



Committee: AUDIT COMMITTEE
Date: WEDNESDAY, 25 NOVEMBER 2020
Venue: THIS WILL BE A VIRTUAL MEETING
Time: 6.10 P.M.

A G E N D A

1. Apologies for Absence

2. Minutes

Minutes of meeting held on 27th August 2020 (previously circulated).

3. Items of Urgent Business authorised by the Chair

4. Declarations of Interest

To receive declarations by Councillors of interests in respect of items on this Agenda.

Councillors are reminded that, in accordance with the Localism Act 2011, they are required to declare any disclosable pecuniary interests which have not already been declared in the Council's Register of Interests. (It is a criminal offence not to declare a disclosable pecuniary interest either in the Register or at the meeting).

Whilst not a legal requirement, in accordance with Council Procedure Rule 9 and in the interests of clarity and transparency, Councillors should declare any disclosable pecuniary interests which they have already declared in the Register, at this point in the meeting.

In accordance with Part B Section 2 of the Code Of Conduct, Councillors are required to declare the existence and nature of any other interests as defined in paragraphs 8(1) or 9(2) of the Code of Conduct.

5. Annual Review of the Regulation of Investigatory Powers Act 2020 (RIPA) Policy and Procedure (inc. appendixes A, B & C) (Pages 3 - 32)

Report of the Information Governance Manager.

6. Revision of Contract Procedure Rules (Pages 33 - 57)

Report of the Head of Financial Services.

7. Internal Audit Monitoring Report (Pages 58 - 67)

Report of the Internal Audit and Assurance Manager.

8. Updated Strategic Risk Register (Pages 68 - 72)

Verbal update from the Internal Audit and Assurance Manager.

9. Statement of Accounts 2019/20 Progress Report (Pages 73 - 76)

Report of the Chief Finance Officer.

10. External Audit Plan: Year ending 31 March 2020 (Pages 77 - 102)

Report of the Chief Financial Officer.

(Appendix A: Lancaster Council Audit Plan 2020 – report published 18:11:2020)

11. FRC Major Local Audits: Audit Quality Local Inspection (Pages 103 - 139)

Report of the Chief Financial Officer.

12. Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting (The Redmond Review) (Pages 140 - 228)

Report of the Chief Finance Officer.

13. Annual Review of Audit Committee Performance (Pages 229 - 236)

Report of the Internal Audit and Assurance Manager.

ADMINISTRATIVE ARRANGEMENTS

(i) Membership

Councillors Paul Stubbins (Chair), Stephie Barber, Abbott Bryning, Geoff Knight (Vice-Chair), Oliver Robinson, David Whitworth and Katie Whearty

(ii) Substitute Membership

Councillors Jason Firth (Substitute), Stewart Scothern (Substitute), David Whitaker (Substitute) and Joanna Young (Substitute)

(iii) Queries regarding this Agenda

Please contact Eric Marsden, Democratic Services - email emarsden@lancaster.gov.uk.

(iv) Changes to Membership, substitutions or apologies

Please contact Democratic Support, telephone 582170, or alternatively email democraticsupport@lancaster.gov.uk.

KIERAN KEANE,
CHIEF EXECUTIVE,
TOWN HALL,
DALTON SQUARE,
LANCASTER, LA1 1PJ

Published on 17th November 2020.

REGULATORY**AUDIT COMMITTEE****Annual review of the Regulation of Investigatory Powers Act 2000 (RIPA) Policy and Procedure****25 November 2020****Report of the Information Governance Manager****PURPOSE OF REPORT**

- To update the committee on the outcome of the IPCO inspection and the Data Assurance recommendations
- To approve the proposed changes to the authority's RIPA policy and procedure as detailed in this report (and in response to the inspection)
- To review the authorities use of RIPA since it was last considered at Audit Committee in November 2019

This report is public.**RECOMMENDATIONS**

- (1) **Members are requested to note the outcome of the Investigatory Powers Commissioner's Office (IPCO) inspection at Appendix A and Appendix B.**
- (2) **Members are requested to approve the revised RIPA policy attached at Appendix C to reflect the information provided in the IPCO inspection**
- (3) **Members are asked to note that the Council has not had any authorisations issued under RIPA since 2014.**

1.0 Introduction

- 1.1 Local authorities can undertake surveillance and access communications data under the framework of the Regulation of Investigatory Powers Act 2000. The rules set high standards for all public authorities that use these powers to undertake a range of enforcement functions to ensure they can keep the public safe and bring criminals to justice, whilst protecting individuals' rights to privacy.

1.2 The RIPA policy was last reviewed and approved by the audit committee on 27 November 2019. The Council has no authorisations issued under RIPA since 2014.

1.3 Following the receipt of the IPCO inspection, the policy has been updated as there were some discrepancies in the paragraphing and reference to the incorrect updated codes.

2.0 Proposal Details

2.1 The Code of Practice requires a number of best working practices to be adopted by all public authorities, including:

- An annual review of the authority's use of RIPA to ensure that it is being used consistently and in accordance with the Council's policy; and
- An annual review of the policy ensuring that it remains fit for purpose

2.2 In 2017 the IPCO took over the inspection and oversight functions on the application of RIPA, which was previously carried out by the Surveillance Commissioner's Office.

2.3 The IPCO have stated that they will continue to ensure Local Authorities are complying with RIPA by conducting a programme of inspections. As a generality, their aim is to inspect each authority once every three years but have also introduced remote desktop inspections for authorities that have significantly reduced or stopped using their powers under RIPA and when there are no apparent significant compliance concerns.

2.4 Lancaster City Council had a remote desktop inspection by the IPCO in July 2020. The report is attached at Appendix A.

2.5 The recommendations in this report that are outside of the policy amendments, i.e. training of officers engaged in investigatory areas and training of the new Director of Corporate Services in their role as Authorising Officer, are being undertaken at the earliest available opportunity. 38 members of staff have attended investigatory training so far. With three more teams identified as potentially requiring updated training, this is currently being explored.

2.6 Once the Director of Corporate Services is in post, they will require "Authorising Officer" training which will be arranged at the earliest opportunity following the pandemic response.

3.0 Details of Consultation

3.1 The Monitoring Officer, Legal Services and Corporate Fraud have been consulted in compiling this report.

4.0 Options and Options Analysis (including risk assessment)

4.1 There are no other options available. It is necessary to carry out a regular review and update of the RIPA policy to ensure it supports the council's officers and protects the rights of the public when carrying out surveillance.

5.0 Conclusion

- 5.1 Updating the policy will ensure that the council remains compliant with the law and will ensure that Officers are able to provide auditable records of activity in relation to social media.

CONCLUSION OF IMPACT ASSESSMENT (including Health & Safety, Equality & Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing):	
Not Applicable	
LEGAL IMPLICATIONS	
The approval of this recommendation will ensure that the statutory requirements are complied with.	
FINANCIAL IMPLICATIONS	
None directly arising from this report. Training for staff to ensure that they are kept up to date with appropriate practice and revisions to RIPA will be allocated from existing budgets.	
SECTION 151 OFFICER'S COMMENTS	
The Section 151 Officer has been consulted and has no further comments.	
MONITORING OFFICER'S COMMENTS	
The Monitoring Officer has been consulted and has not further comments.	
BACKGROUND PAPERS	Contact Officer: Amy Holland Telephone: 01524 58 2205 Email: ajholland@lancaster.gov.uk
None	



Investigatory Powers
Commissioner's Office

PO Box 29105, London
SW1V 1ZU

Mr. Kieran Keane
Chief Executive
Lancaster City Council
Town Hall
Dalton Square
Lancaster
LA1 1PJ

24 July 2020

Dear Mr. Keane,

Inspection of Lancaster City Council

Please be aware that IPCO is not a “public authority” for the purpose of the Freedom of Information Act (FOIA) and therefore falls outside the reach of the FOIA. It is appreciated that local authorities are subject to the FOIA and that they may receive requests for disclosure of our reports. In the first instance the SRO should bring the matter to the attention of the IPCO Data Protection Officer (at: info@ipco.org.uk), before making any disclosure. This is also the case if you wish to make the content of this letter publicly available.

Your Council was recently the subject of a telephone-based inspection by one of my Inspectors, Mr. Graham Wright. This has been facilitated through your Senior Responsible Officer (SRO), Ms. Amy Holland, Information Governance Manager, who was interviewed over the telephone and provided the supporting documentation requested by the Inspector.

The information provided has demonstrated a level of compliance that removes, for the present, the requirement for a physical inspection. There has been an appropriate response to the two recommendations made in the previous inspection of 2017 regarding the need for refresher training, and guidance on the use of social media and the internet. These recommendations can now be considered as discharged.

My Inspector has reviewed your Council's *RIPA Policy and Procedure*. This was reviewed and amended following the previous inspection and further reviewed in November 2019. It was approved by the Audit Committee. This document in many ways provides useful guidance and advice to staff, and applicants and authorising officers in particular. However, the following emendation needs to be made:



0207 389 8900



info@ipco.org.uk



[@IPCOOffice](https://twitter.com/IPCOOffice)



www.ipco.org.uk

- The document refers to the most recent Codes of Practice in relation to Covert Surveillance, and Covert Human Intelligence Sources as being issued in 2014. This is incorrect. In August 2018 the Home Office issued revised versions of the Codes of Practice and as such the references that you make to paragraph numbers in the Codes of Practice are inaccurate. The new codes have new substantial sections regarding online covert activity and new measures regarding juvenile CHIS.
- You still refer to the Office of Surveillance Commissioners and Chief Surveillance Commissioner, and this body and post were replaced by the Investigatory Powers Commissioner's Office and the Investigatory Powers Commissioner in October 2017.

Although your Council has not exercised its powers since December 2014, the SRO was reminded of the importance of ensuring that the designated authorising officer(s) maintain their level of training. The SRO and another senior manager have attended training on external RIPA courses in late 2019 and 2020. There has also been internal RIPA training on several dates in February 2020 and 38 members of staff attended these. A Director of Corporate Services is due to be appointed and this officer will be an authorising officer. Ms. Holland will ensure that training is provided in relation to their potential RIPA role.

The monitoring of social media and the internet can offer initial investigative leads and assist with your enforcement or other responsibilities, but it behoves you to ensure that such resources as these are used in a controlled, auditable, and well understood manner. The Home Office Covert Surveillance and Property Interference Code of Practice provides substantial and helpful advice on this point. The Inspector discussed with the SRO your organisation's approach to these activities and she has confirmed that more expansive guidance has now been issued to all relevant staff, and anyone conducting online research is required to maintain a log of their activity.

The Council owns a CCTV system and the SRO has stated that these have not been used covertly since the date of the last inspection. A protocol exists with Lancashire Constabulary regarding any usage that the force may seek to make of your system.

In accordance with section 4.47 of the Home Office Covert Surveillance and Property Interference Code of Practice, the SRO has confirmed that you provide Elected Members on the Audit Committee with an annual report sufficient to enable them to determine that the Council's policy remains fit for purpose, together with regular reports on RIPA activity (or inactivity).

In relation to the matter of safeguarding measures and data assurance, I wrote to you on 5th May 2020 setting out my concerns and proposed actions in this regard. Ms. Holland informed my Inspector that your policies in relation to data handling and retention were being reviewed prior to the current health crisis occurring, and that the six recommendation points that I make at the end of my letter will be incorporated into that review and acted upon.

In conclusion, it must be emphasised that although your Council has not exercised its RIPA powers since 2014, it is vital that the relevant staff are appropriately trained should the need arise to authorise covert activity, and your efforts in this regard are noted. It is also important that officers engaged in investigatory areas where RIPA considerations are not so immediately apparent (for example Children's Services), maintain their levels of knowledge and know whom to approach for guidance. The SRO has given assurances to the Inspector that the integrity of your Council's processes and governance procedures will be maintained to ensure that high standards of compliance with the Act and relevant codes of practice are achieved.

I hope that this telephone-based inspection has proved to be a worthwhile exercise. My Office is available to you should you have any queries following the recent inspection, or at any point in the future. Contact details are provided at the foot of this letter.

I shall be grateful if you would acknowledge receipt of this letter within two months.

Yours sincerely,

A handwritten signature in cursive script that reads "Brian Leveson". The signature is written in black ink and is positioned above a horizontal line.

The Rt. Hon. Sir Brian Leveson
The Investigatory Powers Commissioner

Appendix B

Investigatory Powers Commissioner's Data Assurance recommendations (sent to all Councils)

- 1) Review the safeguarding obligations in the relevant Code of Practice for any powers used by your authority.
- 2) Ensure that internal safeguard policies for retaining, reviewing and disposing of any relevant data are accurate and up-to-date.
- 3) Ensure that the authorising officer for your authority has a full understanding of any data pathways² used for RIPA or IPA data.
- 4) Ensure that all data obtained under IPA and RIPA is clearly labelled and stored on a data pathway with a known retention policy.
- 5) Review the wording of safeguards in any applications to obtain data under IPA and RIPA and ensure that they accurately reflect the retention and disposal processes at your authority³.
- 6) Review whether data obtained under previous authorisations is being retained for longer than is necessary and, if appropriate, consider disposing of retained data.



