices from connecting to the Council's IT network. This should include restricting the ability to physically connect to the IT network. Where there is a demonstrable need for a device to connect to the IT network, the Service should require: The purpose for the connection has been recorded Appropriate security controls have been enabled on the device connecting to the IT network The period of time that the device will require the connection All connections are approved before being allowed to proceed. Devices connected to the IT network should be reviewed on a routine basis.	network tools. There is also a planned upgraded Office 365 and in particular Intune to manage all mobile (non-network connected) devices. The plan is to ensure that only known devices are allowed to access Council systems.		Procurement of network tools revised to November 2020.	response opposite is therefore the latest comment. <u>September 2019.</u> Intune MDM has been installed and will be rolled out to manage all mobile devices and Windows 10 laptops. Plan in place to upgrade all Laptops to windows 10 is in place to ensure control via Intune encryption using Bitlocker. Financial and resource restrictions have forced the procurement of network tools to financial year 2020/21. <u>December 2019.</u> Revised date as above. It is very rare (if ever) that someone connects an external device to the IT network. The Zero Clients do not allow the transfer of data to anything plugged into it.	

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
						February 2020. Revised implementation date as above. July 2020. Budget obtained to purchase networking tools to cover this and other security areas. The procurement will start shortly. October 2020. Project has a dependency on completion of the networking/Firewall upgrade. As any tools need to be able to work within those systems capabilities. The Networking project is at the end of the procurement phase but has come under some procurement and technical issues which are holding up implementation.	
5	Incident Management follow up (2018/19).	Updating the disaster recovery plan. Management should	With our upgrade to horizon VDI, we are installing hardware which will allow	ICT Strategic Partnership Manager.	August 2019 – DR review. April 2020 - VDI	July 2019. This is a new addition and the management	Partially implemented – continue to monitor.

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
		update the Council's IT disaster recovery plan to include the procedure for establishing all IT services at a single data centre. A complete IT Disaster Recovery scenario test on all applications and systems should take place to provide assurance that recovery could happen within the expected time frame. The Service should document the results of the test to determine the further actions required to improve the efficacy of the plan.	either site to run 100% of capacity allowing the complete downing of one site for upgrade work but will of course allow for full capacity in the event on one data centre being of offline.		upgrade.	response opposite is therefore the latest comment. <u>September 2019.</u> VDI upgrade out to tender with award scheduled for October 2019. <u>December 2019.</u> Expected completion for this work is now April 2020. <u>February 2020.</u> As above. <u>July 2020.</u> A verbal update will be provided at the committee meeting. <u>October 2020.</u> Project dependant on upgrade of infrastructure as above. However limited pilot has been started and work on preparing applications is underway. £5,000 has been obtained from Local Government funding	

No.	Report Title	Recommendation	Management Response	Responsible Officer	Implementation Date	History of Management Comments	SIAS Comment (October 2020)
						source to train 2 staff on DR planning.	

APPENDIX C – AUDIT PLAN ITEMS (APRIL 2020 TO MARCH 2021) – START DATES AGREED WITH MANAGEMENT

Apr	May	Jun	July	Aug	Sept
2019/20 Projects Requiring Completion (5)	On-Street Parking (10) Cancelled	Play Service (6) Cancelled	Void Management (10) Final Report Issued	Climate Change & Sustainability (7) Draft Report Issued	Stevenage Bus Interchange (8) In Fieldwork
	Community Safety (10) Cancelled	Housing Repairs (10) Draft Report Issued	Procurement Activity (5) Final Report Issued	Community Development - Youth Council (6) Cancelled	Compliant Homes (10) In Fieldwork
			Garage Letting (10) Final Report Issued	Statutory Compliance – GF Property (10) In Fieldwork	Payment Card Industry Compliance (c/f from May) (6) Draft Report Issued
					Follow Up on Matters Identified by SAFS (5) Draft Report Issued
Oct	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**
Tree Management (c/f from Apr) (10) In Fieldwork	Council Tax (6) In Fieldwork	Creditors (8) In Planning	Main Accounting (8) Allocated to Auditor	Regeneration – SG1 (10) In Planning	Digitalisation Programme (10) Allocated to Auditor
Partnerships/Shared Services (10) In Planning	Business Rates (6) In Fieldwork	Debtors (8) In Planning	Payroll (10) Allocated to Auditor	Risk Management (6) Allocated to Auditor	Leasehold Properties (c/f from July) (10) Allocated to Auditor
	Housing Benefits (6) In Fieldwork	Housing Rents (8) Allocated to Auditor	Hardware Acquisition, Movement & Disposal (6) Allocated to Auditor	Housing Allocations (10) Allocated to Auditor	
	Cash & Banking (8) (c/f from October) TOR Issued	Licensing (c/f from Aug) (10) TOR Issued	Corporate Governance (6) Allocated to Auditor	Homelessness & Housing Advice (c/f from July) (10) Allocated to Auditor	
			Treasury Management (6) Allocated to Auditor		

Assurance Level	Definition
Good	The design and operation of the internal control framework is effective, thereby ensuring that the key risks in scope are being well managed and core objectives will likely be achieved. There are minor reportable audit findings.
Satisfactory	The internal control framework is largely working well in managing the key risks in scope, with some audit findings related to the current arrangements.
Limited	The system of internal control is only partially effective, with important audit findings in key areas. Improvement in the design and/or operation of the control environment is necessary to gain assurance risks are being managed to an acceptable level, and core objectives will be achieved.
No	The system of internal control has serious gaps, and controls are not effective in managing the key risks in scope. It is highly unlikely that core objectives will be met without urgent management intervention.

Priority Level			Definition
Corporate	**Critical**		Audit findings which, in the present state, represent a serious risk to the organisation as a whole, i.e. reputation, financial resources and / or compliance with regulations. Management action to implement the appropriate controls is required immediately.
Service	**High**		Audit findings indicate a serious weakness or breakdown in control environment, which, if untreated by management intervention, is highly likely to put achievement of core service objectives at risk. Remedial action is required urgently.
	Medium		Audit findings which, if not treated by appropriate management action, are likely to put achievement of some of the core service objectives at risk. Remedial action is required in a timely manner.
	Low / Advisory		Audit findings indicate opportunities to implement good or best practice, which, if adopted, will enhance the control environment. The appropriate solution should be implemented as soon as is practically possible.

Part I – Release to Press

Meeting Audit Committee

Portfolio Area Planning & Regeneration

Date **17 November 2020**

SECTION 106 (S106) ALLOCATION UPDATE

1 PURPOSE

1.1 To provide Members with an update to how the S106 allocations process has historically worked and how it could more effectively work.

2 RECOMMENDATIONS

2.1 For Members to note the update

3 BACKGROUND

3.1 S106 are legal agreements between a developer and council to mitigate the impacts of that development on local facilitates and amenities. S106 relates to Section 106 of the Town and Country Planning Act. S106 agreements are negotiated during the planning application process and bind the landowner to make payments, provide affordable housing / land or access and the like.
It can be used to help fund affordable housing as well as roads, school, parks and youth services, health etc.

3.2 As many of these types of mitigation are provided by other partners, much of the S106 allocations are transfer to HCC as Highways or Education Authority or to the NHS.

3.3 Although the S106 agreements will state the trigger for when the monies are due in terms of the construction, the Council will not know until the monies are received when it is being paid. As such there is always a time lag between received the monies and being able to spend or allocation them. In addition S106's may be tightly limited to the immediate area of the development and have a time limit in which they must be spent. If a suitable scheme that meets the S106 condition can not be found or is outside the deadline for spend these s106 funds are returned to the developer.

3.4 The Community Infrastructure Levy (CIL) is a planning charge introduced by the Planning Act 2008, as a tool for local authorities to help deliver infrastructure to support the development of their area. It allows local authorities to raise funds from developers undertaking new building projects. The money can be used to fund a wide range of infrastructure, such as transport schemes, schools, community facilities, parks and leisure facilities, which are needed as a result of development taking place.

3.5 CIL is fairer, faster and more certain and transparent than the system of planning obligations (S106), which causes delay as a result of lengthy *negotiations and is subject to viability.*

3.6 SBC introduced CIL from the 1st of April 2020 and as such new S106 obligations will be reduced to site specific mitigation, particularly for the larger schemes i.e. where a whole school is required as part of a specific development (e.g. North Stevenage and West of Stevenage) or where road/cycleway improvements are required within or in close proximity to the development. S106 is only allowed for infrastructure that is directly related to the scheme and is required in order for the development to be acceptable.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 As reported in the Quarter 2 Capital Monitoring report to Executive (17 November 2020) S106 balances total £378,147 of which £167,622 has been allocated to identified schemes as detailed in the table below:

Table one: S106 Update					
Available for financing	£	2020/21 Forecast	remaining	Budgeted in Future Years	remaining
		£	£	£	£
Affordable Housing	£62,091	£0	£62,091	£62,091	£0
Childrens Playspace / open space	£9,773	£9,773	£0	£0	£0
Community / Greenspace / Ecological Infrastructure	£70,338		£70,338	£70,338	£0
Parking / Transport	£154,960		£154,960		£154,960
Gardening Club	£4,576		£4,576		£4,576
Arboretum	£25,420	£25,420	£0		£0
Pedestrian Link	£35,000		£35,000		£35,000
Household Surveys	£15,990		£15,990		£15,990
Total	**£378,147**	**£35,193**	**£342,954**	**£132,429**	**£210,525**

4.2 With the introduction of CIL, the new reporting requirements and the need to better spend our S106 budgets there is an opportunity have a more effective and open process.

4.3 The current process has been for Planning to record the S106 obligations and to notify the potential spend departments, and Finance. Finance have encouraged the spend departments to spend the S106 where possible. However as some S106 obligations are very specific it has not always been possible to fully fund a spend project with the S106 available. There is now an opportunity to strengthen the communication between Finance and Planning when looking at opportunities to allocate S106 monies. On an occasion Planning were not given the oversight to ensure the allocations align with the obligations requirements.

4.4 As such it is proposed to bring the S106 allocations more into line with the CIL allocations process as they now both require annual reporting and use the same systems.

4.5 CIL and S106 income and expenditure will be reported annually and published on our website, along with our infrastructure priorities and local needs.

4.6 CIL infrastructure expenditure below £75,000 will be delegated to the Assistant Director of Planning & Regulation after consultation with the Portfolio Holder. Expenditure of CIL on infrastructure of £75,000 and above will be determined by the Planning & Development Committee.

4.7 Officers will explore with Members how best to link the approval process with S106 and CIL given S106 funds will be decreasing and there is now an agreed process for CIL. Furthermore the new process needs to encourage spending on appropriate projects.

4.8 Where S106 obligations allows, the impact of S106 mitigation will be maximised by aligning it with the Corporate Priorities for us and our key infrastructure providers.

5 IMPLICATIONS

Financial Implications

5.1 There are considerable risks to the Council in not spending the monies received in the time limits stipulated in the agreements. This can require the Council to return the funds with interest, which would result in the mitigation of the new developed not being addressed. The risks identified in 5.2 present finance risks too, requiring repayment, compensation and damage our ability to secure future obligations.

Legal Implications

5.2 As S106 monies are payments required by ‘contract’ obligation from a developer to the Council for a prescribed mitigation, there are significant legal risks from inappropriately spending S106 monies on things that are not in accordance with those obligations.

Environmental Implications

5.3 S106 can provide the opportunity to improve our local environment.

Climate Change Implications

5.4 S106 can provide the opportunity to improve our local environment.

Staffing and Accommodation Implications

5.5 There is budget available for 50% of a FTE to support with CIL Policy, and administration. It would be a logical addition to this person’s role to fulfil the same function for S106 as the systems and processes are very similar.

BACKGROUND DOCUMENTS

None.

Part I – Release to Press

Stevenage BOROUGH COUNCIL

Meeting: **Audit Committee**

Portfolio Area: All Portfolio Areas

Date: **17 November 2020**

PROGRESS OF CORPORATE AND SERVICE GOVERNANCE ACTIONS

Author: Suzanne Brightwell Ext: 2966
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1. PURPOSE

1.1 To advise Members of the Audit Committee of:

1.1.1. Progress to date of corporate governance actions to strengthen the Council's corporate governance arrangements as identified in the Council's 2019/20 Annual Governance Statement, reported to Audit Committee on 9 June 2020.

1.1.2. Progress to date of service governance actions identified by the 2019/20 Service Assurance reviews carried out at business unit level to strengthen the Council's service governance arrangements, reported to Audit Committee on 9 June 2020.

2. RECOMMENDATIONS

2.1. That Members of Audit Committee note:

2.1.1 Progress to date of corporate governance actions to strengthen the Council's corporate governance arrangements as identified in the Council's 2019/20 Annual Governance Statement, reported to Audit Committee on 9 June 2020.

2.1.2 Progress to date of service governance actions identified by the 2019/20 Service Assurance reviews carried out at business unit level to strengthen the Council's service governance arrangements, reported to Audit Committee on 9 June 2020.

3. BACKGROUND

3.1. Governance is the policies and procedures in place and the values and behaviours that are needed to ensure the Council runs effectively and can be held to account for its actions.

3.2. In 2016, CIPFA SOLACE published a review Framework and Guidance that reflects the International Framework: 'Good Governance in the Public Sector, developed by CIPFA/IFAC. The Framework defines the principles that should underpin the governance of each local government organisation and outlines the requirement for authorities to test their governance structures and partnerships against the principles contained in the Framework by:

- Developing and maintaining an up to date Local Code of Governance, including arrangements for ensuring ongoing effectiveness
- Reviewing existing governance arrangements, and
- Reporting publicly on compliance with the Local Code of Governance on an annual basis setting out how they have monitored the effectiveness of their governance arrangements in the year and identify any enhancement required.

3.3. The CIPFA/SOLACE seven core principles of good governance are:

A: Behaving with integrity, demonstrating strong commitment to ethical values and respecting the rule of the law

B: Ensuring openness and comprehensive stakeholder engagement

(Principles A and B are considered fundamental and applicable through principles C to G)

C: Defining outcomes in terms of sustainable economic, social and environmental benefits

D: Determining the interventions necessary to optimise the achievement of intended outcomes

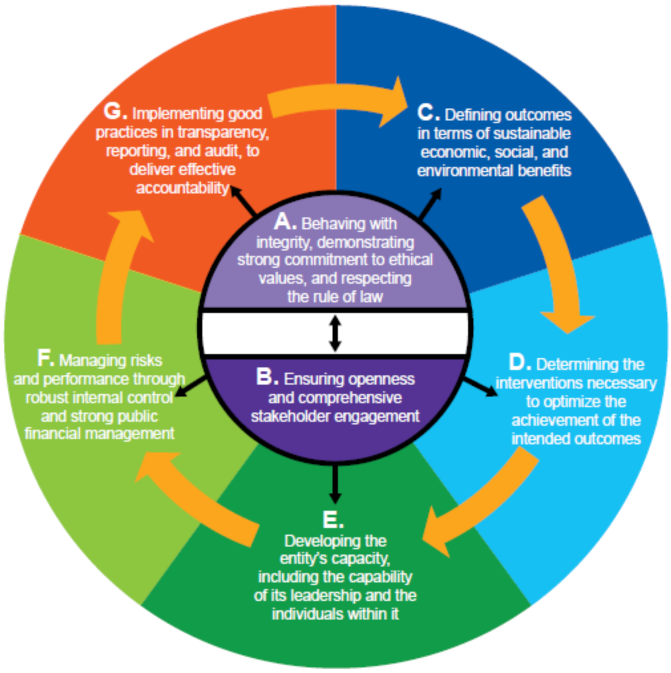
E: Developing the entity's capacity, including the capability of its leadership and the individuals within it

F: Managing risks and performance through robust internal control and strong public financial management

G: Implementing good practices in transparency, reporting and audit to deliver effective accountability.

3.4. For each of the above core principles, the Framework outlines a set of sub-principles and a set of behaviours and actions that demonstrate good governance in practice.

3.5 The diagram on the next page, taken from the International Framework, Good Governance in the Public Sector (CIPFA/IFAC, 2014) illustrates the above principles of good governance in the public sector and how they relate to each other.



3.6 Significant Governance Enhancement Activity – April to September 2020

3.6.1 As a result of the Council's annual assessment of governance arrangements and procedures, actions were identified to improve the high quality of governance arrangements already in place for the Council. Any actions which were deemed as significant were included in the Action Plan in the 2019/20 Annual Governance Statement and these actions are reflected in Appendix A to this report.

3.6.2 Enhancement activity is deemed significant if recommended for inclusion in the Annual Governance Statement by the Shared Internal Audit Service following their review of control arrangements to meet the Audit Plan, or if identified as key to the management of 'very high/high level' strategic risks. By adopting this approach, any concerns over key controls that have a material effect on corporate governance arrangements and the delivery of outcomes should be addressed.

3.6.3 Appendix A outlines the year to date progress of the significant governance enhancement actions included in the 2019/20 Annual Governance Statement. The full year position will be reported to Audit Committee in March 2021.

3.7 Service Governance Enhancement Activity – April to September 2020

3.7.1 At business unit level, assurance of compliance with the principles of good governance requires all Assistant Directors to complete, certify and return a Service Assurance Statement each year. The Service Assurance Statement is designed to provide assurance that the control environment operated effectively during 2019/20 in respect of the business units for which they have responsibility. As a result of this review 36 actions were identified for delivery in 2020/21 to enhance service governance arrangements.

3.7.2 Appendix B outlines the year to date progress of the service governance enhancement actions identified during the service assurance review of service governance at business unit level. The full year position will be reported to Audit Committee in June 2021.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

The self-assessment of the Council's corporate and service governance arrangements against the 'Delivering Good Governance in Local Government' Framework principles and identification of significant governance actions to facilitate continued compliance with this Framework, forms part of the assurance process for the production of the Council's Annual Governance Statement to meet Regulation 6 of the 2015 Accounts and Audit (England) Regulations.

5. IMPLICATIONS

5.1 Financial Implications

There are no direct financial implications arising from this report.

5.2 Legal Implications

The governance enhancements identified in this report will inform the Annual Governance Statement which will be reported to Audit Committee in June 2021. It is a requirement for the Council to publish an Annual Governance Statement alongside its Statement of Accounts.

5.3 Risk Implications

Risk management supports robust corporate governance arrangements by identifying potential risks associated with the achievement of corporate priorities and statutory requirements. Weakness in corporate governance arrangements can increase risk for the Council. Governance arrangements need to be sound and seen to be sound to mitigate risk.

5.4 Other Corporate Implications

Corporate governance affects all aspects of the work of the Council, as well as partners of the Council contributing to outcome delivery, and other agencies with which the Council shares information. External bodies, in particular, need to have confidence in the way the Council operates and this can be achieved by demonstrating robust governance arrangements that are fully embedded and a commitment to ensuring effectiveness.

6. BACKGROUND DOCUMENTS

- CIPFA/SOLACE 'Delivering Good Governance in Local Government' 2016 Framework and Guidance
- CIPFA/IFAC International Framework: 'Good Governance in the Public Sector', published August 2014
- Audit Committee report (9 June 2020) Annual Governance Statement 2019/20

7. APPENDICES

- Appendix A: Progress Review of Corporate Governance Actions 2020/21 - April to September 2020
- Appendix B: Progress Review of Service Governance Actions 2020/21 – April to September 2020

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ANNUAL GOVERNANCE STATEMENT – SIX MONTHS PROGRESS UPDATE

Action	Target Date	Six Month Progress Update
To implement the General Fund Asset Management Strategy the following activity is planned • Complete locality reviews of the Council's current land and buildings to identify new opportunities for better use of existing buildings • Identify potential sites for release for sale and identify land for the Council's own house building programme	 December 2020 March 2021	Executive at its meeting in September 2020 agreed a pipeline of site disposals identified as part of the Locality Ward Asset and Land Review to support the funding of the Capital Strategy and reduce the revenue contribution to capital from the General Fund.
To ensure good governance of the key regeneration projects including the Queensway and SG1 Schemes the following activity is planned: • Continued progress reporting on key projects to Housing Development and Regeneration Executive Committee • Anticipating the implementation of new partnership governance for regeneration schemes, as part of agreed GD3 funding package and new opportunities indicated in Town Deal prospectus • Continuation of the partnership governance arrangements between SBC and Mace; and Queensway Limited Liability Partnership and Reef • Implementation of recommendations arising from the internal audit review of Regeneration Programme Management • Continued internal programme reporting via FTFC Programme Board • Continued monthly and quarterly reporting with Hertfordshire LEP, in addition to Stevenage Borough Council financial reporting to track LEP related expenditure	 Ongoing to March 2021 March 2021 Ongoing to March 2021 September 2020 Ongoing to March 2021 Ongoing to March 2021	The Regeneration and Housing Development meetings have been separated to run on separate dates, to maximise the effectiveness of the session. Regular updates on the key projects in the programme at each session have been provided, as well as focus on a key topic area or emerging project. This has included a session dedicated to Queensway/ Marshgate which Reef attended and presented, and a number of sessions focusing on the Town Investment Plan. The Stevenage Development Board, with an independent Board and wide range of local stakeholders from diverse backgrounds, including the business sector, has been established. Terms of Reference have been adopted and approximately seven meetings held so far in 2020. Steering Group meetings have been held regularly with key members of Mace and SBC teams, with two-weekly operational meetings between the project teams. This has been very valuable when dealing with challenging issues, and regular communication has been a real positive. QLLP continues to run smoothly with regular board meetings and reporting with Reef.

Action	Target Date	Six Month Progress Update
		The implementation of the audit recommendations has been challenging given the changes to the team over the past nine months. There is now stability, additional programme support, and more capacity, and the team is in the process of fully implementing all recommendations. An example of this is the reforms to internal governance and programme management, with quarterly programme reviews. FTFC reporting has gone smoothly, and our milestones have been adjusted to reflect the impact of Covid-19 although the majority of progress remains unaffected. Due to the range of internal and external governance, FTFC reporting is less embedded into service delivery, and there may be further opportunities to work more efficiently through the transformation programme. Monthly meetings are held with the LEP. There continues to be significant pressure on spend deadlines due to the restriction of GD3 funds for three years, but SBC and the LEP are working together to maximise opportunities for delivery. The majority of meetings have been attended by the Assistant Director, Regeneration Manager and Programme Manager, which provides a robust and resilient structure.
To ensure that the Shared Hertfordshire Home Improvement Agency (HHIA) service, operated by Hertfordshire County Council, can deliver its financial targets in the medium term, as well as ensure that minimum key standards are being met, enhance its governance structure and ensure the HHIA Board is offering value for money, the following, the following activity is planned by Hertfordshire County Council: • Review the current business continuity and succession planning arrangements to ensure the service can continue to function in the absence of key officers • Further training to be provided to HHIA staff to ensure the case management	March 2021 March 2021	The Executive at its meeting on 6th October 2020 considered a report which provided information on the Council's second year of participation in the HHIA. The report proposed that the Council remains a member of the HHIA and this was agreed by the Executive. All of the key measures of outputs of the service have improved since 2018/19 and now represent an improvement over both that year and the last year it was provided in house by SBC. A follow up audit was completed by SIAS in August 2020. SIAS were satisfied that systems have been amended to improve the quality and accuracy of information