THE REGULATION OF INVESTIGATORY POWERS ACT (RIPA) POLICY AND PROCEDURE

Document Control

Approved by:	Audit Committee	Date:	25/11/2020
Document location:			
Document owner:	Information Governance		
Review period:	2 Years		
Next review date:	24/11/2022		

Revision History

Version	Date	Reviewed By	Amendment Details
V 1.0	28/11/2018	Audit Committee	Approval of final draft
V2.0	27/11/2019	Audit Committee	Social Media Use and guidance approved
V3.0	25/11/2020	Audit Committee	Update of guidance wording

CONTENTS

1	Purpose.....	5
2	Introduction	5
3	Investigatory Powers Commissioner’s Office.....	6
4	Statement of Intent.....	6
5	Part 1: An explanation of the Key Provisions of RIPA.....	6
5.1	What is meant by ‘surveillance’?.....	6
5.2	When is surveillance “covert”?.....	7
5.3	What is ‘directed surveillance’ or when is surveillance ‘directed’?.....	7
5.4	Is it for the purposes of a specific investigation or operation?.....	7
5.5	Is it in such a manner that it is likely to result in the obtaining of private information about a person?.....	7
5.6	What is meant by ‘intrusive surveillance’ or when is surveillance ‘intrusive’?.....	8
5.7	Why is it important to distinguish between directed and intrusive surveillance?.....	9
5.8	What is a ‘covert human intelligence source’ (CHIS)?.....	9
5.9	Use of Social Networking in investigations.....	9
6	Part 2: General Authorisation Requirements	11
6.1	The authorisation requirements	11
6.2	Who can authorize the use of covert surveillance?	11
6.3	Justification for covert surveillance	12
6.4	CHIS – additional requirements.....	12
6.5	Collateral Intrusion.....	13
6.6	Local community sensitivities.....	13
7	Part 3: Directed Surveillance Authorisation Requirements.....	13
7.1	Applications for directed surveillance authorisation.....	13
7.2	Duration of directed surveillance authorisations.....	13
7.3	Reviews of directed surveillance authorisations.....	13
7.4	Renewals of directed surveillance authorisations.....	14
7.5	Cancellation of directed surveillance authorisations.....	14
7.6	Ceasing of surveillance activity.....	14
7.7	Urgent Cases.....	14
7.8	Confidential Information.....	15
8	Part 4: CHIS Authorisation Requirements	15
8.1	Duration of CHIS authorisations	15
8.2	Renewal of CHIS Authorisations.....	16
8.3	CHIS Forms.....	16
8.4	Vulnerable Adults	16
8.5	Juvenile Sources	16
9	Part 5: Other Authorisation Requirements	16
9.1	Retention and destruction of the product of surveillance.....	17
9.2	Acting on behalf of another	17
10	Part 6: Practical Application of RIPA.....	17
10.1	Who is affected by RIPA?.....	17
10.2	‘General observation vs. ‘systematic surveillance’	18
10.3	‘Covert’ vs. ‘overt’ surveillance.....	18
10.4	CCTV	18
10.5	Recognising a CHIS	19
10.6	“.... establishing or maintaining a personal or other relationship.....”	19
10.7	Simple test purchase transactions	19
10.8	Use of DAT recorders	19
10.9	RIPA forms.....	20
10.10	Role of Authoring Officers.....	20
10.11	How to access RIPA documents?.....	20

REGULATION OF INVESTIGATORY POWERS ACT (RIPA) POLICY AND PROCEDURE

11 Training and awareness 20
Appendix 1: 21
Appendix 2: 22

1 Purpose

The purpose of this policy is to:

- explain the provisions of the Regulation of Investigatory Powers Act 2000 (RIPA);
- provide guidance and give advice to those Services undertaking covert surveillance; and
- ensure full compliance with RIPA and a Council-wide consistent approach to its interpretation and application.

2 Introduction

RIPA came into force on 25th September 2000 to regulate covert investigations by a number of bodies, including local authorities. It was introduced to ensure that individuals' rights are protected while also ensuring that law enforcement and security agencies have the powers they need to do their job effectively.

Lancaster City Council is therefore included within the 2000 Act framework with regard to the authorisation of both Directed Surveillance and the use of Covert Human Intelligence Sources (CHIS)

In summary RIPA requires that when a Council undertakes "directed surveillance" or uses a "covert human intelligence source" these activities must only be authorised by an officer with delegated powers when the relevant criteria are satisfied. In addition, amendments contained in the Protection of Freedoms Act 2012, which took effect on the 1st November 2012, mean that local authority authorisations, and renewals of authorisations under RIPA, can only take effect once an order approving the authorization (or renewal) has been granted by a Justice of the Peace (district judge or lay magistrate) (JP).

Authorisation for both types of surveillance may be granted only where it is believed that the authorisation is necessary, and the authorised surveillance is proportionate to that which is sought to be achieved:

An authorisation may be granted only where the Authorising Officer believes that the authorisation is necessary in the circumstances of the particular case:

"For the purpose of preventing and detecting crime and disorder"

However, amendments which took effect on the 1st November 2012 mean that a local authority may only authorise use of directed surveillance under RIPA to prevent or detect criminal offences that are either punishable, whether on summary conviction or indictment, by a maximum term of at least 6 months' imprisonment or are related to the underage sale of alcohol and tobacco. Local authorities cannot authorise directed surveillance for the purpose of preventing disorder unless this involves a criminal offence punishable by a maximum term of at least 6 months' imprisonment. These amendments are referred to as "the crime threshold".

The background to RIPA is the Human Rights Act 1998, which imposes a legal duty on public authorities to act compatibly with the European Convention on Human Rights (ECHR). Article 8(1) of the ECHR gives a right to respect for private and family life, the home and correspondence. However, this is qualified by Article 8(2) which provides that there shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national

security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others. RIPA was enacted so as to incorporate the provisions of Article 8(2) in English law, and to establish a means by which a public authority may interfere with privacy rights in accordance with the law. The objective is to give protection to the Council and any officer involved in an investigation. The scheme of RIPA is to state that an authorisation for covert surveillance shall be lawful for all purposes, but that such an authorisation may only be granted if the authorising officer believes that what is proposed is necessary and proportionate.

If the authorisation procedures introduced by RIPA are followed, they afford protection to the Council and to investigating officers in respect of challenges to the admissibility of evidence, claims under the Human Rights Act 1998, and complaints to the Local Government Ombudsman or the Investigatory Powers Tribunal.

The Act is supported by statutory Codes of Practice, the most recent versions of which were published in 2018 and are available on the [here](#). These are the 'Covert Surveillance and Property Interference' Code of Practice and the 'Covert Human Intelligence Sources' (CHIS) Code of Practice. RIPA requires the Council to have regard to the provisions of the Codes which are admissible as evidence in criminal and civil proceedings and must be taken into account by any court or tribunal. However, amendments which took effect on the 1st November 2012 mean that a local authority may only authorise use of directed surveillance under RIPA to prevent or detect criminal offences that are either punishable, whether on summary conviction or indictment, by a maximum term of at least 6 months' imprisonment or are related to the underage sale of alcohol and tobacco. Local authorities cannot authorise directed surveillance for the purpose of preventing disorder unless this involves a criminal offence punishable by a maximum term of at least 6 months' imprisonment. These amendments are referred to as "the crime threshold".

3 Investigatory Powers Commissioner's Office

In May 2001 an Inspectorate was formed within the Office of Surveillance Commissioners (OSC) to keep under review the exercise and performance of the powers and duties conferred or imposed by RIPA. This Office was replaced in October 2017 and is now called the Investigatory Powers Commissioner's Office (IPCO) and is led by the Investigatory Powers Commissioner. The most recent Procedures and Guidance document was issued by the Investigatory Powers Commissioner in August 2018, and is available on the Council's intranet.

RIPA requires public authorities to disclose or provide to the Investigatory Powers Commissioner all such documents and information as he may require for the purpose of enabling him to carry out his functions.

4 Statement of Intent

The Council's policy and practice in respect of RIPA is to comply fully with the law and strike a fair and proportionate balance between the need to carry out covert surveillance in the public interest and the protection of an individual's fundamental right to privacy. The Council acknowledges that this policy is very much a living document and will be reviewed and updated in line with the best guidance and advice current at the time.

5 Part 1: An explanation of the Key Provisions of RIPA

5.1 What is meant by 'surveillance'?

'Surveillance' includes:

- a) monitoring, observing or listening to persons, their movements, their conversations or their other activities or communication;
- b) recording anything monitored, observed or listened to in the course of surveillance; and
- c) surveillance by or with the assistance of a surveillance device.

5.2 When is surveillance “covert”?

According to RIPA, surveillance is covert if, and only if, it is carried out in a manner that is calculated to ensure that persons who are subject to the surveillance are unaware that it is or may be taking place. If activities are open and not hidden from the subjects of an investigation, the 2000 Act framework does not apply.

5.3 What is ‘directed surveillance’ or when is surveillance ‘directed’?

Surveillance is directed if it is ‘covert’ but not ‘intrusive’ (see below) and is undertaken:

- a) for the purposes of a specific investigation or a specific operation;
- b) in such a manner as is likely to result in the obtaining of private information about a person (whether or not that person is specifically identified for the purposes of the investigation or operation); and
- c) otherwise than by way of an immediate response to events or circumstances the nature of which is such that it would not be reasonably practicable for an authorisation to be sought for the carrying out of the surveillance.

Essentially, therefore, directed surveillance is any:

- (1) pre-planned surveillance activity;
- (2) undertaken covertly;
- (3) for the purposes of a specific investigation;
- (4) in such a way that is likely to result in obtaining private information about a person.

5.4 Is it for the purposes of a specific investigation or operation?

For example, are CCTV cameras which are readily visible to anyone walking around a Council car park covered?

The answer is no if their usage is to monitor the general activities of what is happening in the car park. If that usage changes at any time the 2000 Act may apply.

For example, if the CCTV cameras are targeting a particular known individual, and are being used in monitoring his activities, that has turned into a specific operation which will require authorisation.

5.5 Is it in such a manner that it is likely to result in the obtaining of private information about a person?

5.5.1 ‘Private Information’

In relation to a person, includes any information relating to his private or family life. Private information should be taken generally to include any aspect of a person’s private or personal relationship with others, including family and professional or business relationships. Whilst a person may have a reduced expectation of privacy when in a public place, covert surveillance of that person’s activities in public may still result in the obtaining of private information. This

is likely to be the case where that person has a reasonable expectation of privacy even though acting in public and where a record is being made by a public authority of that person's activities for future consideration.

If it is likely that observations will not result in the obtaining of private information about a person, then it is outside the 2000 Act framework. However, the use of "test purchasers" may involve the use of covert human intelligence sources see section 10.7

5.5.2 'Immediate response....'

According to the Covert Surveillance and Property Interference Code of Practice, "covert surveillance that is likely to reveal private information about a person but is carried out by way of an immediate response to events such that it is not reasonably practicable to obtain an authorisation under the 2000 Act would not require a directed surveillance authorisation." For example, a police officer would not require an authorisation to conceal himself and observe a suspicious person that he came across in the course of a patrol.

However, if as a result of an immediate response, a specific investigation subsequently takes place, that brings it within the 2000 Act framework.

5.6 What is meant by 'intrusive surveillance' or when is surveillance 'intrusive'?

Surveillance becomes intrusive if the covert surveillance:

- a) is carried out in relation to anything taking place on any 'residential premises' or in any 'private vehicle'; or a "place for legal consultation; and
- b) involves the presence of an individual on the premises or in the vehicle or is carried out by means of a surveillance device; or
- c) is carried out by means of a surveillance device in relation to anything taking place on any residential premises or in any private vehicle but is carried out without that device being present on the premises or in the vehicle, and the device is such that it **consistently provides information of the same quality and detail** as might be expected to be obtained from a device actually present on the premises or in the vehicle.

The definition of surveillance as intrusive relates to the location of the surveillance, and not to other consideration of the nature of the information that is expected to be obtained. Officers of the Council are unlikely to have access to any "place of legal consultation" but should seek advice from Legal Services on the detailed definition.

5.6.1 'Residential premises'

Is defined to include any premises that is for the time being occupied or used by any person, however temporarily, for residential purposes or otherwise as living accommodation. For example, the definition includes hotel rooms. It, however, does not include so much of any premises as constitutes any common area to which a person is allowed access in connection with his use or occupation of any accommodation. For example, a hotel lounge.

5.6.2 'Private vehicle'

Means any vehicle which is used primarily for private purposes, for example, for family, leisure or domestic purposes. It therefore does not include taxis i.e. private hire or hackney carriage vehicles.

5.7 Why is it important to distinguish between directed and intrusive surveillance?

It is imperative that officers understand the limits of directed surveillance or, put another way, recognise when directed surveillance becomes intrusive surveillance because **RIPA does not permit local authorities to undertake intrusive surveillance in any circumstances.**

5.8 What is a 'covert human intelligence source' (CHIS)?

According to RIPA a person is a CHIS if:

- a) he **establishes or maintains a personal or other relationship** with a person for the **covert purpose** of facilitating the doing of anything falling within paragraph b) or c).
- b) he covertly uses such a relationship to **obtain information** or provide access to any information to another person; or
- c) he covertly discloses information obtained by the use of such a relationship or as a consequence of the existence of such a relationship.

A CHIS is effectively an inside informant or undercover officer, someone who develops or maintains their relationship with the surveillance target, having the covert purpose of obtaining or accessing information for the investigator.

A **purpose is covert**, in relation to the establishment or maintenance of a personal or other relationship, if and only if the relationship is conducted in a manner that is calculated to ensure that one of the parties to the relationship is unaware of the purpose.

It is not clear whether '**information**' is restricted to private information in line with directed surveillance. The inference is there, but it is not clear. If in doubt, the Council's policy is to obtain an authorisation.

RIPA also makes reference to the use of a CHIS which refers to inducing, asking or assisting a person to engage in the conduct of a CHIS, or to obtain information by means of the conduct of such a CHIS.

5.9 Use of Social Networking in investigations

Officers often use the internet and social networking sites for the purposes of research and carrying out checks on the subjects of an investigation. Care must be taken to ensure that officers do not stray into a surveillance situation.

It should not be assumed that all monitoring of open social media sites are automatically immune from the need for an authorisation of some sort. Use of open media, in circumstances where there is a reasonable expectation of privacy, is likely to require an authorisation, particularly if the monitoring is intensive or for a prolonged period of time i.e. more than a week. The creation of fake or anonymous websites for investigation purposes is likely to

require an authorisation. Entry on to chat rooms or closed groups for investigatory purposes is also likely to require authorisation unless the officer's identity is made clear from the outset.

Use of a 3rd party's identity requires both an authorisation and express written permission from that person. Whilst overt working in this way might avert the need for a surveillance authorisation officers should be aware that a CHIS situation could inadvertently arise.

It is expected that social media sites will generate significant amounts of sensitive information.

Sensitive material that is not relevant to an investigation should be disposed of quickly and safely. Any interaction between an investigator and the public via social media could inadvertently give rise to a CHIS situation. Investigators should generally avoid interaction whilst monitoring social media sites and take advice should any uncertainty arise. The use of the internet and social media may require an authorisation in the following circumstances:

- (a). Any communications which are made with 3rd parties for the purpose of gathering evidence or intelligence about an offence in circumstances where the third party is not aware that the officer is working for the Council.
- (b) Accessing private pages of social media for the purpose of gathering evidence or intelligence about an offence or other matter subject to potential litigation.
- (c). Any communications between an officer and a 3rd party for the purpose of using that person to gather evidence or intelligence about a suspect.
- (d). Intensive monitoring of a suspect using social media over a sustained period of time particularly when this is used in connection with other methods of investigation.
- (e). The creation of a false personae or use of a third-party identity for investigation purposes.
- (f). Any direct interaction in any forum – open or closed – in which an officer seeks to elicit information, when they are not explicit about their real identity.

Repeated entry to social media sites and copying material for the purpose of an investigation is likely to engage RIPA. As a rule of thumb access to Facebook and other social media sites should be made via the Council's Facebook account as opposed to a private account. If there is any doubt the officer who is conducting this activity is advised to seek legal advice.