Action	Target Date	Six Month Progress Update
system is completed and updated and carry out regular data quality checks to obtain assurance that records are updated in an accurate and timely manner • Enhance financial monitoring and reporting • Enhance performance monitoring and reporting	March 2021 March 2021	recorded on the internal management information systems. The evidence from their testing demonstrated significant improvements since the last audit, as well as improved checks by management to review such progress. The HHIA has continued to work on a refreshed business case and business plan to assess and organise for the longer-term financial sustainability of the service. The HHIA have put in place robust systems to track and report on the progress of all recommendations from the initial audit with progress periodically reported to the Board. The HHIA, whilst addressing recommendations, have sought to identify other improvements that can be made to further improve the service. SIAS have been able to provide good assurance over the direction of travel for the HHIA and satisfactory assurance over the completion of recommendations. Thirteen of the original eighteen recommendations have been completed (including five high priority) while five recommendations are in in progress (including two high priority) with revised target dates.
New for 2020/21: To ensure there is a clear governance structure through a corporate landlord function and ensure compliance of the Council's non-housing property, a review of the current arrangements and responsibilities for managing non-housing property is required. This will be achieved by: • Implementation of the new action plan (informed by a recent CIPFA review) to implement a new Corporate Landlord function. • Produce a preferred model for provision of the compliance contract	December 2020 September 2020	The Buildings and Facilities Management Teams are now part of the Estates Team. The buildings compliance contract has been brought in house and Responsible Officers have now been assigned to all operational buildings. Compliance work continues to be progressed and regular compliance checks have been programmed.The compliance audit has largely been completed for operational buildings, community centres and the depot. Risks have been identified and these are being prioritised. Major works have been identified. A new Compliance Management System is being procured. A data manager is to be

Action	Target Date	Six Month Progress Update
		appointed. Policies, procedures and guidance to be produced for all users of council buildings. Preventative maintenance is being investigated and prioritised. Empty properties are now being inspected weekly for damage, leaks etc.
New for 2020/21: To ensure that the Council's ambitious commercial agenda can be achieved, a programme of work is required to enhance the capacity, information, financial and legal skills of those involved in complex investment or commercial decision making. This will be achieved by: • Development and approval of a Commercial Strategy • Implement a programme of training	September 2020 November 2020	On 12th August 2020 the Executive approved the Council's Co-operative Commercial and Insourcing Strategy 2020-2023 and associated action plan. A new Commercial and Investment Executive Sub Committee has been established, terms of reference have been agreed and the first meeting was held on 22nd October 2020. Commercial key performance indicators have been agreed. These will be reported to the Commercial and Investment Executive Committee on a quarterly basis. A Commercial Culture and Skills Audit has been carried out seeking responses from SBC staff. A Skills and Culture Learning and Development Plan will be developed based on the outcomes of the audit.
New for 2020/21: In response to the challenges which could result from the Government's Local Government Reform and Devolution White paper which is due to be published in Spring 2021, the following action is proposed: • Undertake a review of the White Paper and its implication once it has been published • Engage with other Hertfordshire District and Borough councils to consider a response to the White Paper	September 2020 September 2020	MHCLG officials attended the Hertfordshire Growth Meeting on 4th August 2020 to observe the collegiate way in which the ten Hertfordshire authorities are working together for the good of Hertfordshire communities. Engagement with other Hertfordshire Authorities is continuing and all Districts/Boroughs are working together to ensure appropriate reform options are considered. A residents' poll of more than 2000 people across the county has been carried out. Discussions are taking place with other Local Authorities who have recently

Action	Target Date	Six Month Progress Update
		undergone or are considering devolution options to inform the debate in Hertfordshire.
New for 2020/21: In response to the COVID-19 crisis and to ensure the Council can reinstate and continue to deliver services, continue to meet its FTFC ambitions and enable recovery from the effect of the virus in the town, the following action is planned: • Carry out a review of the General Fund and HRA Medium Term Financial strategies in light of the financial pressures arising from the COVID-19 emergency • Carry out a review of the FTFC Programme to help identify which planned projects can be delivered in the year or where necessary adapted. • Produce and implement a town wide Recovery Plan • Produce and implement an internal Stevenage Borough Council Recovery Plan	June 2020 June 2020 Sept 2020 Aug 2020	A review of the General Fund and HRA Medium Term Financial Strategies in light of the financial pressures arising from the pandemic has been carried out and reported to Executive in June 2020. Executive in July 2020 approved the Council's Recovery Plan and actions are in placed embedded in the Council's FTFC reporting process. Plans are developing for an Economic Taskforce to tackle the effects of the impending recession. Stevenage Together Partnership is working on a joint recovery action plan for the town, covering areas from health, to jobs and skills, environment, regeneration and support to those who need it most.
To ensure there is corporate capacity to deliver sustainable services that meet the needs of customers, the following activity is planned: • Through strategic workforce planning, undertake skills/capacity gap analysis and put in place targeted management and staff development activity in response. • Introduce tools and techniques to manage change effectively whilst maximising levels of staff engagement • Develop communication/engagement strategies that enable all staff to have a clear understanding of organisational direction and the desired culture, behaviours and ways of working • Continue to implement the restructure of services through Future Council Business Reviews	December 2020 September 2020 December 2020 December 2020	The Council's new Workforce Strategy was approved by Executive in October 2020. The Strategy is a critical enabler for delivering the Council's strategic ambitions over the next three years. The Strategy identifies actions that will improve employees' experiences and position the Council as an 'Employer of Choice'. The Strategy has identified five key strategic themes: • New ways of working • Attracting and retaining the best people • Engagement and communications • Inclusion and wellbeing • Organisational development The majority of the Council's business unit reviews are now complete. Initial proposals for the business unit review within Digital

Action	Target Date	Six Month Progress Update
• Recruit to a number of key posts across the Council to enhance capacity and key skill requirements	March 2021	and Transformation have been developed, alongside proposals for the Garages and Markets service. Recruitment of key roles has continued during the Covid-19 pandemic to ensure corporate capacity is maintained. A new Assistant Director for Finance and Estates has recently been recruited and will start in post in December 2020. Other key recruitment includes a new Head of Estates role and the substantive appointment of the previously interim Assistant Director for Regeneration.
To enhance IT infrastructure, cyber security, governance arrangements, policy framework and resilience the Shared IT service to continue to develop and implement a strategy and programme of activity as follows:		A number of ICT actions have been delayed due to the impact of Covid-19 and the work which has been undertaken by the ICT team to ensure that staff can work from home.
• Horizon VDI Upgrade to be carried out to improve resilience resulting in 100% of desktops being available at each data centre, allowing the ability to resolve issues without down time.	March 2021	Detailed design was completed in September. Training and Communications are scheduled to be rolled out by the end of March 2021.
• Update the ICT Disaster Recovery Plan to reflect new infrastructure and arrangements	December 2020	A Disaster Recovery Team is to be created to review all documentation and plans are in preparation for the upcoming changes.
• Install a secondary microwave link between the Council's two data centres to almost eliminate chances of link breakage and therefore ICT interruption.	December 2020	The hardware installation is now complete. The microwave link is due to go live by end of December 2020.
• Replacement of the Council's firewalls • Implementation of controls and management tools to monitor and control the ICT network	March 2021	The replacement of Council's firewalls and implementation of controls and management tools to monitor and control the ICT network are in the soft market testing phase. Procurement is schedule for March 2021.
• Replace Windows 2008 to Windows 2019	September 2020	The roll out of Windows 10 Operating system, which is a pre-requisite for Microsoft 365 and a key requirement of the Security Enforcement Programme, is currently undergoing application suitability testing.

Action	Target Date	Six Month Progress Update
To continue to enhance and embed information and records governance to ensure that best practice records management across the Council continues to be applied and customer data is stored securely and appropriately managed the following activity is planned:		
• Use of data discovery tool to identify all relevant personal data and allow decisions to be made regarding the processes and procedures for teams handling this data.	March 2021	Discussions have now resumed between the ICT Partnership and relevant suppliers after being paused due to Covid-19. A planned formal procurement is now being scoped to ensure the solution meets council requirements.
• Continue the review of data sharing arrangements with local authority partners and public agencies to reflect GDPR requirements on information sharing obligations	June 2020	The review of data sharing arrangements is now complete
• Update supplier agreement which involve the processing of personal data in line with GDP requirement	June 2020	Supplier agreements have been updated. This work is now complete.
To continue to ensure health and safety compliance and performance across the Council the following activity is planned:		
• A monitor of all corporate high health and safety risks to be produced for review by the Strategic Health and Safety Group and monthly HR meetings	March 2021	A RAG monitor of all the Council's high health and safety risks is now being produced which identifies the responsible officer/actions/status commentary. All high risks are reviewed by the Strategic Health and Safety Group and reported to Corporate Risk Group and the Senior Leadership Team quarterly. The monitor is also reviewed by the Chief Executive at the monthly HR meetings.
• The Council's Senior Leadership Team to receive Institution of Occupational Safety and Health training	November 2020	
• Implement revised health and safety arrangements in line with COVID-19 Government guidelines and restrictions for staff, Members and customers	November 2020	The Health and Safety team have assisted to ensure that all Council buildings are Covid Secure. New Covid working arrangements for Daneshill and Cavendish Road have been implemented to ensure the health and safety of staff. The team have also provided support and advice to frontline staff to ensure their safety and the safety of customers. PPE requirements for specific operational settings have been identified and procured. Staff communication messages have been provided to advise staff of Covid-19 guidance.

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SERVICE BASED GOVERNANCE ACTIONS – 2020/21

Action identified for 2020/21	Progress September 2020	Service Area
Principle A – Behaving with integrity, demonstrating strong commitment to ethical values and respecting the rule of law		
Continue to implement the new management system for SDS Operations to provide real time business intelligence in respect of the Operations functions. Links with the new CRM system need to be made live so the full functionality can be realised.	The new system (Collective) went live on 16th March with the waste and recycling module. Back office has not been fully implemented due to delays/Covid-19. Integration with Firmstep went live in October 2020 and missed bins have reduced by an estimated 45% as a direct result. Bins are not being replaced as frequently and some charges have been levied. Streets and Grounds will be the next module to be implemented. Reactive tasks planned to go through in the early New Year.	**Stevenage Direct Services**
Induction process to be carried out for all staff in Housing and Investment when the Housing and Investment Business Unit Review is launched (postponed from the 6 April due to COVID-19 response). The induction process to include awareness of Employee Code of Conduct and Financial Regulations and Contract Standing Orders.	This induction process is yet to happen. Covid has led to delays in recruiting to the vacant posts. The induction itself is due to be finalised in October and will then be rolled out virtually across all members of the Housing Team.	**Housing and Investment**
Review of Council's pay and reward arrangements to attract and retain staff and consider special arrangements to attract staff for hard to recruit posts.	**Complete.** External Consultant engaged and completed this project, benchmarking SBC pay and benefits locally, regionally and nationally. Report presented to Head of Paid Service and SLT and decision made that no changes are currently required.	**Human Resources and Organisational Development**

Data to be added to HouseMark to enhance data analysis, insight and business intelligence	Data being collated and is due to be submitted to Housemark by the end of the year.	**Housing and Investment**
Principle B: Ensuring openness and comprehensive stakeholder engagement		
The IT Shared Service Board Partnership Agreement to be reviewed and agreed by East Herts District Council	The ICT Shared Service Board Partnership Agreement has been reviewed and is currently awaiting approval	**Digital and Transformation**
Financial Regulations to be approved by Audit Committee and staff to be informed of changes	**Complete.** Financial Regulations were approved by Council in July 2020. The Regulations are now on the Council's intranet.	**Finance and Estates**
Complete the review of supervisory/management roles in Stevenage Direct Service Business Unit to further enhance service delivery. This was expected to go live on 1st May 2020 but due to COVID-19 has been delayed until June 2020.	Completed fully for Operations from 1st October with all roles in position and previous interim arrangements ceased. For the Repairs service, phase one is complete. Three of the four positions have been recruited to with one person covered by an interim manager until permanent recruitment is complete. The Garages and Markets team have been decoupled on a trial basis. The service review is underway with the proposed new job descriptions having been considered by the Job Evaluation panel on 29th October. It is anticipated that the review will be completed by 1st January 2021 and the new establishments made permanent.	**Stevenage Direct Services**