Please see **Appendix 2** for the process which is to be followed in relation to the use of social media.

The OSC (now IPCO) issued the following guidance: -

- Whilst it is the responsibility of an individual to set privacy settings to protect unsolicited access to private information and even though data may be deemed published and no longer under the control of the author, it is unwise to regard it as "open source" or publicly available; the author has a reasonable expectation of privacy if access controls are applied. In some cases, data may be deemed private communication still in transmission (instant message for example). Where privacy settings are available but not applied the data may be considered open source and an authorisation is not usually required.
- Providing there is no warrant authorising interception in accordance with section 48 (4) of the 2000 Act, if it is necessary and proportionate for a public authority to breach covertly access controls, the minimum requirement is an authorisation for directed surveillance. An

authorisation for the use and conduct of a CHIS is necessary if a relationship is established or maintained by a member of a public authority or by a person acting on its behalf (i.e. the activity is more than the mere reading of the site's content).

- It is not unlawful for a member of a public authority to set up a false identity, but it is inadvisable for a member of a public authority to do so for a covert purpose without authorisation. Using photographs of other persons without their permission to support the false identity potentially infringes other laws.
- A member of a public authority should not adopt the identity of a person known, or likely to be known, to the subject of interest or users of the site without authorisation, and without the consent of the person whose identity is used, and without considering the protection of that person. The consent must be explicit (i.e. the person from whom consent is sought must agree (preferably in writing) what is and is not to be done.

6 Part 2: General Authorisation Requirements

6.1 The authorisation requirements

RIPA requires that prior authorisation is obtained by all local authorities using directed surveillance and CHIS techniques.

The authorising officer must give authorisations in writing and a separate authorisation is required for each investigation. Any authorisation must also be approved by an order from a JP. The application form for such approval is available on the Council's intranet, but advice should be sought from Legal Services on making an application for judicial approval.

Whilst according to RIPA, a single authorisation may combine two or more different authorisations (for example, directed surveillance and CHIS), the provisions applicable in the case of each of the authorisations must be considered separately. Because combining authorisations may cause confusion, officers must use separate forms for different authorisations.

The purpose of the authorisation is to comply with the Human Rights Act 1998 by providing lawful authority to carry out surveillance. This is why an authorisation must be obtained where the surveillance is likely to interfere with a person's Article 8 rights to privacy by obtaining private information about that person, whether or not that person is the subject of the investigation or operation. If the surveillance is then actually carried out in accordance with the authorisation, it will be less open to challenge.

6.2 Who can authorize the use of covert surveillance?

To give effect to RIPA, The Director of Corporate Services has been designated to authorise the use of directed surveillance and CHIS techniques in respect of external investigations and to sanction the use of such covert surveillance in respect of internal officer/Member investigations. This designation can be directly delegated to the Monitoring Officer Any RIPA authorisation must be approved by an order from a JP. The JP will be provided with a copy of the authorisation, and with a partially completed judicial application/order form, which is available on the Council's intranet. Advice should be sought from Legal Services, who will contact the court to arrange the hearing date for the application.

It should also be noted that in accordance with the relevant Regulations, the designation of

the Director of Corporate Services to sanction the use of RIPA regulated covert surveillance extends upwards to the Chief Executive.

Ideally, the Authorising Officer should not be responsible for authorising their own activities i.e. those operations/investigations in which they are directly involved. However, the Codes of Practice recognize that this may sometimes be unavoidable, especially in the case of small organisations, or where it is necessary to act urgently.

6.3 Justification for covert surveillance

In order to use covert surveillance (both directed surveillance and a CHIS) lawfully the person granting the authorisation (i.e. the authorising officer) will have to demonstrate that the surveillance is both 'necessary' and 'proportionate' to meet the objective of the prevention or detection of crime or of prevention of disorder. The JP must also be satisfied that the use of the technique is necessary and proportionate.

6.3.1 The 'necessity' test

RIPA first requires that the authorising officer must be satisfied that the authorisation is necessary, in the circumstances of the particular case, for the prevention and detection of crime, or prevention of disorder. This is the only statutory ground on which local authorities are now able to carry out directed surveillance and use a CHIS. For the purposes of the authorisation of directed surveillance, the crime threshold referred to in paragraph 4 above must be met. Covert surveillance cannot be "necessary" unless, in that particular case, there is no reasonably available overt method of discovering the desired information.

6.3.2 The 'proportionality' test

Then, if the activities are necessary, the authorising officer must be satisfied that they are proportionate to what is sought to be achieved by carrying them out. This involves balancing the intrusiveness of the activity on the target and others who might be affected by it against the need for the activity in operational terms. The activity will not be proportionate if it is **excessive** in the circumstances of the case or if the information which is sought could reasonably be obtained by other less intrusive means. All such activity should be carefully managed to meet the objective in question and must not be arbitrary or unfair.

6.4 CHIS – additional requirements

In addition, there are further criteria in relation to CHIS authorisations. Namely, that specific arrangements exist to ensure that, amongst other things, the source is independently managed and supervised, that records are kept of the use made of the source, that the source's identity is protected from those who do not need to know it, and that arrangements also exist to satisfy such other requirements as may be imposed by an Order made by the Secretary of State.

RIPA provides that an authorising officer must not grant an authorisation for the use or conduct of a source unless he believes that arrangements exist that satisfy these requirements. In this regard, the particular attention of authorising officers is drawn to paragraph 6.13 of the CHIS Code of Practice concerning the security and welfare of a CHIS and the need to carry out a **risk assessment**.

The Regulation of Investigatory Powers (Source Records) Regulations 2000 (SI No. 2725) details the particulars that must be included in the records relating to each CHIS. The authorising officer should comment on all these aspects in his "comments" box, as he may

have to justify the fact that he has taken account of these requirements and made an appropriate provision to comply.

6.5 Collateral Intrusion

Before authorising surveillance, the authorising officer should also take into account the risk of intrusion into the privacy of persons other than those who are directly the subjects of the investigation or operation (particularly when considering the proportionality of the surveillance). This is referred to as collateral inclusion, and the following should be considered:

- I. measures should be taken, wherever practicable, to avoid or minimise unnecessary intrusion into the privacy of those not directly connected with the investigation or operation;
- II. an application for an authorisation should include an assessment of the risk of any collateral intrusion and the authorising officer should take this into account, when considering the proportionality of the surveillance;
- III. those carrying out the surveillance should inform the authorising officer if the investigation or operation unexpectedly interferes with the privacy of individuals who are not covered by the authorisation; and
- IV. when the original authorisation may not be sufficient, consideration should be given to whether the authorisation needs to be amended and re-authorised or a new authorisation is required.

6.6 Local community sensitivities

Any person applying for or granting an authorisation will also need to be aware of what the Codes of Practice refer to as “any particular sensitivities in the local community” where the surveillance is taking place or of similar activities being undertaken by other public authorities which could impact on the deployment of surveillance.

7 Part 3: Directed Surveillance Authorisation Requirements

7.1 Applications for directed surveillance authorisation

Applications for authorisation to carry out directed surveillance must be made in **writing** using the **standard Application Form** and judicial approval form available on the Council’s intranet.

7.2 Duration of directed surveillance authorisations

A written authorisation granted by an authorising officer, and approved by a JP, will cease to have effect (unless renewed) at the end of a period of **three months** beginning with the day on which it took effect.

7.3 Reviews of directed surveillance authorisations

Regular reviews of authorisations should be undertaken to assess the need for the surveillance to continue. Particular attention is drawn to the need to review authorisations frequently where the surveillance provides access to ‘**confidential information**’ (see below) or involves collateral intrusion.

Authorisations must be reviewed by the authorising officer therefore **at least monthly** using the **standard Review Form** available on the Council's intranet to ensure that they remain in force only for so long as it is necessary.

7.4 Renewals of directed surveillance authorisations

If at any time before an authorisation would cease to have effect, the authorising officer considers it necessary for the authorisation to continue for the purpose for which it was given, he may renew it in writing for **a further period of three months** using the **standard Renewal Form** available on the Council's intranet. The same conditions attach to a renewal of surveillance as to the original authorisation. An order from a JP is required for a renewal in the same way as for an authorisation.

A renewal takes effect at the time at which, or day on which the authorisation would have ceased to have effect but for the renewal. An application for renewal should not be made until **10 working days** before the authorisation period is drawing to an end. However, where renewals are timetabled to fall outside of court hours, for example during a holiday period, care must be taken to ensure that the renewal is completed ahead of the deadline.

Any person who would be entitled to grant a new authorisation can renew an authorisation, but an order from a JP is also required. Authorisations may be renewed more than once, provided they continue to meet the criteria for authorisation.

7.5 Cancellation of directed surveillance authorisations

The authorising officer who granted or last renewed the authorisation **must** cancel it using the **standard Cancellation Form** available on the Council's intranet if he is satisfied that the directed surveillance no longer meets the criteria upon which it was authorised. Authorisations should not be allowed to simply expire.

Where the authorising officer is no longer available, this duty will fall on the person who has taken over the role of authorising officer or the person who is acting as authorising officer (**see the Regulation of Investigatory Powers (Cancellation of Authorisations) Order 2000; SI No: 2794**).

If the authorising officer is on sick or annual leave or is otherwise unable to cancel the authorisation for good reason, any other officer designated to grant authorisations may cancel the authorisation.

7.6 Ceasing of surveillance activity

As soon as the decision is taken that directed surveillance should be discontinued, the instruction must be given to those involved to stop all surveillance of the subject(s). The date and time when such an instruction was given should be recorded in the notification of cancellation where relevant (see standard cancellation form).

7.7 Urgent Cases

A JP may consider an authorisation out of working hours in exceptional cases. This must be arranged through the court, and two completed judicial application/order forms must be provided so that one can be retained by the JP.

7.8 Confidential Information

RIPA does not provide any special protection for 'confidential information'.

The Codes of Practice, however, do provide additional safeguards for such information. Confidential information consists of matters subject to legal privilege; confidential personal information (information relating to the physical or mental health or spiritual counselling of a person who can be identified from it) or confidential constituent information (relating to communications between a Member of Parliament and a constituent in respect of constituency matters) or confidential journalistic material (material acquired or created for the purposes of journalism and held subject to an undertaking to hold it in confidence). Further details about these categories of confidential information are set out in the Codes themselves, and advice can be obtained from Legal Services.

Special care should be taken if there is a likelihood of acquiring any confidential information. Such authorisations should only be granted in exceptional and compelling circumstances with full regard to the proportionality issues such surveillance raises.

In accordance with the provisions of the Code, in cases where through the use of the surveillance it is likely that confidential information will be acquired, the use of surveillance must be authorised by the Chief Executive.

If, exceptionally, any Council investigation is likely to result in the acquisition of confidential material, officers are required to obtain the prior approval of Legal Services before applying for an authorisation.

If confidential material is acquired during the course of an investigation, the following general principles apply:

- confidential material should not be retained or copied unless it is necessary for a lawful purpose;
- confidential material should be disseminated only where an officer (having sought advice from the Legal Services Manager) is satisfied that it is necessary for a lawful purpose;
- the retention or dissemination of such information should be accompanied by a clear warning of its confidential nature. It should be safeguarded by taking reasonable steps to ensure that there is no possibility of it becoming available, or its content being known, to any person whose possession of it might prejudice any criminal or civil proceedings related to the information; and confidential material should be destroyed as soon as it is no longer necessary to retain it for a specified purpose.

8 Part 4: CHIS Authorisation Requirements

Generally speaking, the authorisation requirements for directed surveillance also apply to a CHIS authorisation. There are, however, some variations, and the crime threshold as set out in paragraph 4 does not apply to a CHIS authorisation.

8.1 Duration of CHIS authorisations

A written CHIS authorisation granted by an authorising officer and approved by a JP, will cease to have effect (unless renewed) at the end of a period of **twelve months** beginning with the day on which it took effect.

8.2 Renewal of CHIS Authorisations

An authorising officer may renew a CHIS authorisation in writing **for a further period of twelve months**. This is subject to approval from a JP.

The same conditions attach to a renewal of surveillance as to the original authorisation. However, before renewing an authorisation for the use or conduct of a CHIS, officers are required to carry out a review of the use made of that source, the tasks given to that source and the information so obtained.

8.3 CHIS Forms

Standard **CHIS Application; Review; Renewal, and Cancellation Forms**, and the **Judicial Approval form** are available on the Council's intranet. Officers are required to use these forms in the appropriate circumstances.

8.4 Vulnerable Adults

In accordance with the CHIS Code of Practice, a **'vulnerable person'** should only be authorised to act as a CHIS in the most exceptional circumstances and must be authorised by the **Chief Executive**. Legal advice should always be sought. A 'vulnerable individual' is a person who is or may be in need of community care services by reason of mental or other disability, age or illness and who is or may be unable to take care of himself, or unable to protect himself against significant harm or exploitation.

8.5 Juvenile Sources

Special safeguards also apply to the use or conduct of juvenile sources; that is sources under the age of 18 years. Legal advice should always be sought. On no occasion should the use or conduct of a CHIS under 16 years of age be authorised to give information against his parents or any person who has parental responsibility for him. In other cases, authorisations should not be granted unless the special provisions contained within **The Regulation of Investigatory Powers (Juveniles) Order 2000 (SI No. 2793)** are satisfied. Authorisations for juvenile sources must be authorised by the **Chief Executive** the duration of such an authorisation is **one month only** instead of the usual twelve months.

9 Part 5: Other Authorisation Requirements

The Codes of Practice provide that a centrally retrievable record of all authorisations should be held by each public authority and regularly updated whenever an authorisation is granted, reviewed, renewed or cancelled. The record should be made available to the relevant Commissioner or an Inspector from the Investigatory Powers Commissioner's Office (IPCO), upon request. These records will be retained for a period of at least three years from the ending of the authorisation and will comprise of the information prescribed in the Codes.

The Council will also maintain a record of specified documentation relating to authorisations as further required by the Codes.

To give effect to these requirements The Authorising Officer is required to e-mail all completed RIPA forms to the Monitoring Officer within two working days of the grant; review; renewal; or cancellation of the authorisation so that the Council's central recording and monitoring systems can be kept up to date.

The Authorising Officer should however ensure that original RIPA forms are kept on the investigation case file and stored securely.

In addition, the Monitoring Officer will report periodically to Audit Committee with the register of authorisations to enable them to be satisfied that RIPA authorisation requirements are being complied with.

9.1 Retention and destruction of the product of surveillance

Where the product of surveillance could be relevant to pending or future criminal or civil proceedings, it should be retained in accordance with established disclosure requirements for a suitable period, commensurate to any subsequent review.

The Codes of Practice draw particular attention to the requirements of the code of practice issued under the **Criminal Procedure and Investigations Act 1996**. This requires that material which is obtained in the course of a criminal investigation and which may be relevant to the investigation must be recorded and retained.

Where material is obtained by surveillance, which is **wholly unrelated** to a criminal or other investigation or to any person who is the subject of the investigation, and there is no reason to believe it will be relevant to future civil or criminal proceedings, it should be **destroyed immediately**. Consideration of whether or not unrelated material should be destroyed is the responsibility of the authorising officer.

There is nothing in RIPA which prevents material obtained from properly authorised surveillance from being used in other investigations. Each Service must ensure that arrangements are in place for the handling, storage and destruction of material obtained through the use of covert surveillance. Authorising officers must ensure compliance with the appropriate data protection requirements relating to the handling and storage of material.

9.2 Acting on behalf of another

In cases where one agency is acting on behalf of another, it is usually for the tasking agency to obtain or provide the authorisation. For example, where surveillance is carried out by the Police with the use of the Council's CCTV systems, an authorisation must be obtained by the Police.

10 Part 6: Practical Application of RPIA

10.1 Who is affected by RIPA?

As the Council has already recognised in respect of the application of the **Human Rights Act 1998**, RIPA will impact on the enforcement activities of all the Council's regulatory Services, but, in the case of authorisations for directed surveillance, the crime threshold referred to in paragraph 4 must be met. This means that directed surveillance will no longer be able to be used in some investigations where it was previously authorised, e.g. dog fouling. However, this does not mean that it will not be possible to investigate these matters with a view to stopping offending behaviour. Routine patrols, observation at trouble "hotspots", immediate response to events and overt use of CCTV are all techniques which do not require RIPA authorisation.

A public authority may only engage RIPA when in performance of its "core functions" in contrast to the "ordinary functions" which are undertaken by all authorities (e.g. employment and contractual matters). Accordingly, the disciplining of an employee is not a core function, although related criminal investigations may be.

10.2 'General observation vs. 'systematic surveillance'

According to the Covert Surveillance Code of Practice "General observation duties of many law enforcement officers, and other public authorities do not require authorisation under the 2000 Act". For example, police officers will be on patrol to prevent and detect crime, maintain public safety and prevent disorder or trading standards or HM Customs and Excise officers might covertly observe and then visit a shop as part of their enforcement function to verify the supply or level of supply of goods or services that may be liable to a restriction or tax. Such observation may involve the use of equipment to merely reinforce normal sensory perception, such as binoculars, or the use of cameras, where this does not involve systematic surveillance of an individual.

The clear view expressed therefore is that usually low-level activity such as general observation will not be regulated under the provisions of RIPA provided it does not involve the systematic surveillance of an individual. That said, the determination of what constitutes 'general observation' on the one hand and 'systematic surveillance' on the other is a question of fact, the determination of which is not always straightforward and depends on the particular circumstances of an individual case.

In practice, the issue will turn on whether the covert surveillance is likely to result in obtaining any information in relation to a person's private or family life, whether or not that person is the target of the investigation or operation. If in doubt you are strongly recommended to obtain an authorisation.

10.3 'Covert' vs. 'overt' surveillance

In accordance with the Council's usual practice, wherever possible and appropriate Services should give advance warning of their intention to carry out surveillance. This is because the provisions of RIPA regulate the use of covert surveillance only. In some cases, a written warning may itself serve to prevent the wrongdoing complained of.

However, in order to properly put a person on notice that he is or may be the subject of surveillance, the notification letter must be couched in sufficiently precise terms so that he knows what **form** the surveillance will take (i.e. record of noise; photographs etc.). In fact, in line with directed surveillance requirements, notification letters should state **how long** the surveillance is likely to last (which should not be longer than three months); the necessity for the surveillance should be **reviewed at least monthly**; if it is necessary to continue the surveillance beyond the initial specified period a **renewal letter** should be sent to the 'noisy' neighbour, for example, and he should be informed when the surveillance has ceased.

It is also important to instruct the investigating officer not to exceed the limits of the 'surveillance' he has been asked to carry out.

Whilst it is accepted that the definition of 'covert' set out in RIPA could be interpreted very broadly, it is suggested that whether the surveillance activity is covert or not depends on the investigator's intention and conduct. If there is some element of **secrecy** or **concealment** the activity is likely to be covert.

Wherever possible or appropriate, officers should be **open; obvious and overt**.

10.4 CCTV

Overt CCTV systems used for general purposes are not usually regulated by RIPA (but CCTV in general is regulated by the Data Protection Act 2018, the GDPR 2016/679 and the CCTV

Code of Practice issued by the Information Commissioner' If, however, CCTV systems are used to **track individuals** or **specific locations** and the surveillance is **pre-planned** (i.e. not an immediate response to events or circumstances which by their very nature, could not have been foreseen) a **directed surveillance** authorisation must be obtained.

10.5 Recognising a CHIS

The provisions of RIPA are not intended to apply in circumstances where members of the public volunteer information to the police or other authorities, as part of their normal civic duties, or to contact numbers set up to receive information (such as Crime stoppers, Customs Confidential, the Anti-Terrorist Hotline, or the Security Service Public Telephone Number). Members of the public acting in this way would not generally be regarded as sources.

However, when an informant gives repeat information about a suspect or about a family, and it becomes apparent that the informant may be obtaining the information in the course of a family or neighbourhood relationship, this probably means that the informant is a CHIS, to whom a duty of care is owed if the information is then used, even though he or she has not been tasked by the authority to obtain information on its behalf.

The use of professional witnesses to obtain information and evidence is clearly covered.

10.6 "... establishing or maintaining a personal or other relationship....."

Whilst the meaning of "...establishing or maintaining a personal or other relationship..." is not clear and is open to interpretation, it is suggested that there has to be some measure of **intimacy** beyond the ordinary conversation. Only if an officer, for example, establishes some measure of **trust and confidence** with the person who is the subject of the surveillance will he be establishing or maintaining a personal or other relationship.

Usually a simple enquiry or a request for general information (i.e. a request for information which would be supplied to any member of the public who enquired) not obtained under false pretences is not likely to be regulated by RIPA.

10.7 Simple test purchase transactions

Whether or not test purchase transactions are regulated by RIPA depends on the circumstances and in particular the conduct of the person carrying out the surveillance. Usually simple covert test purchase transactions carried out under existing statutory powers where the officer involved does not establish a personal or other relationship will not require a CHIS authorisation.

Officers should, however, be wary of the law on '**entrapment**'. Whereas officers can in appropriate circumstances, present a seller or supplier, for example, an opportunity which he could act upon, officers cannot 'incite' the commission of an offence i.e. encourage, persuade or pressurise someone to commit an offence.

10.8 Use of DAT recorders

If it is appropriate to do so, Environmental Health officers, and to a much lesser extent Council Housing officers, use a recorder to monitor noise levels (usually at residential premises) following noise nuisance complaints. Whilst the recorder is installed by officers, the complainant decides when to switch the recorder on and off.

The covert recording of suspected noise nuisance where the intention is only to record excessive noise levels from adjoining premises, and the recording device is calibrated to record only excessive noise levels, may not require an authorisation, as the perpetrator would normally be regarded as having forfeited any claim to privacy.

That said, a Digital Audio Tape (DAT) recorder is a sophisticated piece of monitoring equipment and if used covertly may constitute directed surveillance. In general, a letter is sent to the person who is to be the subject of the surveillance, and this should mean that subsequent surveillance is overt, and an authorisation will not as a matter of course be required. However, if there is any doubt as to whether surveillance is covert, e.g. if any longer than a few weeks has passed since the alleged perpetrator was informed that monitoring might be carried out, and if it is likely that private information will be obtained, then an authorisation should be sought.

10.9 RIPA forms

It is imperative that RIPA forms are completed in full whenever RIPA regulated surveillance activity is planned. The information given must be specific and detailed; must relate to the particular facts of an individual case (i.e. avoid standard wording if at all possible) and must demonstrate that a proper risk assessment has been carried out. Both those who apply for an authorisation and the Authorising Officer should refer to this policy and to the relevant Code of Practice in completing the relevant form,

10.10 Role of Authoring Officers

The Authorising Officer is required to ask themselves: "Have I got sufficient information to make an informed decision as to whether or not to authorise surveillance activity on the particular facts of this case?" and must recognise that RIPA imposes new and important obligations on those Services affected by RIPA

Authorising officers must be satisfied that there are adequate checks in place to ensure that the surveillance carried out is in line with what has been authorised. Such monitoring should be properly documented as well as the decision-making process in general.

Officers are strongly recommended to read this policy in conjunction with the Covert Surveillance and CHIS Codes of Practice which provide supplementary guidance.

If the surveillance is not properly authorised, the protection offered by RIPA will be lost.

10.11 How to access RIPA documents?

RIPA itself; explanatory notes to RIPA, the Covert Surveillance and CHIS Codes of Practice; RIPA statutory instruments and other RIPA documents are available on the Home Office website: <https://www.gov.uk/government/collections/ripa-codes>

Relevant RIPA documents as well as this policy and the Council's standard forms have also been posted on the Council's intranet.

11 Training and awareness

It is the policy of the Council to provide adequate training for all its employees so that they are aware of the RIPA provisions and know when certain activities are required to be authorised. Authorising Officers will be trained in the proper use of their powers as with investigating officers. The Council seeks to ensure that all staff likely to be engaged in surveillance work and

the use of CHIS understand the regulatory framework and know which officers are authorised Investigating Officers and the Authorising Officer

Training and refresher training shall be provided on a regular basis.

Appendix 1:

Directed surveillance forms

Application for the authorisation of directed surveillance:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAA0ADkAOAAzAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Review of directed surveillance authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANQAYAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Renewal of directed surveillance authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANQAZAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Cancellation of a directed surveillance authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANQA0AHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

CHIS (Covert Human Intelligence Source) forms

Application for authorisation of use or conduct of a CHIS:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAA0ADkAOAA0AHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Review of a CHIS authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANgAwAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Renewal of a CHIS authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANgAxAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Cancellation of a CHIS authorisation:

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAAyADQANgAyAHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Judicial Approval Form

<http://intranet.lancaster.gov.uk/GetAsset.aspx?id=fAA0ADAAOQA5AHwAfABGAGEAbABzAGUAFAB8ADAAfAA1>

Appendix 2:

PROCESS TO BE FOLLOWED WHEN CONSIDERING USING SOCIAL NETWORKING SITES IN INVESTIGATIONS OR TO GATHER EVIDENCE.

Where an officer considers it necessary to view a social networking site to investigate an allegation or to gather information the following process is to be followed:

1. Officers must not use their own personal or private account when accessing social networking sites for investigations/evidence gathering, only Council accounts should be used.
2. Officers may access the main page of an individual's profile to take an initial view as to whether there is any substance to the allegation of the matter being investigated and is unlikely to interfere with a person's reasonably held expectation of privacy and therefore is not likely to require a directed surveillance authorisation.
3. Officers are required to keep a log recording when social networking sites are viewed for investigations/evidence gathering. Each viewing of a company or individual's social networking site must be recorded on the log. This is to enable the Council to monitor the use of these sites for investigations/evidence gathering and use this information to review policies and guidance. See attached excel template below.
4. If it is considered that there is a need to monitor a company's or individual's social networking site, for example by systematically collecting and recording information about a particular person or group, then the officer must refer the matter to their Head of Service for consideration as to whether a RIPA authorisation from the Magistrates Court may be required. If officers are in any doubt as to whether an authorisation is required, they should seek advice

from the Information Governance Manager or Authorising Officer (Director for Corporate Services), before continuing to access a social networking site.

5. If the offence being investigated falls under RIPA, a formal RIPA application must be completed, authorised by the Council's Authorising Officer and then approved by a Magistrate.

6. If the offence being investigated falls outside RIPA, a 'Non-RIPA' form must be completed and forwarded to the Authorising Officer.

7. Officers also need to be aware that any evidence captured as part of a criminal investigation will need to comply with the relevant legislation (The Police and Criminal Evidence Act 1984, Criminal Procedure Rules 2018 and the Criminal Procedure and Investigations Act 1996) and advice should be sought from the Council's Legal Services Manager.

8. A copy of all forms should be forwarded to the Council's Information Governance Manager so that a central record of RIPA requests and Authorisations can be kept.



Social Media Access
Log v1.0.xlsx

AUDIT COMMITTEE**Revision of Contract Procedure Rules
25 November 2020****Report of Head of Financial Services****PURPOSE OF REPORT**

To seek Members' approval for a revised set of corporate Contract Procedure Rules.

This report is public.

RECOMMENDATIONS

- (1) **That the Committee consider and endorse the revisions to the Council's Contract Procedure Rules.**

1.0 Introduction

- 1.1 The Audit Committee's Terms of Reference include "To consider and endorse amendments to the Council's Financial Regulations and Contract Procedure Rules'. Lancaster City Council Constitution (Part 2 section 5 para 6.12)
- 1.2 The Council's current Contract Procedure Rules were adopted in January 2013. Since their introduction, there have been many changes both to the structure and operational management of the Council and to the environment in which it conducts its procurement activities. A fundamental review and revision of the Rules has therefore become due and was given as an action within the recently adopted Procurement Strategy.

2.0 Proposal Details

- 2.1 Efficient and effective procurement and contract management arrangements play an important role across the full range of the Council's activities and are necessary to enable achievement of the Council's ambition to deliver Social Value – Environmental, local Wealth-Building and Economic benefits to the district. The significance of these ambitions is reflected throughout the document.
- 2.2 A key objective of the review has been to develop a modern set of Contract Procedure Rules which fit the Councils Management structure and the changes made to the Constitution in 2019. Therefore, the following key changes are proposed.
- a. Financial thresholds
Thresholds have been changed to replicate the delegated authority within the constitution.

b. Procurement Methods

The use of the corporate supplier portal for the issuing and receiving of requests for quotation or invitation to tender has been made mandatory, this should assist in the publication of the contracts register and the completion of regulatory award notices.

c. Roles and Responsibilities

Throughout the document the titles of specific officers or groups of officers have been changed to reflect the current management structure.

2.3 The Rules are designed to establish the fundamental controls and framework for procurement, and they will be accompanied by more detailed guidance in specific areas with particular attention to Social Value. Once the revised Rules are adopted, it is planned to deliver a programme of training and induction and to redesign and update the information and guidance provided via the Intranet.

2.4 The revised Contract Procedure Rules are attached to this report at Appendix A

3.0 Details of Consultation

3.1 The revised Rules have been developed and Senior Officers and Members have been invited to comment. Comments received have been addressed in the current revision.