Deliver and embed a new customer service model for the Customer Service Centre, supported by new and enhanced digital processes.	A new website and Digital Platform have gone live offering easier navigation, improved accessibility and enhanced digital options for residents. In order to ensure continuous improvement of the customer experience and to realise efficiencies, a review of the model for customer services and customer complaints delivery as part of the Digital and Transformation Business Unit Review will be carried out.	**Digital and Transformation**
Update the Council’s Communications Strategy, including a review of the Council’s branding and corporate identity	Communications strategy and style guide updated for 2020. Review of sub-brands is currently underway to help provide clarity on the SBC corporate identity. Guide to be launched when time allows.	**Communications**
Carry out a review of staff engagement	Regular pulse staff surveys undertaken throughout the pandemic to monitor staff engagement and digital staff survey platform options currently being appraised for the longer term.	**Human Resources**
Principle C – Defining outcomes in terms of sustainable economic, social and environmental benefits		
Service Plans for the Planning and Regulatory Services Business Unit to be reviewed and updated	The Service Plans are being reviewed and is scheduled to be complete by March 2021.	**Planning and Regulation**
Implementation of the recommendations from the Waste Scrutiny Review	**Complete.** In place with the integration of systems.	**Stevenage Direct Services**

Principle D: Determining the interventions necessary to optimise the achievement of the intended outcomes		
An inclusive Economy Charter to be produced alongside an action plan to ensure the council drives social value through its activities and those of other partners working in Stevenage.	Approved at Executive in July 2020. A formal launch is being planned for the end of October/early November. The council will produce its first community balance sheet at the end of March 2021.	**Communities and Neighbourhoods**
Recommendations from the peer review of Constitutional Services to be implemented	Peer review has been completed. Plans have been devised and are likely to be implemented during 2021/22. The review has helped to inform potential future savings options.	**Constitutional Services**
Principle E – Developing the entity's capacity, including the capability of its leadership and the individuals within it		
Recruit to the Head of Estates, Commercial Asset Manager and Surveyor posts in the Estates service to enhance capacity and implement the Corporate Landlord function	The Head of Estates has been recruited and is now looking to recruit to vacant roles in the Team. The Head of Estates has also taken management responsibility for Facilities Management and Property Services and is recruiting to the vacant Facilities Manager post.	**Finance and Estates**
Recruit to the vacant roles in Reconciliation and the Paralegal Service as a result to the recent restructure of these services	The restructure of the Reconciliation Team is complete and recruitment activity has taken place, however there are still vacant posts to fill.	**Finance and Estates**
Recruitment to a Graduate post in Accountancy and a Corporate Graduate post to be assigned to Estates to enhance succession, capacity and workforce planning. Recruitment to these posts is currently being delayed due to the COVID-19 response.	The recruitment to these posts continues to be delayed due to Covid-19. One of these posts may now be deleted as part of the Council's need to find financial savings..	**Finance and Estates**

Corporate Governance Group to consider the implementation of induction training for Interim Staff	This has been considered by Corporate Governance Group and HR will be making arrangements for agency staff to receive induction training.	**Finance and Estates**
Update the final two job descriptions in the Planning and Regulatory Services unit	This is scheduled to be completed by March 2021.	**Planning and Regulation**
Recruit to vacant ICT posts. Three positions remain unfilled. One growth post is currently under review and should be completed in May. One post is being recruited to temporarily. Proposal is to fill the other post with a graduate trainee.	All ICT posts have now been filled with the exception of one post in the Applications team. Work is in progress to appoint a graduate trainee for this post.	**Digital and Transformation**
Implementation and embedding of the SDS Workforce Plan	**Complete.** This action has been superseded by the recent Business Unit Reviews.	**Stevenage Direct Services**
Finalise proposals, implement and embed the service reviews for Housing Repairs and Maintenance and Environmental Performance and Development	The service review for the Environmental and Commercial Support functions will go live from 2nd November. Recruitment to 1.5 FTE vacant posts has commenced. The service review for the Policy and Development Team is temporarily suspended in lieu of the recruitment freeze. Phase One of the Repairs review is complete. Three of the four positions have been recruited to with one position covered by an interim manager until permanent recruitment is complete. Phase two to commence in January 2020.	**Stevenage Direct Services**

Recruit to the vacant posts which have been created as a result of the Housing and Investment Future Council Business Review	Recruitment to the last remaining posts is underway and would anticipate that this will be complete by the end of the financial year.	**Housing and Investment**
Review of job descriptions for all posts within the scope of the second phase of the Stevenage Direct Services Business Unit review	First phase of the Operation service complete (as Per Principle B), the second phase to commence in October 2020. First phase of the repairs service review due to complete in October 2020. Second to commence Nov/Dec 2020 and will look at all posts including Terms and conditions for the roles to ensure future service standards are met.	**Stevenage Direct Services**
Principle F: Managing risks and performance through robust internal control and strong public financial management		
Business Case which outlines how ongoing GDPR monitoring/information governance is going to be resourced and proposals for a shared service with East Herts to be agreed and implemented.	**Complete.** A Business Case was submitted to East Herts District Council. The proposal to develop a shared service for Information Governance will not be going ahead.	**Digital and Transformation**
Complete the review of the Communities and Neighbourhood web pages to ensure that information is still valid and up to date for the launch of the Council's new website	**Complete.** The web pages have been reviewed. This action is therefore now complete.	**Community and Neighbourhoods**
Shared Legal Service Partnership Risk Register to be produced	**Complete.** A Shared Service Partnership Risk Register has been produced and agreed by the Shared Legal Service.	**Shared Legal Service**
Shared Legal Service Partnership Agreement to be updated to reflect GDPR requirements	This action is in progress.	**Shared Legal Service**

Complete the review of documentation dating back to before the transfer to the new Shared Legal service under the advice of the Borough Solicitor and Lead Lawyer for the Shared Legal Service.	This has been delayed due to absence of staff in the office due to Covid-19. Prior to this, work has been carried out to rationalise the files but this work is not yet complete.	**Shared Legal Service**
Appointment of a Compliance Manager to carry out compliance activity as outlined in the five year Compliance Action Plan	**Complete.** The new Compliance Manager started on 14th October 2020.	**Housing and Investment**
Delivery of the five year Compliance Action Plan, incorporating actions identified following an independent compliance review of Housing Revenue Account properties	**Closed.** This has either been incorporated in the asset management strategy and covered by that action plan or superseded by changes such as building safety since this action was originally added. A number of the actions have been completed and put in place such as the electrical inspection programme, changes to processes etc.	**Housing and Investment**
Stevenage Direct Service budgets to be reviewed as part of SDS Business Unit Review to ensure they support both long term and short term outcomes	Service review within the support team will deliver full year savings from April 2021.	**Stevenage Direct Services**
Anti-Money Laundering and Anti-Bribery Policies to be launched and staff made aware.	The Anti-Money Laundering and Anti-Bribery Policies have been approved and are now available on the Council's intranet.	**Finance and Estates**
Complete the actions identified by the recent SIAS follow-up audit of the Street Cleansing Service	Complete, with the exception of those actions relating to the implementation of the systems to support the service delayed due to Covid-19 as highlighted in Principle A.	**Stevenage Direct Services**
Review of Operational Risk Registers to reflect new corporate services structure and reporting arrangements	**Complete.** Operational risk reporting has been reviewed to reflect new organisational structure.	**Various Services**

Principle G – Implementing good practice in transparency		
Continued monitoring of the new Shared Home Improvement Agency Function to ensure its effective implementation and medium term financial viability.	A report went to Executive on 6th October outlining the improvements which have been made to this service since the SIAS audit. Significant improvement has been made and Executive has agreed to remain a member of HHIA.	**Planning and Regulation**

Stevenage BOROUGH COUNCIL

Meeting:	**Audit Committee / Executive / Council**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**17 November 2020 / 18 November 2020 / 16 December 2020**	Financial security

2020/21 MID YEAR TREASURY MANAGEMENT REVIEW

NON-KEY DECISION

Author	– Belinda White	Ext No. 2515
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1. PURPOSE

1.1 To update Members on the Treasury Management activities in 2020/21 and review effectiveness of the 2020/21 Treasury Management and Investment Strategy including the 2020/21 prudential and treasury indicators.

2. RECOMMENDATIONS

2.1 That subject to any comments from Executive and the Audit Committee, recommend to Council to approve the 2020/21 Treasury Management Mid-Year review.

2.2 That subject to any comments from Executive and the Audit Committee, recommend Council to approve the latest approved Countries for investments (Appendix D).

2.3 That the updated authorised and operational borrowing limits are approved (paragraph 4.4.7).

2.4 Comments from the Audit Committee meeting of 17 November will be verbally updated to the Executive and incorporated into the report to Council on 16 December 2020.

3. BACKGROUND

3.1 This report covers one of three reporting requirements under the Prudential and Treasury Management Code of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), the other reports being;

- Annual Treasury Strategy (in advance of the year) (last reported to Council 26 February 2020)
- Annual Treasury Management Review after the year end (2019/20 was reported to Council 14 October 2020)

3.2 In December 2017, CIPFA revised the Code to require, all local authorities to report on:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

These elements are covered in the annual Capital Strategy reported to Council in February each year.

3.3 This report summarises:

- Capital expenditure and financing for 2020/21;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Reporting of the required prudential and treasury indicators, including the impact of the expenditure on the Council's underlying indebtedness (the Capital Financing Requirement);
- Update on the Treasury Management Strategy Position;
- An economic update for the first part of 2020/21.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 The Council's Capital Expenditure and Financing 2020/21

4.1.1 Capital expenditure[1] can be financed either by capital resources the Council has on its balance sheet (e.g. capital receipts and capital grants) or by making a revenue contribution to capital. If sufficient capital resources are not available to fund the expenditure the council would need to borrow to meet the funding gap. This borrowing may be taken externally in new loans or internally from cash balances held by the council (see also 4.3.3). The need to borrow is measured and reported through the prudential indicators.

4.1.2 The Treasury Management Strategy and Prudential Indicators for 2020/21 were originally approved by Council on the 26 February 2020. Since then, capital budget changes have been approved and the Prudential Indicators updated in

[1] Council expenditure can be classified as capital when it is used to purchase assets with a life of more than one year, exceeds £5,000 in value and meets the guidelines laid out in CIPFA accounting practices.

the 2019/20 Annual Treasury Management Review (approved by Council 14 October 2020). The Treasury Management Mid-Year Review Indicators have been updated based on the 1st quarter capital programme reported to Executive (16 September 2020).

4.1.3 Table One (shown below) shows the original capital programme, the revised capital programme (approval Executive 16 September 2020) and financing.

Table One: 2020/21 Capital Expenditure and Financing		
	2020/21 Original Capital Strategy (Council February 2020) £'000	2020/21 Revised Mid-Year Review (Q1 Capital Strategy -Executive September 2020) £'000
Capital Expenditure:		
General Fund Capital Expenditure	20,429	35,271
HRA Capital Expenditure	50,384	34,057
Total Capital Expenditure	**70,813**	**69,328**
· Capital Receipts	(13,515)	(9,389)
· Capital Grants / Contributions	(14,196)	(11,111)
· Capital Reserves	(2,449)	(2,295)
· Revenue contributions	(59)	(176)
· Major Repairs Reserve	(11,662)	(4,247)
Total Resources Available	**(41,881)**	**(27,219)**
Capital Expenditure Requiring Borrowing	**(28,932)**	**(42,110)**

4.2 The Council's overall borrowing position.

4.2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR)[2]. Whether physical borrowing is taken out depends on the level of cash balances held by the Council. The treasury service manages the Council's cash position to ensure sufficient cash is available to meet the capital payments, based on the Capital Strategy and Treasury Management Strategy. This may be through internal borrowing from utilising cash balances held by the Council in the short to medium term or external borrowing such as using the Government, through the Public Works Loan Board (PWLB) or the money markets.