4.0 Options and Options Analysis (including risk assessment)

	Option 1: Approve the proposed Contract Procedure Rules as presented	Option 2: To approve the proposed Rules with changes	Option 3: Do nothing
Advantages	Aligns with the Constitution, Council Priorities and Themes, gives officers clear instruction on procedures to be followed and supports the Council's desire to achieve Social Value through Procurement. Provides an opportunity to raise understanding of procurement activities.		Officers generally have an overview of the current rules avoids resource implications of implementation.
Disadvantages	Resources will be required to deliver training material to launch new CPR's Will take time for new rules to be fully adopted/implemented.		The 2013 version of the CPR's is out of date and not aligned to the current management structure, Constitution and there is conflict between the two documents. There would be the missed opportunity to support the Corporate Procurement Strategy and deliver on the Councils Priorities and Themes
Risks	Potential for misunderstanding and mistakes until rules are fully adopted (low impact)		Confusion over roles and responsibilities may lead to mistakes. The opportunity to obtain social Value through procurement would not be endorsed.

5.0 Officer Preferred Option (and comments)

5.1 The officer preferred option is 1 – for the revised Contract Procedure Rules to be approved as proposed. Implementation of the new Rules will be covered by existing resources within the Procurement function within Financial Services. The Procurement Manager and Procurement Assistant provide the corporate resource to support Services in managing their procurement activity.

6.0 Conclusion

6.1 A revised and update of the Council’s Contract Procedure Rules is timely to ensure they remain current and in tune with modern procurement practices and continue to make an effective contribution to the Council’s vision and priorities of delivering Environmental. Local wealth-building and economic benefits to the district.

**CONCLUSION OF IMPACT ASSESSMENT
(including Health & Safety, Equality & Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing):**

None

LEGAL IMPLICATIONS

Legal have been consulted and approve the form of the Contract Procedure Rules. Whilst officers understand that any legislative changes to the public procurement regime as a result of Public Procurement (Amendment etc) (EU Exit) Regulations 2019 will not have any significant effect upon the current procurement regime following the end of the transition period on 31 December 2020, they recommend the Contract Procedure Rules are kept under review if further legislation is subsequently brought in.

FINANCIAL IMPLICATIONS

The delivering of the new rules comes with no direct financial impact however it will create a training capacity for their introduction. This cost is expected to be minimal and can be managed from within existing budgets.

OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services, Property, Open Spaces

None directly from this report

SECTION 151 OFFICER’S COMMENTS

The Council’s current Contract Procedure Rules (CPR’s) were last updated in January 2013. Since this time there have been many changes both to the structure and operational management of the Council and to the environment in which it conducts its procurement. The updating of the CPR’s is overdue and now better supports the Council’s ambition to deliver Social Value – Environmental, local Wealth-Building and Economic benefits to the district.

MONITORING OFFICER'S COMMENTS

Amendments to the Contract Procedure Rules fall within the Terms of Reference of this Committee. The Monitoring Officer will update the Constitution to reflect any changes made.

BACKGROUND PAPERS

Appendix A Contract Procedure Rules 2020

Contact Officer: Helen McMahon

Telephone: 01524 582122

Email: hcmahon@lancaster.gov.uk

Lancaster City Council

Contract Procedure Rules

(Revised November 2020)

Record of Document Version Control

Date	By Whom	Reason	Version
16/11/2020	H McMahon	Initial draft for consultation	0.05
16/11/2020	H McMahon	Contract storage	0.06

Table of Contents

Introduction	4
Section 1: Scope of the Contract Procedure Rules	5
1.0 Basic Principles.....	5
2.0 Officer Responsibilities	5
3.0 Grants.....	6
4.0 Collaboration.....	6
5.0 Relevant Contracts.....	6
Section 2: Common Requirements	8
6.0 Steps Prior to Purchase.....	8
7.0 Procurement Records	8
Section 3: Purchasing Rules	10
8.0 Competition Requirements for Purchases, Partnership Arrangements Frameworks and Concession contracts	10
9.0 Pre-Tender Stage.....	12
10.0 Advertising and Prequalification.....	12
11.0 Standards & Award Criteria	13
12.0 Invitations to Tender & Quotations	13
13.0 Shortlisting	14
14.0 Submission, Receipt & Opening of Tenders & Quotations	14
15.0 Clarification Procedures and Post Tender Negotiation	14
16.0 Evaluation, Award of Contract & Debriefing of Candidates	15
17.0 Waivers (Single Tender Action – Direct Award Contracts)	15
Section 4: Contract Documents & Other Formalities	18
18.0 Contract Documents	18
19.0 Contract Formalities.....	19
20.0 Bonds & Parent Company Guarantees	19
21.0 Prevention of Corruption.....	19
22.0 Declaration of Interest	20
Section 5: Contract Management	21
23.0 Managing Contracts.....	21
24.0 Risk Assessment & Contingency Planning.....	21
25.0 Contract Monitoring, Evaluation & Review	21

Introduction

These Contract Procedure Rules (CPRs) are intended to promote good procurement practice, public accountability and to deter corruption. The CPR's are mandatory for all Officers. Following them is the best defence against allegations that a purchase has been made unfairly, incorrectly or fraudulently. Officers responsible for purchasing must comply with these CPRs. They lay down minimum requirements. These Contract Procedure Rules have been written to allow social value, community wealth-building and environmental benefits to be included in procurement decisions.

Social Value for the purpose of these contract procedure rules is taken to include Community Wealth-Building, Environmental and Economic benefits.

Further advice on the CPRs can be sort by contacting procurement in the first instance. You may also need to contact Legal.

All procurement approaches, whether established and traditional or modern and innovative must comply with all elements of these CPR's.

All values referred to in these CPR's are exclusive of VAT

Section 1: Scope of the Contract Procedure Rules

1.0 Basic Principles

1.1 All purchasing procedures must:

- Comply with the Treaty of Rome principles of equality, transparency, non-discrimination, Equal Treatment, Mutual Recognition and proportionality
- Achieve value for money for all public money spent
- Be consistent with the highest standards of integrity
- Ensure fairness and transparency in allocating public contracts
- Comply with UK & EU law and all legal requirements
- Ensure that non-commercial considerations (except those allowed for in the Social Value Act) do not influence any contracting decision
- Comply with the Council's various Codes of Practice and the Council's aims and policies
- Seek to incorporate social value, community wealth-building and environmental benefits.

2.0 Officer Responsibilities

2.1 Officers responsible for purchasing must comply with these Contract Procedure Rules, the Council's Financial Regulations, the Staff Code of Conduct, the Council's Anti-Bribery policy, arrangements for declaring conflicts of interest and Council's Scheme of Delegation and with all UK and European Union binding legal requirements. Officers must ensure that any agents, consultants and contractual partners acting on their behalf also comply. Officers must:

- Have proper regard for all necessary legal, financial and professional advice
- Declare any personal financial interest in a contract. Corruption is a criminal offence
- Report any offers of bribes or inducements
- Conduct any relevant value for money review
- Ensure that there is adequate budget provision for the procurement being undertaken
- Check whether there is an existing contract that can be used before undergoing a competitive process
- Allow sufficient time for the submission of bids
- Keep all supplier bids confidential
- Keep records of all dealings with suppliers
- The project manager should ensure the safe keeping of contract documentation in line with Lancaster's document retention policy.
- Obtain all required approvals and complete a written contract (and sealed, as required) before placing an order or raising a purchase order for any supplies, services or works
- Where appropriate, not award a contract until the standstill period is over
- Enter all purchase order information onto the Oracle financial system
- Based on the Scheme of Delegation, identify a senior manager who is the designated contract owner responsible for the relationship with the supplier. In addition, a contract manager with responsibility for day to day issues and ensuring the contract delivers as intended may also be appointed
- Ensure that contracts are legally, financially and technically capable of delivery to the Council

2.2 When any employee either of the Council or of a service provider may be affected by any transfer arrangement, Officers must ensure that the Transfer of Undertaking (Protection of Employment - TUPE) issues are considered.

2.3 Unless otherwise delegated, Directors should:

- Keep records of all purchases and contracts valued below £100,000
- Ensure that all signed and sealed contracts valued at £100,000 and greater are scanned and entered onto the Contract Register
- Ensure that all Waivers are recorded under Rule 17

3.0 Grants

3.1 For the purposes of these Contract Procedure Rules, a grant refers to grant-in-aid and is the provision of funding to cover, in whole or, more likely, in part, the running costs of an organisation whose work complements that of the Council. The recipient will have discretion over the spending of that funding within the general framework of controls agreed between the Council and the recipient of the grant.

3.2 The terms of a grant are likely to require the other organisation to use the money only for a particular project or service and might require the recipient to pay back the grant, or part of it, in some circumstances. The Council would still, of course, monitor the achievement of the proposed outcomes and any giving of a grant should be subject of a formal contract.

3.3 The Council should determine on a case by case basis whether funding is to be considered as a grant or a Relevant Contract by reference to the decision making tool published by the National Audit Office at <http://www.nao.org.uk/decision-support-toolkit/>. A Relevant Contract is any arrangement made by, or on behalf of the Council the carrying out of works or for the supply of goods, materials or services.

4.0 Collaboration

4.1 In order to secure value for money, the Council may enter into a procurement arrangement with a Central Purchasing Body (CPB). The terms and conditions of the CPB must be fully complied with, including any requirement to undertake competition between providers. In order to secure value for money, the Council may enter into collaborative procurement arrangements with another local authority, government department, primary care trust, statutory undertaker or other contracting authority.

4.2 In some areas, the Council may enter into a collaborative service delivery arrangement with one or more other 'partner' organisations (whether local authorities, other public bodies or private sector organisations). In such circumstances, the council may wish to take advantage of a partner's procurement arrangements, expertise and agreements (e.g. frameworks).

5.0 Relevant Contracts

5.1 All Relevant Contracts must comply with these Contract Procedure Rules. These include arrangements made by or on behalf of the Council for the carrying out of works or the supply of goods, materials or services, for:

- The supply of goods, services and works
- The hire, rental or lease of goods or equipment
- Concession contracts for the supply of services and works
- Contracts or agreements where the provider is employed on a no win/no fee basis.

5.2 Relevant Contracts do not include:

- Contracts of employment which make an individual a direct employee of the Council
- Grants – see rule 3
- Fines
- Payment of taxes
- Agreements regarding the acquisition, disposal, or transfer of land (for which Financial Regulations shall apply)
- Delivery of works and services by an in-house provider, including for example: construction, engineering, maintenance, professional services, etc
- Contracts for the provision of any product or service that has been manufactured or delivered by an illegal means

Section 2: Common Requirements

6.0 Steps Prior to Purchase

- 6.1 Officers should take the following steps before beginning a procurement exercise:
- a. Determine the service, product or works output taking into account the requirements from any relevant value for money review and the Council's commissioning outcomes
 - b. Appraise the need for the expenditure and its priority
 - c. Define the objectives of the purchase
 - d. Assess the risks associated with the purchase and how to manage them
 - e. Officers involved in the evaluation of tenders must complete the declarations of interest form prior to the evaluation criteria being developed and agreed and prior to the start of the evaluation process
- 6.2 Officers should also consider what procurement method is most likely to achieve the purchasing objectives, including packaging strategies, internal or external sourcing, shared services, concession arrangements, partnering arrangements and collaborative procurement arrangements with other local authorities and government departments. Officers should also consider working with Primary Care Trusts, statutory undertakers, members of the Lancaster and South Cumbria Joint Committee and Central Purchasing Bodies.
- 6.3 Officers should ensure that all procurements including method, contract standards and performance and user satisfaction monitoring and including any collaborative arrangements, are carried out using the Council's principles of co-production and co-delivery. Officers should also use the Council's standard terms and conditions of contract where possible.
- 6.4 The officer must confirm that they have the authority to spend, have obtained the required approval(s) for the expenditure and the purchase accords with the Scheme of Delegation. If the purchase is valued at £250,000 and greater, an entry onto the Council's Forward Plan has been made. If the purchase is valued at £50,000 and greater, the relevant Cabinet Member has been consulted.

7.0 Procurement Records

- 7.1 Where the total value is less than £100,000, the relevant officer must ensure that the following records are kept:
- Invitations to quote and quotations
 - A record of any waivers to the procurement process and the reasons for them
 - Written records of communications with the successful contractor or an electronic record if a written record of the transaction would normally not be produced
 - Copies of the quotes received must be appended to the relevant requisition
- 7.2 Where the total value exceeds £100,000, the relevant Head of Service must ensure that the following records are kept:
- The method for obtaining bids
 - The calculation of the estimated value
 - The reason for entering into a contract
 - Any waiver under Rule 17 together with the reasons for it
 - The award criteria in descending order of importance
 - Tender documents sent to and received from tenderers
 - Pre-tender research, benchmarking and consultation information

- All tender evaluation documentation. To include the scoring assessment sheet for each of the tender evaluators. Any post-tender clarification information, to include minutes of meetings
- The contract documents
- Contract due diligence checks, implementation and evaluation plan and any monitoring and management information
- Communications with all tenderers throughout the tendering exercise and with the successful supplier(s) throughout the period of the contract
- Record of Social Value offering that is to be measured and delivered through out the contract.

7.3 All contracts must be entered onto the Council's Contract Register held on the supplier portal. The manager responsible for procuring the contract should ensure the safe keeping of contract documentation in line with Lancaster's document retention policy.

Section 3: Purchasing Rules

8.0 Competition Requirements for Purchases, Partnership Arrangements Frameworks and Concession contracts

8.1 Officers must calculate the total aggregate value of any contract or purchase. If in doubt, Officers should seek the advice of their procurement team.

8.2 The following table shows the procedures and approval process for the Council's tendering activities:

	Total Aggregate Value	Procedure	Internal Approval	Other Essential Requirements
A	£0.00 up to & including £10,000	One Written Quote	RSO	<ul style="list-style-type: none"> The quote must represent value for money
B	Greater than £10,000 & up to £100,000*	One of: <ul style="list-style-type: none"> A framework or dynamic purchasing system (DPS) Three Written Quotes 	RSO	<ul style="list-style-type: none"> Unless a framework is used, 3 written quotes to be secured under sealed bid, of which, at least one quote from a local Lancaster supplier*. opportunities valued at or greater than £25,000 which are being openly advertised must, in addition to the supplier portal be advertised on the Contracts Finder Above £50,000 relevant cabinet member to be consulted. <p>*it should be noted that for procurements below EU Thresholds a restricted process can be permitted with all suppliers from the local area, subject to a waiver under Rule 17.</p>
C	£100,000* & up to and including £150,000*	Formal Tendering through one of the following: <ul style="list-style-type: none"> A Framework or DPS Tender including advertisement 	Director	<ul style="list-style-type: none"> Pre-qualification Questionnaires may not be used to restrict providers below Public Services Contract Threshold. However Suitability questions are permitted.

		<p>on Lancaster's supplier portal, Contracts Finder,</p> <ul style="list-style-type: none"> • Relevant cabinet member to be consulted. 		<ul style="list-style-type: none"> • Details on Contract Register • Contract placed under seal if advised by Legal
D	Greater than £150,000 and up to and including £200,000	<ul style="list-style-type: none"> • Formal tendering • Refer to EU rules and requirements 	<ul style="list-style-type: none"> • Chief Executive 	<ul style="list-style-type: none"> • As C, above, • Above EU threshold pre-qualification allowed.
E	Greater than £200,000	<ul style="list-style-type: none"> • Formal tendering 	<ul style="list-style-type: none"> • Chief Executive with delegated authority 	<ul style="list-style-type: none"> • As D, above • Above £250,000 published on the Councils Forward Plan of decisions.

8.3

- a. Where a contract is valued between public services contract threshold and any higher applicable public contract threshold, it is possible to use a restricted tendering (two stage) process.
- b. Where a contract is valued between the Lancaster tendering threshold and the public services contract threshold, a single stage process shall be used.
- c. **Framework Contracts** – An agreement between one or more contracting authorities and one or more economic operators. The term of a framework shall, save duly, justified and exceptional circumstances not exceed 4 years. Frameworks cannot be used in an improper manner that may hinder, restrict or distort competition. All terms and conditions of contract must set out how call-offs from the framework will be made and must be followed.
- d. **Dynamic Purchasing System (DPS)** – A completely electronic system used to purchase commonly used goods, services or works. Unlike a traditional framework the process shall be open throughout the contract term allowing new suppliers to join at any time. A DPS must follow the rules of restricted procedure.
- e. **Concession Contracts** – To grant to the provider the sole and exclusive right to deliver the contract and to make money from the contact. A Concession contract must follow the requirement of the Concession Contract Regulation and can follow a single or restricted procedure.

Where two-stage process is allowed, the tender advertisement must show the number of suitably qualified tenderers who will be invited to submit bids.

- 8.4 An Officer must not enter into separate contracts nor select a method of calculating the total value in order to minimise the application of these contract procedure rules or to avoid the requirements of the EU.
- 8.5 Where extensions of time or variations in price (or both together) are made to an existing contract, Officers must adhere to the extension and/or variation provisions in the terms and conditions. Officers must compute the amount of the variation and seek approval in accordance with the Council's Scheme of Delegation.
- 8.6 Where a contract is to be terminated before its contracted termination date, this must be approved by the relevant Director.
- 8.7 Legal must be consulted where contracts to work for organisations other than the Council are contemplated.

9.0 Pre-Tender Stage

- 9.1 The Officer responsible for the purchase may consult potential suppliers prior to the issue of the invitation to tender in general terms about the nature, level and standard of the supply, contract packaging and other relevant matters, provided this does not prejudice any potential candidate. Or give an unfair advantage to a potential candidate. Officers are strongly advised to engage with suppliers during the tender process.
- 9.2 The responsible officer must consider Responsible Procurement at this stage. Contracts tendered must not only achieve value for money on a whole life costing basis for the organisation but also for society, the economy and the environment. Steps must be taken to incorporate social value, community wealth-building and environmental benefits.

For Contracts or orders over £50,000 Officers are required to engage with their Cabinet Member before the approval of tender has been given. Discussions should include the contract's outcomes and outputs and opportunities for social value, community wealth-building and environmental benefits.

10.0 Advertising and Prequalification

- 10.1 Officers should ensure that, where proposed contracts, irrespective of their total aggregate value, might be of interest to potential suppliers located in other member states of the EU, a sufficiently accessible advertisement is published. Generally, the greater the interest of the contract to potential bidders from other member states, the wider the coverage of the advertisement should be. Advertisements for tenders should be placed as below:
 - a. For procurements valued between £0.00 and up to £100,000, officers are not obliged to formally advertise the purchase but may do so using the Council's supplier portal
 - b. For contracts above £25,000 and that are being openly procured, Officers must advertise the opportunity on Contracts Finder.
 - c. Where the value exceeds the current EU thresholds for supply, service and works contracts, tender advertisement rules must be followed in accordance with the current EU Public Procurement Directive
 - d. For procurement activity of any value officers may use additional advertisements in national official journals, specialist trade papers or websites, if relevant and if affordable.

11.0 Standards & Award Criteria

- 11.1 The Officer must ascertain the relevant EU, UK, European or international standards which apply to the subject matter of the contract. The Officer must include those standards which are necessary properly to describe the required quality. Legal Services team must be consulted if it is proposed to use standards other than European standards.
- 11.2 The Officer must define award criteria that are appropriate to the purchase and designed to secure an outcome giving Value for Money for the Council. The basic criteria shall be:
 - a. "Most Economically Advantageous", where price and quality elements are considered. All elements to be fully identified (including sub-criterion) in the Invitation to Tender (ITT) documentation. Quality elements should include delivery of Social Value.
 - b. "Highest Price" if payment is to be received for sale or disposal
- 11.3 Award criteria must not include non-commercial considerations except those set out in the Public Services (Social Value) Act 2012, the Procurement Strategy or matters which discriminate against suppliers from the European Economic Area or signatories to the Government Procurement Agreement and must reflect the subject matter of the contract.
- 11.4 Social Value outputs will be included in any contract award criteria, where the contract value is above £100,000. For contracts below £100,000 officers should include Social Value output wherever possible.

12.0 Invitations to Tender & Quotations

- 12.1 The invitation to tender shall state that no tender will be considered unless it is received by the date and time stipulated in the Invitation to Tender.
- 12.2 All Requests for Quotes or Invitation to Tenders valued at £10,000 and greater must be conducted online through the Supplier Portal. Officers and suppliers will be provided with guidance and support on how the system works and where they can get help.
- 12.3 All Invitations to tender to include the following:
 - a. The requirement that all Tenders and their responses for contracts valued at £100,000 and greater must be completed online
 - b. A specification that describes the Council's requirements. A requirement for tenderers to declare that the tender content, price or any other figure or particulars concerning the tender have not been disclosed by the tenderer to any other party (except where such a disclosure is made in confidence for a necessary purpose)
 - c. A requirement for tenderers to complete fully and sign all tender documents including a form of tender and certificates relating to canvassing and non-collusion
 - d. Notification that tenders are submitted to the Council on the basis that they are prepared at the tenderer's expense
 - e. A description of the award procedure and, a definition of the award criteria in objective terms and if possible, in descending order of importance
 - f. The method by which any arithmetical errors discovered in the submitted tenders is to be dealt with; in particular, whether the overall price prevails over the rates in the tender or vice versa
- 12.4 All Invitations to tender or quotations must specify the goods, service or works that are required, together with the terms and conditions of contract that will apply (see Rule 16).
- 12.5 Tenders that are returned without a requested signed Form of Tender will be considered as non-compliant.
- 12.6 All candidates invited to tender, or quote must be issued with the same information at the same time and subject to the same conditions. Any supplementary information must be given on the same basis.

13.0 Shortlisting

- 13.1 Any shortlisting must have regard to the financial standing, technical capacity and capability relevant to the contract and the award criteria.
- 13.2 Where the contract value relates to the EU thresholds, Officers must adhere to specific shortlisting rules that apply in respect of the EU Directives.

14.0 Submission, Receipt & Opening of Tenders & Quotations

- 14.1 Tenders of £100,000 or greater must be returned directly using the Council's supplier portal. Further information on the e-tendering system is available from the procurement team. Tenders must be submitted directly to the portal.
- 14.2 An electronic reverse auction should only be used following discussion with the Procurement Manager. The procedure enables suppliers/providers to adjust their tender price in the light of information from the tender prices submitted by competing suppliers/providers, then alterations will be accepted as permitted by the auction process.
- 14.3 All submitted tenders must be opened at the same time when the period for submission has ended and not before the date of submission.
- 14.4 Suppliers who have expressed interest or have been invited to participate in a tender must be given adequate period in which to prepare and submit a proper quotation or tender, consistent with the complexity of the contract requirement. The EU Directive on public procurement includes specific tendering time periods.
- 14.5 Any tender that does not comply with the Council's requirement as set out in the tender invitation should normally be excluded from consideration, with the circumstances recorded. Officers may, however, seek the agreement of the Head of Legal and procurement to relax these requirements in appropriate circumstances.

15.0 Clarification Procedures and Post Tender Negotiation

- 15.1 Providing clarification of an invitation to tender to potential or actual candidates or seeking clarification of a tender, in writing, is permitted. Discussions with tenderers after submission of a tender and before the award of a contract (post tender clarification) with a view to clarifying mistakes or errors in the tender submitted, operational provisions or terms and conditions of contract are permitted. Where post tender clarification discussions are to take place with a supplier, all tenderers involved in the respective exercise must be notified and all information must be documented by the Officers conducting the clarification.
- 15.2 However, discussions with tenderers after submission of a tender and before the award of a contract with a view to obtaining adjustments in scope, price, delivery or content (i.e. post-tender negotiations) must be subject to the current EU/UK Public Procurement Directives.
- 15.3 The officer may negotiate the terms of a Tender form one or all Candidates in writing or at a meeting, provided that:
- The Director is satisfied that the officer carrying out the negotiation has the skill and competency commensurate with the complexity and value of the contract and has authorised such action. Confirmation of authorisation is to be kept as a record.
 - The procurement manager should be made aware of any Post Tender negotiations that are taking place.
 - Notes of that meeting are taken and agreed with all the parties
 - The officer seeks advice and support from the Procurement Manager
 - The officer has regard and follows the Council's Code of Conduct for Employees at all times.

- 15.4 Officers may seek authorisation to carry out negotiations on contracts that are currently being delivered; this may be with regard to price or quality. Authorisation will be granted by the Director.
- 15.5 Where post-tender clarification results in a fundamental change to the specification (or contract terms) the contract must not be awarded but re-tendered.

16.0 Evaluation, Award of Contract & Debriefing of Candidates

- 16.1 Apart from the debriefing required or permitted by these CPRs, the confidentiality of quotations, tenders and the identity of candidates must be preserved at all times and information about one candidate's tender submission must not be given to another candidate.
- 16.2 In accordance with Regulation 24 you must "take appropriate measures to effectively prevent, identify and remedy conflicts of interest arising in the conduct of procurement procedures so as to avoid any distortion of competition and to ensure equal treatment of all economic operators". Contracts must be evaluated and awarded in accordance with the award criteria and agreed evaluation methodology.
- 16.3 Any evaluations that are undertaken independently should have scores determined, if necessary, by a tender evaluation panel during a moderation meeting. All documentation pertaining to the evaluation and decision including minutes, individual scores and notes are to be retained.
- 16.4 If arithmetical errors are found in a tender or the tender submission is deemed to be "abnormally low" they should be clarified with the tenderer. If the rates in the tender, rather than the overall price, were stated within the tender invitation as being dominant, an amended tender price may be requested to accord with the rates given by the tenderer.
- 16.5 Officers may accept quotations and tenders received in respect of proposed contracts, provided they have been sought and evaluated fully in accordance with these contract procedure rules and in respect of the Scheme of Delegation.
- 16.6 Where the total value is at £100,000 and greater, both the successful and unsuccessful tenderers should be notified as soon after the decision as possible.
- 16.7 If the contract falls within the PCR's 2015 then the appropriate Regulations should be followed. The standstill period will commence from the date the final letter is sent. The letters must
- a. Follow the Alcatel period as specified under Regulation 87 of the PCR 2015.
 - b. In accordance with Regulation 86(2) the notice must provide the unsuccessful tenderers feedback to their total score, the reasons for the decision, including a narrative explanation of the characteristics and relative advantages of the winning tender.
 - c. Officers must provide unsuccessful candidates with a period of at least ten calendar days in which to challenge the decision before the Officer awards the contract. If the decision is challenged by an unsuccessful candidate, then the Officer shall not award the contract and should immediately seek the advice of the Lancaster Legal team.
 - d. If during the alcatel period a candidate requests in writing the reasons for a contracting decision, the Officer must give the reasons in writing within 15 days of the request.

17.0 Waivers (Single Tender Action – Direct Award Contracts)

- 17.1 For Contracts above the PCR's 2015 thresholds it is recognised that, under exceptional circumstances, only one provider may be able to fulfil the needs of the Council. The Public

Contracts Regulations do not provide a single term to cover such arrangements and consequently they may be referred to by various names. These will include Single Tender Action, Direct Awards, Single Sourcing, Waivers etc. All must be treated in the same manner.

A Single Tender Action is the award of a contract to a single or a limited group of Suppliers, Service Providers or Contractors without undertaking a competitive tendering exercise. Such action is permitted under the EU Procurement Directives in the following, exceptional circumstances:

- a. **Technical Reason** – Only one enterprise has the expertise to do the work
- b. **Exclusive Rights** - only one party can perform the contract due to intellectual/industrial property rights e.g. patents/trademarks or copyright
- c. **Artistic Rights** - engaging an artist or performer
- d. **Consultancy Services** - follow up work to complete the assignment previously awarded on a competitive tendering exercise.

17.2 For Contracts below the PCR's 2015 threshold The Council and its Cabinet may waive any requirements within these CPRs for specific projects. However, consideration must be given to the risk of legal challenge should a decision not to advertise the requirement and proceed to award the contract or framework without competition be made. The Council may delegate that authority in line with section 8.2 of these Standing Orders and the Head of Legal. Normally the circumstances under which a waiver can be agreed include those listed in 17.1 and:

- a. **Demonstrable Best Interest:** it can be demonstrated that it is in the Council's best interest and this is clearly demonstrated in the comments section in the waiver report
- b. **Emergency:** There is a clear need to provide a service or product immediately in the instance of a sudden unforeseen crisis; the immediate risk is to health, life, property or environment. Normal competitive processes are not feasible
- c. **Changing an Existing Contract:** making significant improvements and/or changes to an existing contract. This will usually be captured in a contract variation waiver
- d. **Urgency:** there exists an unforeseen situation calling for prompt action in order to provide a product or service that fulfils a specific statutory obligation, e.g. health and safety requirements. Competitive processes may not be feasible
- e. **Exigencies of a Service:** there are demonstrable circumstances that are genuinely exceptional
- f. **Extension as Waiver:** where a contract extension is being sought which was not duly authorised in the original Officer Delegated Decision

Single Tender Actions **will not** be permitted in the following circumstances:

- time constraints through poor project planning
- previous relationships with suppliers
- to avoid a competitive tendering exercise.

17.3 All waivers, the reasons and the justification for them and the period for which the waiver is valid must be recorded and signed off by the relevant officer and manager in accordance with the Council's Scheme of Delegation.