4.2.2 The 2020/21 Capital Strategy identified the need for borrowing for financing elements of the capital programme. The Council has not undertaken any new external borrowing to date in 2020/21.

4.2.3 On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps[3] on top of the current margin of 80bps. The

[2] Capital Financing Requirement (CFR) represents the amount of debt the Council needs to/has taken to fund the capital programme after debt repayments and Minimum Revenue Provision (MRP) are taken into account

[3] 100bsp is 100 basis points, the equivalent of 1%.

margin of 80bps was used for all Council project appraisals including the HRA business plan, Wholly Owned Housing company and investment portfolio. Subsequently the Government announced a separate margin for housing which returned the rate to the previous margin over gilts, after representations were made that this should not be subject to such a large increase in borrowing cost. Other Council schemes were re-assessed in light of this unscheduled increase by the Treasury, and the business plan for the Wholly Owned Housing Company is being reviewed and a report will be taken to Executive. As reported in the Annual Treasury Management Review of 2019/20, there has also been a consultation into the lending arrangements for PWLB funding. The deadline for the consultation was extended to 31 July 2020, and the date for the outcome of the consultation has yet to be confirmed. Changes may be introduced that prohibit Council's use of PWLB borrowing for investment property purchases, and this could impact on the Commercial Property budgets in 2020/21 of £13.2 Million for Investment Property and £613K for Commercial Properties Refurbishment (MRC Programme).

4.2.4 In 2020/21 the average cash holding between April and September was £62Million (£63Million April to September 2019/20). While investment returns are low the "internal" borrowing rate is significantly cheaper than the cost of external borrowing and remains a prudent use of the Council's cash balances, unless it is prudent to secure long term borrowing in accordance with the HRA business plan.

4.2.5 As at the 30 September 2020 the Council had total external borrowing of £209,097,845 which is projected to increase to £247,840,036 by 31 March 2021 if all approved borrowing is taken as per the revised capital programme approved by Executive 16 September 2020.

4.2.6 The General Fund currently has £2,413,845 external borrowing with the PWLB, comprising an Equal Instalments of Principal (EIP) loan with the final principal repayment in February 2022, and a Maturity loan of £1.756Million which matures in March 2028.

4.2.7 The HRA has external borrowing of £206,684,000 with the PWLB, with the majority of the HRA debt (£194,911,000) taken out in March 2012 to finance the payment required to central government for self-financing. This debt was arranged over a number of loans at fixed rates and with varying maturities and is not impacted by the recent changes in PWLB rates.

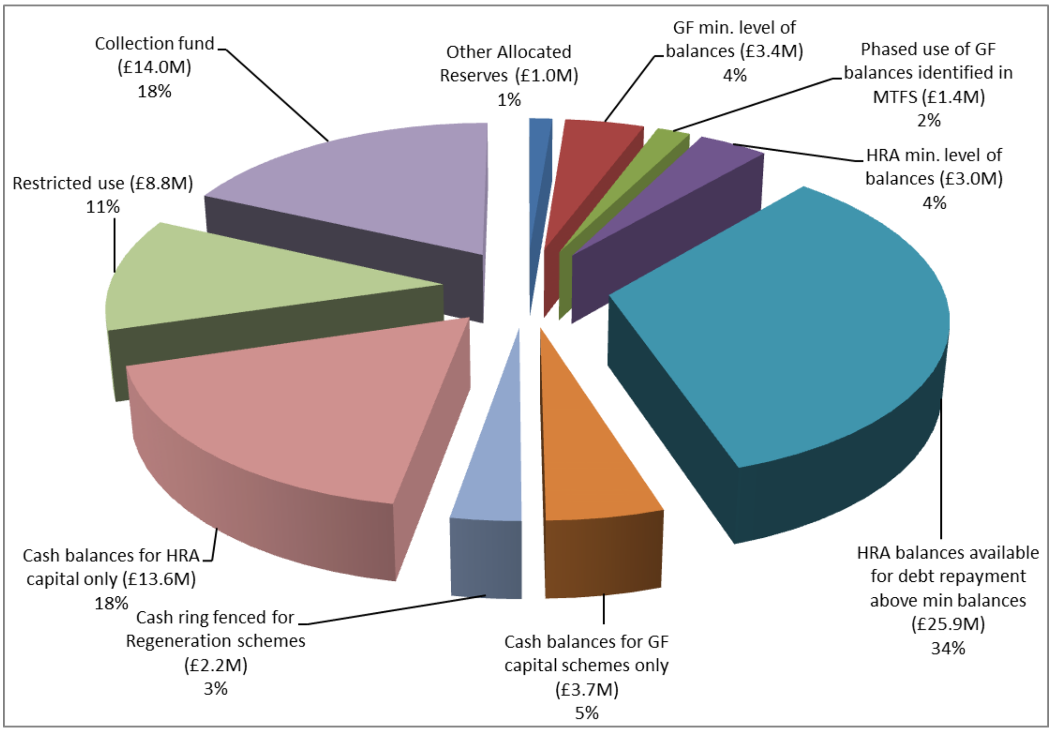
4.2.8 The HRA borrowing includes £7,763,000 used to fund the pre 2012 Decent Homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio. An additional £4,010,000 was taken in 2019/20 to fund more recent Decent Homes expenditure.

4.2.9 Since the lifting of the HRA Debt Cap, which was formerly £217,685,000, HRA borrowing limits are based on affordability rather than legislation. These limits are now reviewed as part of the annual HRA Business Plan. An MTFS update HRA 2020/21 - 2024/25 is being reported to Executive on 18 November 2020.

4.3 Cash balances and cash flow management

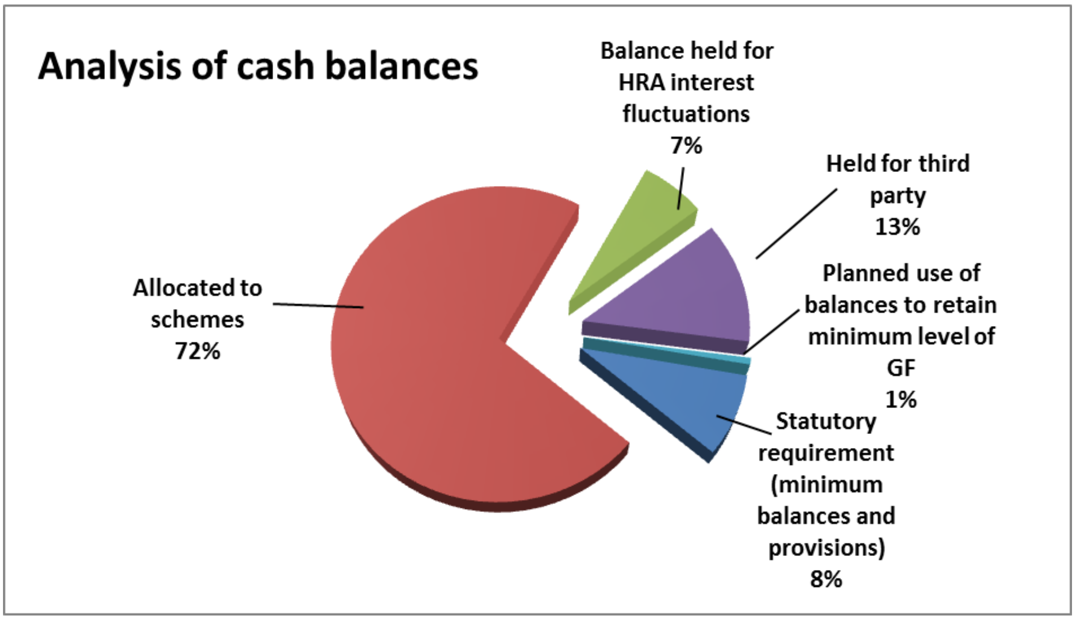
4.3.1 As at 1 April 2020 cash balances held by SBC totalled £54.1Million. The revised cash balance expected to be held as at 31 March 2021 is £60.6 Million. The breakdown of these cash balances is shown in the following chart.

Chart One: Cash Balances expected as at 31 March 2021



4.3.2 These cash balances can be further analysed between allocated, held for statutory requirements and held for third parties. This identifies that of the £60.6Million, all cash resources have been allocated, so unless allocated reserves are no longer needed in the future, there are **currently no cash resources available** for new projects.

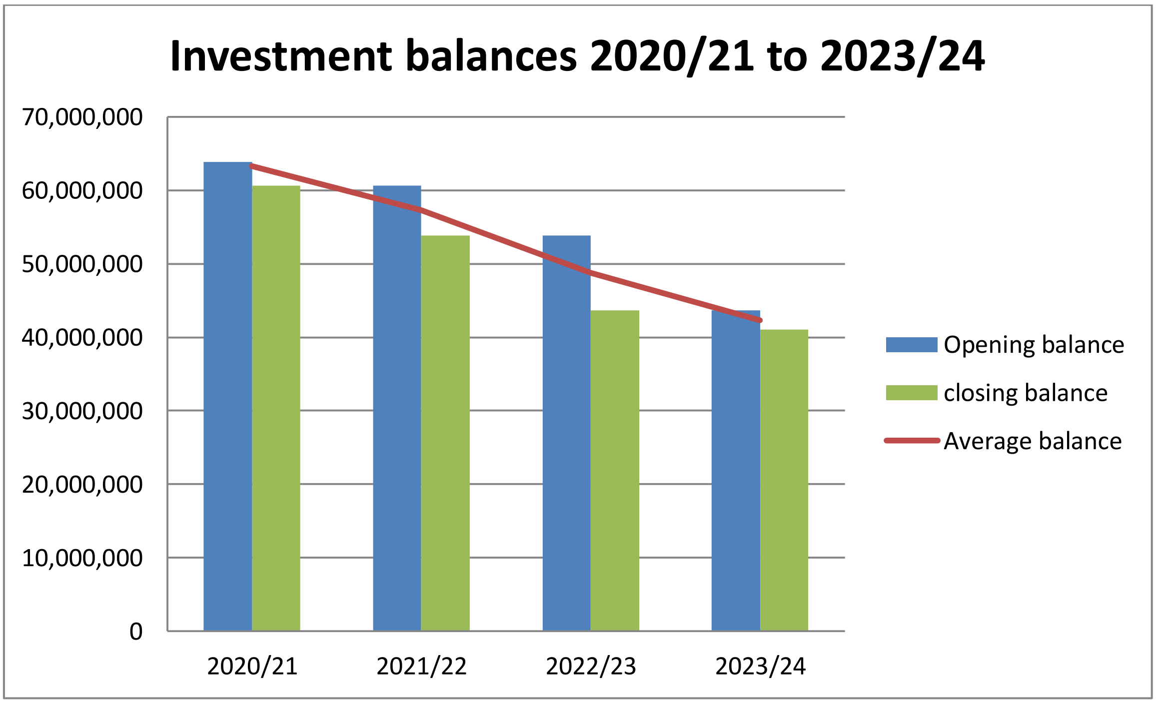
Chart Two: Analysis of Cash Balances



4.3.3 Cash investment balances are expected to be £60.6Million by 31 March 2021 (reserves and balances of £77.0Million less actual internal borrowing of £16.4 Million), but is dependent on current spending projections and approved borrowing included in the capital strategy and current HRA business plan (General Fund - £15.071Million and HRA - £23.803Million) for 2020/21. Decisions as to when to take this borrowing will be considered based on cash balances and anticipated interest rates.

4.3.4 The forecast investment balances to 2023/24 has been updated to reflect the latest General Fund MTFS and HRA MTFS projections and the revised capital programme. Note that, like the pie chart in paragraph 4.3.2, the balances in the chart below includes those being held on behalf of third parties.

Chart Three: Investment Balances forecast



4.4 Prudential Indicators

4.4.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators, (which measures affordability limits), are included in the approved Treasury Management Strategy and an update on those indicators is included in this report. During the year to date, the Council has operated within the treasury and prudential indicators set out in that strategy. Further explanation of key prudential indicators is given below and is also shown in Appendix A.