A single tender still requires a set of Invitation to Tender documents including terms and conditions and scope of works to be drafted and issued, and a written formal response to be made by the supplier through the Councils e-tendering portal.

17.4 The decision-making route for waivers is as follows: Waiver

Value	Decision Maker
£0.00 up to £150,000	<ul style="list-style-type: none"><li data-bbox="802 259 954 286">• Director
£150,000 and greater	<ul style="list-style-type: none"><li data-bbox="802 331 1374 358">• Monitoring Officer or Section 151 officer

Section 4: Contract Documents & Other Formalities

18.0 Contract Documents

- 18.1 All relevant contracts should be in writing and should set out the parties' obligations, rights and risk allocations.
- 18.2 All relevant contracts, irrespective of value, should clearly specify:
- a. What is to be supplied (i.e. the works, materials, services, matters or things to be furnished, had or done)
 - b. The provisions for payment (i.e. the price to be paid and when)
 - c. The time, or times, within which the contract is to be performed
 - d. The provisions for the Council to terminate the contract
 - e. The terms and conditions to be applied to the contract
- 18.3 The Council's terms and conditions of contract should be used wherever possible rather than the suppliers. If you intend to use the supplier's terms advice must be sought from the Legal team.
- 18.4 If the Council's standard terms and conditions are not used, every relevant contract of purchase over £100,000 must also state clearly as a minimum:
- a. That the contractor may not assign or sub-contract without prior written consent
 - b. How the contractor would indemnify the Council against any negligent act or omission
 - c. Any insurance requirements
 - d. How the contract may be ended because of non-performance or otherwise
 - e. How intellectual property is dealt with
 - f. How services may be varied
 - g. That the contractor should pay the living wage
 - h. Important performance indicators
 - i. Health and safety requirements
 - j. Ombudsman requirements, if relevant
 - k. Data protection requirements (GDPR), if relevant
 - l. That charter standards are to be met if relevant
 - m. Race relations requirements
 - n. Requirements under the Equalities Act 2010
 - o. Anti-fraud, Corruption and Modern Slavery
 - p. Freedom of Information Act requirements
 - q. Where Agents are used to let contracts, that Agents must comply with the Council's contract procedure rules
 - r. A right of access to relevant documentation and records of the contractor for monitoring and audit purposes if relevant
 - s. Special conditions relating to Responsible Procurement
 - t. Where required Special Conditions relating to Works Contracts
- 18.5 The formal advice of the Legal team must be sought for the following contracts:
- a. Where it is proposed to use a supplier's own terms
 - b. Those that involve insourcing or outsourcing
- 18.6 In addition to Legal advice the advice of the Procurement Manager should be sought for contracts:
- a. Where the total value exceeds £100,000
 - b. Those involving leasing arrangements
 - c. That are complex in any other way.
- 18.7 Officers must arrange for the original copy of all signed contracts to be lodged with Legal Services, as soon as the contract has been awarded.

19.0 Contract Formalities

- 19.1 All contracts should be concluded formally in writing before the supply, service or construction work begins.
- 19.2 The Officer responsible for securing signature of the contract must ensure that the person signing for the other contracting party has authority to bind it.
- 19.3 Subject to any exceptions as provided elsewhere in the Scheme of Delegation, all contracts to be made under seal (other than contracts for the sale and acquisition of land at auction, electronic e-auctions and insurance contracts) will be determined by the Head of Legal.
- 19.4 Where contracts are completed by each side adding their formal seal, such contracts shall be attested by the Chief Executive or Director. The seal must not be affixed without the proper authority. A contract must be sealed where in the opinion of the Head of Legal:
 - a. The Council wishes to enforce the contract more than six years after its end
 - b. The price paid or received under the contract is a nominal price and does not reflect the value of the goods or services
 - c. There is any doubt about the authority of the person signing for the other contracting party

20.0 Bonds & Parent Company Guarantees

- 20.1 The Officer must consult the appropriate Director to determine whether a Parent Company Guarantee is necessary and at what level when a Candidate is a subsidiary of a parent company and:
 - a. Award is based on evaluation of the parent company, or
 - b. There is some concern about the stability of the candidate
- 20.2 The Officer must consult the appropriate Director about whether a Bond is needed, where it is proposed to make stage or other payments in advance of receiving the whole of the subject matter of the contract and there is concern about the stability of the candidate

21.0 Prevention of Corruption

- 21.1 The Officer must comply with the Officer Code of Conduct and must not invite or accept any gift or reward in respect of the award or performance of any contract. High standards of conduct are obligatory. Findings of corrupt behaviour in Council officers may lead to dismissal.

22.0 Declaration of Interest

- 22.1 If it comes to the knowledge of a member or an employee of the Council that a contract in which he or she has a pecuniary interest has been or is proposed to be entered into by the Council, he or she shall immediately give written notice to the Head of Legal
- 22.2 Such written notice is required irrespective of whether the pecuniary (financial) interest is direct or indirect. An indirect pecuniary interest is distinct from a direct pecuniary interest in as much as it is not a contract to which the member or employee is directly a party.
- 22.3 A shareholding in a body not exceeding a total nominal value of £1,000 or 1% of the nominal value of the issued share capital (whichever is the less) is not a pecuniary interest for the purposes of this standing order.
- 22.4 A record of all declarations of interests notified by Officers will be maintained

Section 5: Contract Management

23.0 Managing Contracts

- 23.1 Heads of Service are to name contract managers for all new contracts. All contracts should have a named Council contract owner and contract manager for the entirety of the contract.
- 23.2 Contract managers must follow the procedures set out in the Council's Contract Procedure Rules.

24.0 Risk Assessment & Contingency Planning

- 24.1 Provision for resources for the management of the contract, for its entirety, must be identified in the business case.
- 24.2 For all contracts with a value of £100,000 and greater, the contract manager must:
 - a. Maintain a risk register during the contract period
 - b. Undertake appropriate risk assessments and for identified risks
 - c. Ensure contingency measures and business continuity plans are in place

25.0 Contract Monitoring, Evaluation & Review

- 25.1 All contracts valued at £100,000 and greater are to be subject to regular formal reviews with the contractor. An initial review should be done at the first 3 months of a contract start date and on-going reviews should then be conducted on a regular schedule.
- 25.2 A formal review process must be applied to all contracts deemed to be High Risk, High Value, or High Profile. This process must be applied at key stages of major procurements.
- 25.3 During the life of the contract, the Officer must monitor a contract in respect of:
 - a. Performance and compliance with specification and contract
 - b. Cost and any value for money requirements
 - c. User satisfaction and risk management
 - d. Equality Assessment Progress Report (including Living Wage)
 - e. Supplier Financial Health Check
 - f. Relevant Due Diligence clarifications including Modern Slavery

AUDIT COMMITTEE

25 November 2020

Internal Audit Monitoring

Report of Internal Audit and Assurance Manager

PURPOSE OF REPORT
<p>To advise Members of the latest monitoring position regarding the 2020/21 Internal Audit plan.</p> <p>To advise Members of the latest monitoring position regarding the implementation of the Annual Governance Statement (AGS) action plan for 2019/20.</p>
This report is public

RECOMMENDATIONS

- (1) That the latest monitoring position in relation to the 2020/21 audit plan be noted.**
- (2) That the last progress in relation to the AGS action plan for 2019/20 also be noted.**

1.0 Audit Plan monitoring

- 1.1 The 2020/21 Internal Audit plan was approved by the Audit Committee on 19 February 2020 and then subsequently amended and approved on the 27 August 2020. This report is based on the monitoring position between the periods 22 July (publication of the Internal Audit Annual Report) up to 1 November 2020.
- 1.2 Following a priority piece of work completed during September and October, a number of pieces of audit work from the revised 2021/22 audit plan will not be completed as planned: namely
 - Psychological safety / staff wellbeing; and
 - Property Investment Strategy.
- 1.3 In addition, a piece of work is required to be completed on the council sickness recording system following concerns identified during the HR assurance work. This piece of work will be completed in quarter four.

1.4 Summary of monitoring position at 1 November 2020

2018/19 Audit Plan Work rolled forward and completed in 2019/20			
TITLE	STATUS	LEVEL OF ASSURANCE	SUMMARY
Recovery of Legal Fees and Court Costs	Fieldwork in progress		Testing was started in quarter four, however owing to the Covid-19 pandemic, this piece of work was put on hold due to the auditor being re-deployed to Business Support. This piece of work will be picked up and finalised in December 2020.
Council Housing Assets	Fieldwork in progress		This piece of work was due to be completed jointly with Lancashire County Council. A start-up meeting took place start, however owing to the Covid-19 pandemic, this piece of work was put on hold due to the auditor being re-deployed to Business Support. Whilst the Principal Auditor has now resumed normal audit work, Lancashire County Council have stated that they will be unable to assist with this work due to limited resources. Therefore, this piece of work will be rolled into the 2021/22 audit plan.
VAT	Final Report Issued November 2020	Substantial ✓	
2019/20 Audit Plan completed during 2020/21			
Project Assurance Work			
Procure to Pay (P2P)	Owing to the departure of the Exchequer Services Manager in May 2020 (post now filled) and the Covid-19 pandemic, this project came to a slight halt. However, good progress has since been made, the council now having fully migrated to automated electronic scanning of invoices. The Principal Auditor will continue monitoring the project until the project is completed.		
Payroll – E Budgeting	Unfortunately, the new Payroll / E budgeting module was not ready in time to assist with the 2020/21 budget setting process, therefore no detailed testing could be carried out. However, testing will be carried out in quarter three / four once the system has been used to assist the budget setting cycle for 2021/22.		
Fixed Asset Register	Final Report Issued November 2020	Substantial ✓	
Data Protection – Policy and Process Review	Final Report Issued May 2020	Limited ⚠	A follow-up review will be completed as part of the 2021/22 audit plan.

Follow-up work completed / due in 2019/20

Procurement and Contract Management	Follow-up Review in Progress		The piece of work was due to be followed up in April 2019 but was delayed awaiting the publication of the national procurement strategy so that the council could refresh its own procurement strategy. This strategy has since been produced and was approved by Cabinet in July 2020 and a new set of Contract Procedure Rules have also been produced which are due to be approved by the Audit Committee November 2020 (see later in this agenda). Once approved both documents will form part of the Procurement re-launch exercise to ensure that they are effectively rolled out and embedded across the council. It is anticipated this follow-up will be completed in December 2020.
Dog Seizure and Kennelling Service	Follow-up Review in Progress		The original report was issued in November 2018 and was given a limited assurance opinion. It was followed up in February 2020 and again, given a limited assurance opinion. A further follow up was due in July 2020 however, owing to the Covid-19 pandemic, this piece of work was put on hold due to the auditor being re-deployed to Business Support. This piece of work is now in the process of being followed up and following initial discussions it is expected to achieve a Substantial assurance opinion. It is anticipated this follow-up will be completed in December 2020.
Insurance	Follow-up Review in Progress		The original report was issued in November 2019 with a limited assurance opinion being given. A subsequent follow-up was completed in July 2020 and again, received a limited assurance opinion. A further follow up was due in September 2020, however owing to significant resources being utilised on another piece of audit work, this follow-up review has yet to be completed. It is anticipated this follow-up will be completed in quarter four.
Payroll	Follow-up Review in Progress		The original report was issued in August 2019 with a limited assurance opinion being given. A subsequent follow-up was due in May 2020, however owing to the Covid-19 pandemic and the retirement of the Exchequer Services Manager (post now filled), this follow-up has been delayed. There are several officers who will be required to assist with this work who were previously re-deployed elsewhere. It is anticipated this piece of work will be completed in quarter four.
Asbestos Management – Council Housing	Follow-up Review in Progress		The original report produced by Fylde Borough Council was issued in May 2019 with a limited assurance opinion being given. A subsequent follow-up was due to be completed in November 2019, however due to another piece of audit work taking priority, this follow-up review was delayed and is still outstanding. A management update has since been provided and following some testing it is hoped that the assurance opinion will be raised to substantial. It is anticipated this follow-up will be completed in quarter four.

2020/21 Audit Plan work

Job Evaluation	This work will commence in quarter four,
Housing Benefits – Lancaster (Housing Benefit cases transferring to UC and the accuracy of calculations)	The Assessment Manager that originally requested this piece of work is happy that this can be removed from the 2020/21 Audit Plan based on the end of year checks they carry out prior to the subsidy claim.
Housing Benefits – Lancaster (assurances surrounding accurate earnings information)	The Assessment Manager that originally requested this piece of work is happy that this piece of work can be rolled to the 2020/21 Audit Plan based on the current checks that are being carried out by the Team.
Housing Benefits e-form - Lancaster	This work will commence in quarter four.
Other Assurance work	During September and October 2020, a piece of assurance work relating to Human Resources was undertaken. A minimal overall assurance opinion was given following a significant number of findings and recommendations being made. A follow-up piece of work will be completed in the new-year to monitor the progress of the recommendations made.
National Fraud Initiative	Data files were uploaded by the Principal Auditor in October 2020. The Corporate Enquiry Team will filter and process the results as normal over the coming months. The exercise in respect of the annual Single Person Discount will commence in December 2020 with the results being released early January 2021. The Corporate Fraud Manager will report on the findings of both exercises in his annual report to the Audit Committee.
Embedding Risk Management	<p>Whilst good progress was made in 2019/20 to strengthen the council's risk management processes across the organisation, work came to a halt in March 2020 when Internal Audit staff were redeployed to work in other areas of the council assisting with the covid-19 pandemic.</p> <p>To date, a Risk Management Policy and Strategy has been approved, risk management software has been procured and implemented to assist with the administration of both strategic and operational risks and a strategic risk register has been populated within the new software, however owing to limited resources, the monitoring of these risks has been limited. An update on the council's strategic risks will be given later in this agenda.</p> <p>Now that both the Internal Audit and Assurance Manager and the Principal Auditor have now returned to their normal work activities, the next steps are to roll out the Risk Management Policy, carry out training across the organisation, shortly followed by the implementation of operational risk registers. It is hoped that work in this area will commence in January 2021.</p>

2.0 Annual Governance Statement (AGS) 2019/20 Action Plan update – November 2020

A - Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law			
Behaving with integrity			
Weakness Identified	Action Needed	Officer Responsible / Timescale	Update as at November 2020
A1. Numerous procedural gaps within the Code of Conduct have been identified over time.	A1. The ongoing constitutional review (which started on the 31/3/19) will include review of Codes of Conduct, links to values and behaviours, scheme of delegation etc. In addition, an annual constitutional review is required to ensure it remains up to date. Head of Legal/ Monitoring Officer & Deputy Monitoring Officer in process of continuous review. Annual Council on 18 th May 2020 will include changes to schemes of delegation.	A1. Head of Legal/ Monitoring Officer – on-going	LGA has committed to reviewing the current model member code of conduct, as recommended by the Committee on Standards in Public Life's report into Local Government Ethical Standards. The consultation on the draft member code of conduct has now taken place and we await the final draft which will be reviewed by the LGA's Executive Advisory Board before being presented to the next LGA General Assembly which, it is hoped, will be held in the Autumn of 2020. It has been developed in collaboration with the sector and will be offered as a template for councils to adopt in whole and/or with local amendments. The LGA will undertake an annual review of the Code to ensure it continues to be fit-for-purpose, particularly with respect to advances in technology, social media and any relevant changes in legislation. Once finalised, the LGA will also offer support, training and

			mediation to councils and councillors on the application of the Code, whilst the National Association of Local Councils (NALC) and the county associations of local councils can offer advice and support to town and parish councils. It is anticipated that this will move forward in April 2021.
A2. The Equity and Diversity mop-up training session as part of the embedding of the council's values and behaviours framework planned for March 2020 was delayed owing to the Covid-19 pandemic.	A2. A mop up session will be completed once we return to business as usual.	A2. Head of HR – TBC	Due to the absence of the HR Manager this action has not yet been implemented. The estimated date for completion is not known.
A3. Parish Councillors do not receive any training on the Code of Conduct.	A3. The Monitoring Officer is to ensure Parish Councils are offered appropriate training.	A3. Head of Legal/ Monitoring Officer – on-going	See A1. The Council has 35+ parish council's, therefore consideration needs to be given as to how training can be provided on the new Code of Conduct. It is anticipated that this will move forward in April 2021.
A4. An updated register of interests' policy / procedure is not in place for all relevant staff.	A4. Following the identification of politically restricted staff, the Democratic Services Manager will contact each officer asking them to submit a new declaration form, this should include a 'NIL' response.	A4. Democratic Services Manger – August 2020	Completed – except for one officer. A further reminder will be issued.