4.4.2 **Borrowing and the 2020/21 Capital Financing Requirement (CFR)** - The Council's underlying need to borrow for capital expenditure is referred to as the Capital Financing Requirement (CFR). The Council's original estimate and latest CFR for the year is shown below. The estimate of the CFR for 2020/21 has been updated for the capital strategy approved by Members (16 September 2020 Executive). Further updates may be required pending completion of the external audit of the 2019/20 accounts.

4.4.3 The HRA MTFS update (HRA 2020/21 - 2024/25) will be reported to the 18 November 2020 Executive, and the Final HRA and Rent Setting Report 2021/22 to Executive to the 20 January 2021 Executive and to Council on 28 January 2021. The CFR and prudential indicators included in this report have been updated to reflect the current projections for the HRA revised business plan.

Table Two: Capital Financing Requirement 2020/21			
CFR Calculation	**2020/21** **Original: Annual TM Strategy (Approved Council February 2020)** **£'000**	**2020/21** **Revised: Annual TM Review of 2019/20(Approved Council October 2020)** **£'000**	**2020/21** **Revised: Mid-Year Review (Executive November 2020)** **£'000**
Opening Balance	**258,141**	**241,724**	**241,987**
Closing Capital Financing Requirement (General Fund)	45,544	46,004	42,918
Closing Capital Financing Requirement (Housing Revenue Account)	239,627	233,771	237,474
Closing Balance	**285,171**	**279,775**	**280,391**
Increase/ (Decrease)	**27,030**	**38,051**	**38,404**

4.4.4 Total debt repayments made in the first half of 2020/21 relating to principle on PWLB General Fund loans were £131,579 (paid in August). A further repayment of £131,579 will be made in February 2021 in relation to General Fund debt.

4.4.5 The Council could further reduce its CFR by:

- The application of additional capital financing resources (such as unapplied capital receipts) if available; or
- Charging more than the statutory revenue charge (Minimum Revenue Provision (MRP)) each year through a Voluntary Revenue Provision (VRP) which would increase the cost to the General Fund

4.4.6 The **net borrowing position** of the Council at 31 March 2021 is estimated to be **£187.2M** (total borrowings/loans of £247.8M less total investments held of £60.6M). This updated position also reflects the current projections for the HRA revised business plan.

4.4.7 The **operational boundary and authorised limit** refer to the borrowing limits within which the treasury team operate. To date there have been **no breaches** of either limit in 2020/21).

4.4.8 As raised in the Treasury Management report to Council, at the time of publication of this report the external audit of the 2019/20 accounts had yet to be completed. Any changes following the completion of the external audit will be reported to Members in subsequent reports.

4.4.9 **Minimum Revenue Provision** (MRP)[4] – In 2020/21 the MRP calculated on previous years' borrowing is £411,021, however there will be no MRP charge to the General Fund with respect to borrowing for regeneration assets of £193,703, due to the overpayment calculated following the MRP review, which reviewed the asset lives used in calculating MRP. Based on the current forecasts this 'MRP holiday' period for regeneration assets will result in no MRP charges to the General Fund until 2025/26. Further detail can be found in Appendix E MRP Policy.

4.4.10 MRP needs to be made regardless of whether actual external borrowing has been taken and hence differs from the treasury management arrangements, the latter considers utilising cash balances when borrowing rates are higher than investment interest rates.

4.4.11 The **ratio of financing costs to net revenue stream** is equal to General Fund interest costs divided by the General Fund net revenue income from Council Tax and business rates.

4.4.12 The treasury management indicators for 2020/21 onwards have been calculated based on the 1st quarter capital programme reported to Executive 16 September 2020. There will be subsequent updates to the capital programme including the capital bidding process for the period 2021/22 to 2025/26 and as such the data relating to future years is indicative only and will be subject to change. The full list of Treasury Prudential Indicators is shown in Appendix A.

4.5 Update on Treasury Management Strategy Position 2020/21

4.5.1 The Council's debt and investment position is managed by the treasury management section to ensure adequate liquidity for revenue and capital activities. In addition, investment decisions are based on the security of the investments and spread over a number of counter parties to manage the Council's exposure to risk.

4.5.2 The Council's **average investment returns** are modest due to historically low Bank of England Base Rate which is currently 0.10% and the risk appetite in the treasury management strategy. As at 30 September 2020 the 2020/21 average rate of interest being earned on investments was 0.98% (compared to 0.98% earned in 2019/20). This exceeded the 7 day LIBID benchmark rate of 0.53% (source: LINK Asset Services 29-9-20).

4.5.3 At current interest rates it is still prudent to utilise the Council's cash balances (as shown in paragraph 4.3.1) for short-term internal borrowing. However, PWLB borrowing costs will be kept under review and officers will determine

[4] MRP- The Council must base its borrowing decisions in accordance with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing for the General Fund is affordable. The Council's MRP policy, as required by CIPFA guidance, is approved annually by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement and the life of the assets for which borrowing was required.

whether it may be prudent to take some borrowing at lower interest rates based on the forecast reduction of future cash balances and borrowing identified in the HRA business plan. The decision and timing of when to borrow is being monitored by officers.

4.5.4 The Council's treasury position for the first half of year was as follows:

Table three: Treasury Position 2020/21						
	30 Sep 2020 Principal £'000s	**Rate / Return %**	**Average Life (Yrs)**	**31 Mar 2021 Principal £'000s**	**Rate / Return %**	**Average Life (Yrs)**
Fixed rate loans - PWLB	209,098	3.37	14	208,966	3.37	13
General Fund Prudential Borrowing				15,071		
HRA Borrowing				23,803		
Total Borrowing	**209,098**	**3.37**	**14**	**247,840**	**3.37**	**13**
CFR				280,391		
less finance lease and other technical adjustments				(10,248)		
less self financing agreement				(5,929)		
Over/(under) borrowing*				(16,375)		
Investments Portfolio	**56,560**	**0.98**	**N/A**	**60,629**	**0.69**	**N/A**

** financed by internal borrowing (£4.857Million HRA £11.517Million General Fund)*

4.5.5 The maturity structure of the debt portfolio was as follows (see also Appendix B):

Table four: Maturity of Debt Portfolio for 2019/20 and 2020/21		
Time to maturity	**31 March 2020 Actual £'000's**	**30 September 2020 Actual £'000's**
Maturing within one year	263	263
1 year or more and less than 2 years	263	263
2 years or more and less than 5 years	263	132
5 years or more and less than 10 years	39,156	39,156
10 years or more	169,284	169,284
Total	**209,229**	**209,098**

4.5.6 There are six investments with **maturities over one year** as detailed below:

Table five: Maturities Over One Year					
Counterparty	**Country**	**Rating**	**Deposit amount**	**Start date**	**Maturity on**
Birmingham City Council	UK	AA	3,000,000	15/04/2020	14/04/2021
Great Yarmouth BC	UK	AA	2,000,000	16/05/2018	17/05/2021
Barnsley Metropolitan Borough Council	UK	AA	2,700,000	15/09/2017	15/09/2021
Kingston Upon Hull City Council	UK	AA	5,000,000	28/09/2020	27/09/2021
Worthing Borough Council	UK	AA	5,000,000	05/12/2019	06/12/2021
Bury M.B.C.	UK	AA	2,300,000	18/05/2020	18/11/2024

Table five: Maturities Over One Year					
Counterparty	**Country**	**Rating**	**Deposit amount**	**Start date**	**Maturity on**
			20,000,000		

4.5.7 All other investments held during the first half of 2020/21 are due to mature within one year. A summary of the Council's exposure to fixed and variable rate investments is shown below in Table Six. (See also Appendix B).

Table Six : Fixed and Variable Rate Investment Totals		
	31 March 2020 Actual	**30 September 2020 Actual**
	£'000's	**£'000's**
Fixed rate principal	48,000	48,000
Variable rate principal	6,072	8,560
Total	**54,072**	**56,560**

4.5.8 Since the last Treasury report, no further Money Market funds have been added to the portfolio, however an application is in progress to add the CCLA Public Sector Deposit Fund due to the recent closure of the Amundi Money Market fund (see paragraph 4.6.6 for additional information).

4.5.9 There have been **no breaches** of treasury **counter party limits,** with the investment activity during the year conforming to the approved strategy. Any breach would be notified to the Chief Finance Officer. The Council has had no liquidity difficulties and no funds have been placed with the Debt Management Office (DMO) during 2020/21 to date, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy are working

4.5.10 The use of "Ultra Short Dated Bond" (USDB) funds was approved in February 2017 and added to the Specified/Non-specified Investments is detailed in Appendix C. No investments have been made to date with USDB funds.

4.5.11 The list of "Approved Countries for Investments" is detailed in Appendix D.

4.5.12 **Money Market Fund Regulatory Change** took place in early 2019, and Liquidity (non-government) Funds have been converted from Constant Net Asset Value (CNAV) funds to Low Volatility Net Asset Value (LVNAV) pricing. Government-type funds will remain as "CNAV" funds under the new regulations. This change has continued to have no impact on the Treasury Management strategy.

4.5.13 As part of the Council regeneration programme and financial security objectives officers have establishing special purpose vehicles (SPV) to deliver regeneration in the town and to improve the offer in the private rented sector. These SPV's have included a Limited Liability partnership and a wholly owned company. As completely separate legal entities the board of Directors of the SPV needed to delegate authority for the treasury management function to the Council, for officers to invest monies on behalf of the SPV's subject to Director's delegation. Any sums invested on behalf of theses SPV's are to be done in accordance with the Councils own treasury management policies. No such investments have been made on their behalf to date.

4.6 Economic Review & Interest Rate Outlook

4.6.1 UK Growth

The Bank of England's Monetary Policy Report August 2020 reports that UK GDP is expected to have been over 20% lower in 2020 Q2 than in 2019 Q4. But other indicators imply that spending has recovered significantly since April. Payments data suggest that household consumption in July was less than 10% below its level at the start of the year. Housing market activity appears to have returned to close to normal levels, despite signs of a tightening in credit supply for some households. There is less evidence available on business spending, but surveys suggest that business investment is likely to have fallen markedly in Q2 and investment intentions remain very weak.

4.6.2 Inflation and Bank Rate

Twelve-month CPI inflation increased to 0.6% in June from 0.5% in May but then reduced to 0.2% in August as a result of the impact of energy prices and the temporary cut in VAT for hospitality, holiday accommodation and attractions. The latest CPI figure (September was 0.5%) which is used to set HRA rents and Business rate increases. CPI inflation is expected to fall further below the 2% target, largely reflecting the direct and indirect effects of Covid-19. However as these effects unwind, inflation rises, supported by a gradual strengthening of domestic price pressures as spare capacity diminishes. In the Monetary Policy Committee (MPC) central projection, CPI inflation is expected to be around 2% in two years' time. At its meeting ending on 4 August 2020, the MPC voted unanimously to maintain Bank Rate at 0.1%, which has been the rate since 19 March 2020 in response to the Coronavirus pandemic. The assumption is that Bank Rate remains at 0.1% throughout the three years of the MPC forecast period, before moving towards the market path over the subsequent three years.

4.6.3 Wage inflation

Unemployment has increased, including job losses arising from business closures due to the Coronavirus pandemic. Lockdown measures, such as school closures, mean that some people who have lost their jobs are likely to have not been actively searching for work, or have not been available to start work. As a result, the proportion of the population classed as inactive has also increased. Wage growth has been significantly affected by the impact of the Coronavirus Job Retention Scheme. Underlying wage growth is likely to have weakened. There is evidence from the Bank of England's agents that wage pressures are muted.

4.6.4 Brexit

The UK left the European Union on 31 January 2020. Under the Withdrawal Agreement, we are now in a transition period until the end of 2020, however the details of any trading agreements following the transition period remain unclear. The MPC's central projections assume that there is an immediate but orderly move to a comprehensive free trade agreement between the UK and the EU on 1 January 2021. Some restrictions on trade between the UK and EU are assumed to come into place at that point as the UK leaves the EU's Single

Market and Customs Union. Market uncertainty makes forecasting of interest rates challenging.

4.6.5 The Council registered with HMRC's Transitional Simplified Procedures to simplify import procedures should we procure goods from the EU post Brexit. Mitigation plans have been put in place for contracts which may be affected by Brexit and continuity plans have been reviewed for service areas including fuel supplies.

4.6.6 Although the advice from our treasury advisors is that there should be no issues with the placing of investments domiciled within the EU after the Brexit transition period ends, the Amundi fund based in Luxembourg has closed. Officers received a communication on 14 October that the fund would be closed to all new investments effective immediately, and any remaining deposits not called back by clients would be settled on 22 October. Treasury staff redeemed the SBC deposit of £1.2Million on 15 October. As per paragraph 4.5.8, an application is in progress to the UK-domiciled CCLA Public Sector Deposit Fund to retain an available pool of investment options.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for 2020/21 to date. Any consequential financial impacts of the Strategy will be incorporated into the Capital Strategy updates and subsequent quarterly budget monitoring reports.

5.1.2 During the financial year to date officers have operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy Indicators are intended to ensure that the Council complies with relevant legislation and best practice.

5.2.2 The potential changes to PWLB borrowing arrangements in paragraph 4.2.3 refer to the use of PWLB for 'Investment for Yield' schemes. Councils may be prohibited from the use of this borrowing source for commercial investment property purchases. This could have an impact on the plans currently in the Council's Capital Strategy.

5.3 Risk Implications

5.3.1 The current policy of minimising external borrowing only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to take borrowing at higher rates which would increase revenue costs.

5.3.2 There remains uncertainty on the impact of exiting the EU on UK economy and borrowing rates. Officers monitor interest rate forecasts to inform the timing of borrowing decisions.

5.3.3 The Council's Treasury Management Strategy is based on limits for counterparties to reduce risk of investing with only a small number of institutions.

5.3.4 The thresholds and time limits set for investments in the Strategy are based on the relative ratings of investment vehicles and counter parties. These are designed to take into account the relative risk of investments and also to preclude certain grades of investments and counterparties to prevent loss of income to the Council.

5.4 Equalities and Diversity Implications

5.4.1 This purpose of this report is to review the implementation of the Treasury management policy in 2020/21 to date. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

5.4.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

5.6 Climate Change Implications

5.6.1 The council's investment portfolio is sterling investments and not directly in companies. However the TM team will review the use of Money Market funds in 2020/21 to ensure, where possible, money market funds that invest in environmentally sustainable companies are used. In this way the TM team will align with the Councils ambition to attempt to be carbon neutral by 2030.

BACKGROUND DOCUMENTS

BD1 Prudential Code Indicators and Treasury Management Strategy 2020/21 (26 February 2020 Council)

BD2 Annual Treasury Management Review of 2019/20 (14 October 2020 Council)

APPENDICES

- Appendix A – Prudential Indicators for Mid Year Review.
- Appendix B – Investment and Loan Portfolios
- Appendix C – Specified & Non-Specified Investment Criteria
- Appendix D – Approved Countries for Investments
- Appendix E – MRP Policy

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Appendix A

2020/21 Treasury Management Strategy - Mid year review

Treasury Management Prudential Indicators

Capital Expenditure (Based on Q1 Capital report September 2020):	2020/21 Original February 2020	2020/21 Revised September 2020 (TM report)	2020/21 Revised Mid year review 20-21	2021/22 Revised Mid year review 20-21	2022/23 Revised Mid year review 20-21	2023/24 Revised Mid year review 20-21
	£000	£000	£000	£000	£000	£000
General Fund	20,429	36,715	35,271	10,216	18,041	24,141
HRA	50,384	34,763	34,057	49,286	45,389	36,314
Total	**70,813**	**71,478**	**69,328**	**59,502**	**63,429**	**60,455**

Ratio of financing costs to net revenue stream:	2020/21 Original February 2020	2020/21 Revised September 2020 (TM report)	2020/21 Revised Mid year review 20-21	2021/22 Revised Mid year review 20-21	2022/23 Revised Mid year review 20-21	2023/24 Revised Mid year review 20-21
	%	%	%	%	%	£000
General Fund Capital Expenditure	6.43%	6.43%	8.17%	14.50%	15.78%	15.96%
HRA Capital Expenditure	18.68%	18.68%	15.93%	16.14%	15.76%	15.29%

General Fund: Net revenue stream is the RSG, NNDR grant and Council Tax raised for the year.

HRA: The net revenue stream is the total HRA income shown in the Council's accounts from received rents, service charges and other incomes. The ratio of financing costs to net revenue stream reflects the high level of debt as a result of self financing.

Authorised Limit for external debt	2020/21 Original February 2020	2020/21 Revised September 2020 (TM report)	2020/21 Revised Mid year review 20-21	2021/22 Revised Mid year review 20-21	2022/23 Revised Mid year review 20-21	2023/24 Revised Mid year review 20-21
	£000	£000	£000	£000	£000	£000
Borrowing - General Fund	73,544	70,004	49,918	52,624	56,288	55,699
Borrowing - Queensway residential			15,000	15,000	15,000	15,000
Borrowing - HRA	247,627	241,771	245,474	272,076	287,716	298,196
Total	**321,171**	**311,775**	**310,391**	**339,700**	**359,004**	**368,895**

The authorised limit in that it is the level up to which the Council may borrow without getting further approval from Full Council. The Council may need to borrow short term for cash flow purposes, exceeding the operational boundary. The authorised limit allows for £8m headroom above the Operational Boundary (£2m General Fund and £6m HRA), which is in addition to our capital plans.

Operational Boundary for external debt	2020/21 Original February 2020	2020/21 Revised September 2020 (TM report)	2020/21 Revised Mid year review 20-21	2021/22 Revised Mid year review 20-21	2022/23 Revised Mid year review 20-21	2023/24 Revised Mid year review 20-21
	£000		£000	£000	£000	£000
Borrowing - General Fund	71,544	68,004	47,918	50,624	54,288	53,699
Borrowing - Queensway residential			15,000	15,000	15,000	15,000
Borrowing - HRA	241,627	235,771	239,474	266,076	281,716	292,196
Total	**313,171**	**303,775**	**302,391**	**331,700**	**351,004**	**360,895**

The operational boundary differs from the authorised limit in that it is the level up to which the Council expects to have to borrow. The Council may need to borrow short term for cash flow purposes, exceeding the operational boundary. The operational boundary allows for £7m headroom in addition to our capital plans (£5m General Fund and £2m HRA).

Gross & Net Debt	31/03/2021 Original February 2020	31/03/2021 Revised September 2020 (TM report)	31/03/2021 Revised Mid year review 20-21	31/03/2022 Revised Mid year review 20-21	31/03/2023 Revised Mid year review 20-21	31/03/2024 Revised Mid year review 20-21
	£000	£000	£000	£000	£000	£000
Gross External Debt - General Fund	20,752	20,963	17,353	20,262	24,340	24,340
Gross External Debt - HRA	235,033	226,784	230,487	257,089	272,729	283,209
Gross External Debt	**255,785**	**247,747**	**247,840**	**277,351**	**297,069**	**307,549**
Less Investments	(47,240)	(61,176)	(60,629)	(53,880)	(43,624)	(41,037)
Net Borrowing	**208,545**	**186,571**	**187,211**	**223,471**	**253,445**	**266,512**

The Gross External Debt is the actual debt taken out by the Council plus any relevant long term liabilities. The Gross External Debt should not exceed the Operational

The Net Borrowing is defined as gross external debt less investments. The net borrowing requirement may not, except in the short term, exceed the total capital financing requirement in the preceding year, plus the estimates of any additional financing.

Capital Financing Requirement	31/03/2021 Original February 2020	31/03/2021 Revised September 2020 (TM report)	31/03/2021 Revised Mid year review 20-21	31/03/2022 Revised Mid year review 20-21	31/03/2023 Revised Mid year review 20-21	31/03/2024 Revised Mid year review 20-21
	£000	£000	£000	£000	£000	£000
Capital Financing Requirement GF	45,544	46,004	42,918	45,624	49,288	48,699
Capital Financing Requirement HRA	239,627	233,771	237,474	264,076	279,716	290,196
Total Capital Financing Requirement	**285,171**	**279,775**	**280,391**	**309,700**	**329,004**	**338,895**

The Capital Financing Requirement (CFR) reflects the amount of money the Council would need to borrow to fund it's capital programme. This is split between the Housing Revenue Account CFR (HRACFR) and the General Fund CFR (GFCFR).

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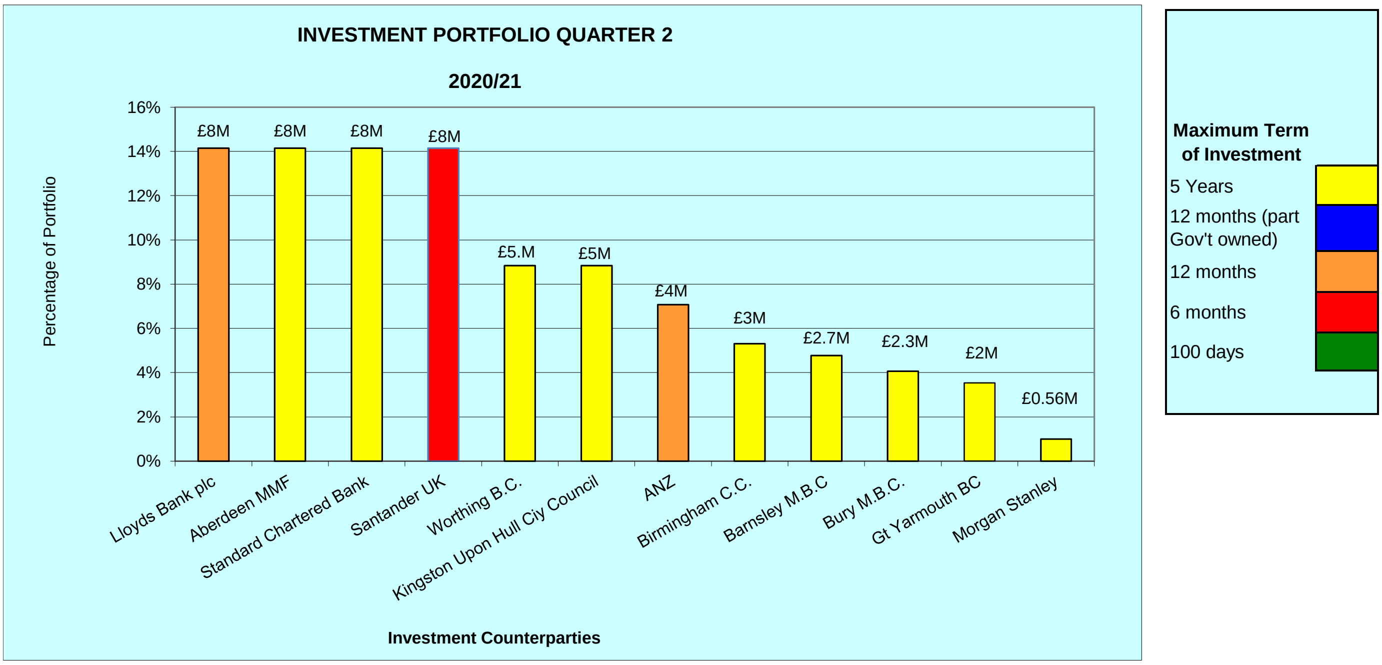
INVESTMENT PORTFOLIO QUARTER 2 (30th September 2020) Appendix B

Average interest rate - 2019/20	**0.98%**
Average interest rate - 2020/21	**0.76%**
Bank of England Bank Rate	**0.10%**

Borrower	Nation	Sovereign Rating (Fitch)	Amount £'s	From	To	Rate %
Money Market Funds (Instant Access)						
Morgan Stanley MMF	UK		560,000			0.01
Aberdeen MMF	UK		8,000,000			0.09
95 Day Notice						
Standard Chartered Bank	UK	AA-	7,000,000			0.36
Fixed Term Deposit						
Lloyds Bank plc	UK	AA-	5,000,000	22-Nov-19	20-Nov-20	1.10
Santander UK	UK	AA-	8,000,000	02-Jul-20	31-Dec-20	0.40
Australia & New Zealand Banking Corporation	AUS	AAA	4,000,000	16-Jul-20	18-Jan-21	0.24
Lloyds Bank plc	UK	AA-	3,000,000	22-Jan-20	20-Jan-21	1.10
Standard Chartered Bank	UK	AA-	1,000,000	12-Aug-20	12-Feb-21	0.19
Birmingham City Council	UK	AA-	3,000,000	15-Apr-20	14-Apr-21	1.15
Great Yarmouth Borough Council	UK	AA-	2,000,000	16-May-18	17-May-21	1.45
Barnsley Metropolitan Borough Council	UK	AA	2,700,000	15-Sep-17	15-Sep-21	0.98
Kingston Upon Hull City Council	UK	AA-	5,000,000	28-Sep-20	27-Sep-21	0.32
Worthing Borough Council	UK	AA-	5,000,000	05-Dec-19	06-Dec-21	1.50
Bury M.B.C.	UK	AA-	2,300,000	18-May-20	18-Nov-24	2.00
			56,560,000			



LOAN PORTFOLIO QUARTER 2 (30th September 2020)

Decent Homes Borrowing

Lender	Type	Rate %	Amount £'s	From	To	Life of Loan
PWLB	Fixed Rate/Maturity	4.75	2,000,000	04/03/2010	04/03/2035	25 years
PWLB	Fixed Rate/Maturity	4.28	1,800,000	25/05/2010	25/05/2035	25 years
PWLB	Fixed Rate/Maturity	4.24	963,000	17/08/2010	17/08/2035	25 years
PWLB	Fixed Rate/Maturity	4.65	3,000,000	25/03/2010	25/09/2035	25 1/2 years
PWLB	Fixed Rate/Maturity	1.72	510,000	25/03/2020	25/03/2045	25 Years
PWLB	Fixed Rate/Maturity	1.60	3,500,000	25/03/2020	25/03/2037	17 years
			11,773,000			

Self Financing Borrowing

Lender	Type	Rate %	Amount £'s	From	To	Life of Loan
PWLB	Fixed Rate/Maturity	2.92	500,000	28/03/2012	28/03/2026	14 years
PWLB	Fixed Rate/Maturity	3.01	8,000,000	28/03/2012	28/03/2027	15 years
PWLB	Fixed Rate/Maturity	3.08	8,700,000	28/03/2012	28/03/2028	16 years
PWLB	Fixed Rate/Maturity	3.15	9,600,000	28/03/2012	28/03/2029	17 years
PWLB	Fixed Rate/Maturity	3.21	10,600,000	28/03/2012	28/03/2030	18 years
PWLB	Fixed Rate/Maturity	3.26	11,000,000	28/03/2012	28/03/2031	19 years
PWLB	Fixed Rate/Maturity	3.30	16,000,000	28/03/2012	28/03/2032	20 years
PWLB	Fixed Rate/Maturity	3.34	17,500,000	28/03/2012	28/03/2033	21 years
PWLB	Fixed Rate/Maturity	3.37	17,600,000	28/03/2012	28/03/2034	22 years
PWLB	Fixed Rate/Maturity	3.40	17,300,000	28/03/2012	28/03/2035	23 years
PWLB	Fixed Rate/Maturity	3.42	15,300,000	28/03/2012	28/03/2036	24 years
PWLB	Fixed Rate/Maturity	3.44	21,000,000	28/03/2012	28/03/2037	25 years
PWLB	Fixed Rate/Maturity	3.46	18,200,000	28/03/2012	28/03/2038	26 years
PWLB	Fixed Rate/Maturity	3.47	19,611,000	28/03/2012	28/03/2039	27 years
PWLB	Fixed Rate/Maturity	3.48	4,000,000	28/03/2012	28/03/2040	28 years
			194,911,000			

Prudential Borrowing

Lender	Type	Rate %	Amount £'s	From	To	Life of Loan
PWLB	Fixed Rate/EIP	2.37	657,895	19/08/2013	19/02/2022	9 1/2 years
PWLB	Fixed Rate	2.29	1,755,950	19/03/2018	19/03/2028	10 years
			2,413,845			

Total Borrowing	**209,097,845**

Appendix C **TM Review Update**
Specified and Non-specified Investment Criteria
(including Treasury Limits and Procedures)

Table 1

Specified Investments are sterling denominated with maturities up to maximum of one year and must meet the following minimum high credit quality criteria:

Investment Counterparty	Investment Instrument	Minimum High Credit Quality Criteria	Investment Duration
Banks or Building Societies	Overnight Deposit	Fitch: Short Term F1 and Long Term A and Moody, Standard & Poor, equivalent where rated, the lowest rating used where different OR Part-nationalised or Nationalised UK banking institutions (subject to regular reviews of government share percentage).	Maximum duration as per Treasury Advisor's (Link Asset Services (LAS)) colour coded Credit List, and less than one year
	Notice Account		
	Short Term Deposit		
Debt Management Office or UK Local Authority	Any deposit	No limit	
Money Market Funds	Instant Access	AAA rated	Instant Access

Table 2

Non-Specified Investment are sterling denominated with a maturity longer than one year but no longer than five years, and must meet the following criteria:

Investment Counterparty	Investment Instrument	Minimum High Credit Quality Criteria	Investment Duration
Banks or Building Societies	Any deposits with maturity over one year up to a maximum of five years	Fitch: Short Term F1+ and Long Term AA- and Moody, Standard & Poor, equivalent where rated, the lowest rating used where different	Maximum duration suggested by Treasury Advisor's (LAS) colour coded Credit List, and not in excess of five years
Debt Management Office or UK Local Authority		No Limit	

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Table 3 **Treasury Limits**

Investment Instrument	Cash balances less than £30Million	Cash balances higher that £30Million
	Limits	Limits
Variable Rate Investments (Excluding Enhanced Cash Funds)	Maximum holding £30M	Maximum holding 100%
Counterparty limits (to encompass all forms of investment)	Maximum £5M	Maximum £8M
Instant Access Or Overnight Deposit	Maximum holding 100%	
Fixed Rate less than 12 month maturity	Maximum holding 100%	
Fixed Rate more than 12 months to maturity (includes all types of Fixed Rate Investments i.e. Certificates of Deposits)	Maximum £5M	Maximum £20M
Money Market Funds - Traditional Instant Assess (Counterparty Limit per Fund)	Maximum £5M per MMF	Maximum £8M per MMF
	No limit on total cash held	
Enhanced Cash Funds	Maximum £3M	
Certifcates of Deposits	Maximum £5M	
Property Funds	Maximum of £3M - No durational limit. Use would be subject to consultation and approval	

	Procedures of Applying the Criteria and Limits
	Before the Treasury Team makes an investment, the Team will follow the follow procedure to ensure full compliance with the Specified and Non-Specified Criteria and Treasury Limits:
1	Check that the Counterparty is on the Counterparty List (also known as Current Counterparty Report for Stevenage) produced LAS, specifically meeting the Council's Specified and Non-specified Minimum High Credit Quality Criteria in the above Table 1 & 2. If it is not on the list, the Treasury Team will not invest with them.
2	If the Counterparty is on the list, then the Treasury Team refers to the Credit List produced by LAS in colour coding, to determine the maximum investment duration suggested for the deposit, as per the column of Suggested Duration (CDS Adjusted with manual override).
3	Refer to the Treasury Limits in the above Table 3 to ensure the amount invested complies with the Treasury Limits.

APPENDIX D: Approved Countries (with Approved counterparties) for Investments (October 2020)

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- United Arab Emirates
- France

AA-

- Belgium
- Qatar

The UK is exempt from the sovereign rating criteria as recommended by Link Asset Services

The above list includes the possible countries the Council may invest with. Not all of these countries are used or will be used in treasury management investments

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Appendix E (October 2020 Update)

Minimum Revenue Provision Policy

Minimum Revenue Provision Policy Statement 2020/21

From 2013/14, the council has not had a fully funded capital programme, and although there has not been a need to borrow in full externally, due to the use of investment balances, it will be necessary to make adequate provision for the repayment of debt in the form of Minimum Revenue Provision in 2019/20 for the unfunded element of 2013/14 and 2014/15 expenditure. The **preferred method for existing underlying borrowing is Option 3 (Asset Life Method**) whereby the MRP will be spread over the useful life of the asset. Useful life is dependent on the type of asset and was reviewed in 2019/20. Following that review asset lives now ranges from 7 years (ICT equipment) to 50 years (Investment properties, regeneration sites and carparks for example).

In applying the new asset lives historic MRP had been overpaid and in accordance with MHCLG MRP Guidance can be reclaimed in future years. The council has a policy to ring fence costs and income associated with regeneration assets and as such has shown these MRP changes separately, see table below. The overpayment of £1,057,660.39 results in no MRP needing to be charged to the accounts for the regeneration assets until 2025/26, when a partial charge will be required, utilising the remainder of the overpayment balance.

voluntary MRP made	
	Regeneration
2012/13	£46,929.65
2013/14	£140,788.95
2014/15	£163,165.30
2015/16	£141,355.30
2016/17	£141,355.30
2017/18	£141,355.30
2018/19	£141,355.30
2019/20	£141,355.30
cumulative total	**£1,057,660.39**

The Council has approved a **Property Investment** Strategy – an investment of £15Million in property funded from prudential borrowing. The MRP calculation will be calculated under **Option 3 (Asset Life Method) and the annuity method** which links the MRP to the flow of benefits from the properties.

The forecast annual MRP for 2020/21 is £411,021 based on the capital expenditure in the draft 2019/20 Financial Accounts, with the lower figure of £217,318 needing to be charged to the 2020/21 Financial Accounts taking into account the overpayment on the regeneration assets.

In addition finance lease payments due as part of the Queensway regeneration project are also applied as MRP, funded from the payments received in the year.

Additional Information

1. What is a Minimum Revenue Provision (MRP)?

The Minimum Revenue Provision is a charge that Councils which are not debt free are required to make in their accounts for the repayment of debt (as measured by the underlying need to borrow, rather than actual debt). The underlying debt is needed to finance the capital programme. Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It is therefore prudent to charge an amount for the repayment of debt over the life of the asset or some similar proxy figure, allowing borrowing to be matched to asset life. Setting aside an amount for the repayment of debt in this manner would then allow for future borrowing to be taken out to finance the asset when it needs replacing at no incremental cost. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and is now determined by Guidance.

2. Statutory duty

Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year.

The share of Housing Revenue Account CFR is not subject to an MRP charge.

3. Government Guidance

Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

The four recommended options are thus:

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity).

This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the Supported Capital Expenditure (SCE) annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

This is not applicable to the Council as it is for existing non supported debt

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -
Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:
equal instalment method – equal annual instalments,
annuity method – annual payments gradually increase during the life of the asset.

This is the preferred method as it allows costs to be spread equally over the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

This method is not favoured by the Council as if the asset is subject to a downturn in value, then that amount would have to be written off in that year, in addition to the annual charge

4. Date of implementation
The previous statutory MRP requirements ceased to have effect after the 2006/07 financial year. Transitional arrangements included within the guidance no longer apply for the MRP charge for 2009/10 onwards. Therefore, options 1 and 2 should only be

used for Supported Capital Expenditure (SCE). The CLG document remains as guidance and authorities may consider alternative individual MRP approaches, as long as they are consistent with the statutory duty to make a prudent revenue provision.

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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