A6. Training has not been provided on the acceptance of gifts and hospitality and the new thresholds.	A6. A short training clip is to be produced for the intranet.	A6. Democratic Services Manager – December 2020	Not yet implemented. Owing to the on-going pandemic the implementation date has moved to April 2021.
Demonstrating strong commitment to ethical values			
A12. Following the Ethical Governance Survey carried out in 2018 several actions were identified that require attention.	A12. Internal Audit will monitor the implementation of the actions required.	A12. Internal Audit – December 2020	Not yet implemented – Owing to the on-going pandemic the implementation date has moved to April 2021.
A13. Guidance procedures for external funding and accountable bodies are documented within the Financial Regulations however these need to be reviewed.	A13. Guidance procedures for external funding and accountable bodies are documented within the Financial Regulations need to be reviewed to ensure they are fit for purpose and allow the organisation to function accordingly.	A13. Financial Services Manager – January 2021	Not yet implemented – estimated date for completion January 2021
A15. Whilst the Procurement Strategy has been updated to take account of the new values and ethical behaviour, this has yet to be approved and rolled out.	A15. The Procurement Strategy is to be approved by Full Council in July 2020 and it will take some time to roll out and embed across the council.	A15. Procurement Manager – December 2020	A new procurement strategy and action plan 2020 - 2024 was agreed by Cabinet in July 2020 and a revised set of Contract Procedural Rules have been drafted and are awaiting Audit Committee approval (November 2020)TH. Once approved both documents will be rolled out and embedded across the council as part of a Procurement Re-launch exercise.
A17. Whilst a 'values based competency agreement' was agreed by	A17. The newly agreed values based competency agreement	A17. Head of HR – TBC	Due to the absence of the HR Manager this action has not yet been

the Executive Team and approved by Personnel Committee, roll out to line managers has now been put on hold owing to Covid-19 pandemic.	will be rolled out when we return to business as usual.		implemented. The estimated date for completion is not known.
A25. Delays in report clearances are being caused by ICT issues (lack of laptops / Mod.Gov issues) and there are still issues around version control and the need to improve standard report pro-formas.	A25. The availability of laptops, appropriate training and the introduction of electronic clearance of reports on Modgov will improve this.	A25. Democratic Services Manager – on-going	The process for clearing Cabinet Reports has now improved by using the Modern Gov software. Laptops are Over the next 12-18 months the process for clearing reports through Modern Gov. will be rolled out to other committees. The issue with the lack of laptops has now been resolved.

B – Ensuring openness and comprehensive stakeholder engagement			
Openness			
Weakness Identified	Action Needed	Officer Responsible / Timescale	Update as at November 2020
Engaging comprehensively with institutional stakeholders			
B16. No Partnership framework in place setting out any principles to assist officers when entering into partnership working	B16. Financial Regulations needs to include guidance on partnership working principles but these are not to be prescriptive.	B16. Financial Services Manager – January 2021	Not yet implemented – estimated date for completion January 2021
E - Developing the entity's capacity, including the capability if its leadership and the individuals within it			
Developing the entity's capacity			
Weakness Identified	Action Needed	Officer Responsible / Timescale	
E1. There is no workforce plan in place.	E1. Strategic workforce planning needs to be developed, taking	E1. HR Manager – TBC	Due to the absence of the HR Manager this action has not yet been

	into account current and planned measures and be rolled out as part of emergency planning.		implemented. The estimated date for completion is not known.
E4. The last review of Member's allowances was completed by the IRP in December 2018 to come into effect from May 2019. Since the last review 2 panel members have resigned. Therefore, the panel is no longer quorate.	E4. Additional IRP members need to be recruited prior to the next interim review to ensure the panel is quorate.	E4. Democratic Services Manager – November 2020	Following the recruitment and appointment of two new IRP panel members, the panel is now quorate. The Head of Democratic Services is in the process of arranging a first 'remote' meeting to look at the current allowances scheme.
Developing the capacity of the entity's leadership and other individuals			
E8. Internal Audit have been requested to carry out a review of the job evaluation process following completion of the Pay and Grading review.	E8. An Internal Audit review has been included in the 2020/21 Audit plan.	E8. Internal Audit and Assurance Manager – August 2020	Due to other audit work commitments, this piece of work has not yet commenced. It is expected to be completed before 31 March 2021.
E10. Financial Regulations and Financial Procedure Rules are reviewed should be annually reviewed by the Audit Committee but aren't currently.	E10. An annual review of the Financial Regulations will be programmed into the Audit Committee work programme following the completion of the Constitutional review.	E10. Internal Audit and Assurance Manager / Financial Services Manager – 30 September 2020.	Due to other work commitments, this piece of audit work has not been completed. It will be included in the Audit Committee work programme for 2021/22.

3.0 Details of Consultation

3.1 Management Team and Service Managers continue to be consulted in delivering both the audit plan and the Annual Governance Statement action plan.

4.0 Options and Options Analysis (including risk assessment)

4.1 There are no other options available.

5.0 Conclusion

5.1 The programme of audits for the rest of the year continues to be implemented in consultation with Service Managers.

5.2. The Annual Governance Statement action plan will continue to be monitored by Internal Audit and Management Team.

**CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)**

Not applicable

FINANCIAL IMPLICATIONS

None directly arising from this report

SECTION 151 OFFICER'S COMMENTS

Internal Audit provides independent assurance that the Council's risk management, governance and internal control processes are operating effectively. Unfortunately, the impact of COVID 19 and the redeployment of Council officers, together with the introduction of a significant high priority piece of work has severely impacted on the service's ability to deliver the 2020-21 audit plan. The report notes these issues are not uncommon. Lancashire County Council advised they are unable to assist in delivery of the plan due to limited resources.

Consideration will need to be given to the impact of the lost opportunity or resulting delays in undertaking reviews where risks were identified as part of the audit planning process. This impact should be reflected within the Council's Annual Governance Statement 2020/21.

LEGAL IMPLICATIONS

None directly arising from this report

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS

Internal Audit Plan 2019/20

Annual Governance Statement 2018/19

Contact Officer: Joanne Billington

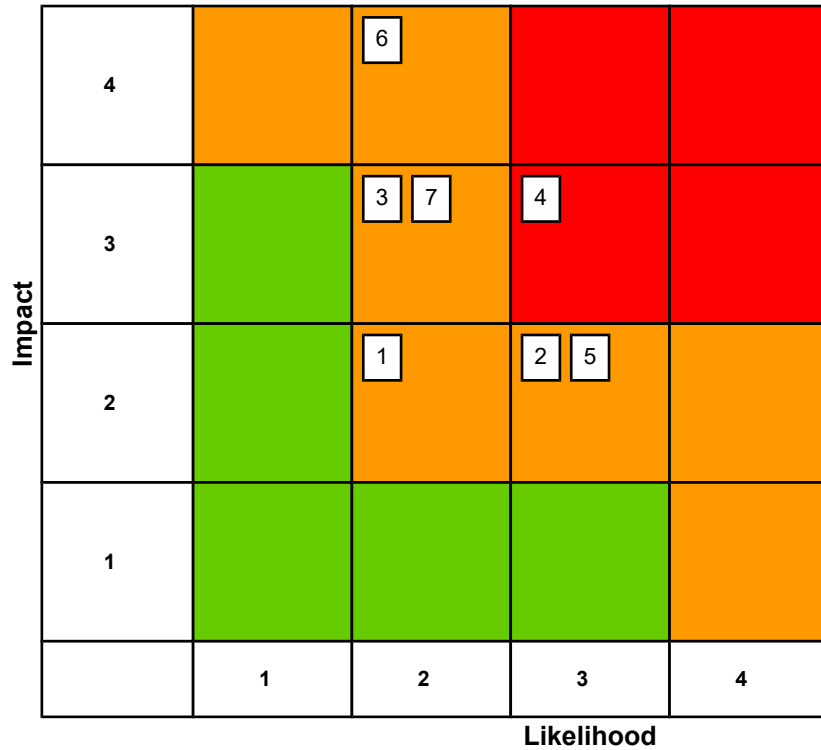
Telephone: 01524 582028

E-mail: jbillington@lancaster.gov.uk

Ref:

Actions Plans By Entity with Mitigating Actions

Entity: Strategic Risk Register, Risk Assessment open, Current Risk version, Risk is open




Risk	Risk Owner	Inherent Risk Score	Existing Control Measure Description	Residual Risk Score	Risk Response Category	Target Risk Level	Action Plan Description
------	------------	---------------------	--------------------------------------	---------------------	------------------------	-------------------	-------------------------




Strategic Risk Register

Items in Group: 7

Risk	Risk Owner	Inherent Risk Score	Existing Control Measure Description	Residual Risk Score	Risk Response Category	Target Risk Level	Action Plan Description
SR1 Central Government funding is insufficient to provide the current level of service leaving the council unable to achieve financial stability.	Sarah Davies (Corporate Director Corporate Services) Paul Thompson (Financial Services Manager)	9	Officer/Member Working Groups - Capital Strategy Group (CSG) and Financial Resilience Group (FRG)	4	Reduce	1	Review of existing budgets to identify areas for realignment/ refocusing or cessation to deliver efficiencies but ensuring that Services remain aligned with the Councils Priorities.
			Council Strategies - Funding the Future Strategy, Road to Ambition, Investment Strategy, Reserves Strategy and Medium Term Financial Strategy				Development of LATCO's or other alternative service delivery vehicles to deliver efficiencies and/ or operational surpluses which can be reinvested into Council Services.
							The Strategy contains 4 Pillars to achieve Financial Stability.
							Strategic acquisitions of established investments to obtain rental or other income at a commercial rate of return. Multidiscipline Property Investment Team established to review and challenge investment opportunities ahead of review by Capital Strategy Group.
							A number of Lean Process Reviews are in progress to identify efficiencies within a number of core Council processes.

Risk	Risk Owner	Inherent Risk Score	Existing Control Measure Description	Residual Risk Score	Risk Response Category	Target Risk Level	Action Plan Description
SR2 The Council fails to meet the £2m 2021/22 funding gap as a result of ineffective delivery of the efficiency programme and failure to deliver on key projects. 	Sarah Davies (Corporate Director Corporate Services) Paul Thompson (Financial Services Manager)	9	Budget and Performance Panel	6	Reduce	2	Consisting of Executive Team to monitor delivery via monthly and quarterly reports and provide support and challenge to each project as required. Meeting Monthly. Several projects delayed due to COVID 19 – reporting now suspended for Projects & Performance (Finance Continues)
			Reserves Policy				Established to provide a central co-ordination point for all the Council's projects. Responsible for co-ordination and monitoring.
			Project Managers				Monitoring report linking Projects, Performance and Resources presented to Cabinet and Budget & Performance Panel. Several projects delayed due to COVID 19 – reporting now suspended for Projects & Performance (Finance Continues)
			Programme Managers				Project and Financial information present to Cabinet/ Portfolio providing an opportunity for review and discussion of performance. See above
			Programme Delivery Board				Outcome based resourcing exercise underway to identify revenue saving for 21/22 and beyond
			Cabinet				
			Portfolio Holder				

Risk	Risk Owner	Inherent Risk Score	Existing Control Measure Description	Residual Risk Score	Risk Response Category	Target Risk Level	Action Plan Description
SR3 The Council fails to recruit and retain competent / key staff resulting in ineffective leadership, increased costs and failure to deliver effective services, projects and council priorities.	Jayne Cordley-Williams (Human Resources Manager)	12	Pay and Grading Structure in place	6	Accept	6	<p>The new pay and grading structure and job evaluation process will ensure that all posts are objectively evaluated and then placed on a new pay and grading scale.</p> <p>Recent experience suggests that this assisted in attracting applicants with the desired skills and values.</p> <p>The Council is progressing its approach to developing its existing workforce, via an apprentice programme and also via a reallocation / talent team, which has shown its effectiveness and potential during the pandemic.</p> <p>The Council also recognises that an further attraction to applicants are work/ life balance, wellbeing, attractive pension scheme, pool car scheme, cycle to work scheme, employee supportive policies, equality of opportunity etc. These are all in place and being developed further</p>
			Recruitment and Retention Policy				
			Annual Appraisal Process				
SR4 The use of council assets is not maximised leading to insufficient funding to meet the funding gap and deliver capital projects.	 Mark Davies (Corporate Director Communities and the Environment) Sarah Davies (Corporate Director Corporate Services) Kieran Keane (Chief Executive) Sarah Price (Facilities Manager) Jason Syers (Director for Economic Growth and Regeneration) Paul Thompson (Financial Services Manager)	12	Capital Strategy Group	9	Reduce	6	Asset Management Plan

Risk	Risk Owner	Inherent Risk Score	Existing Control Measure Description	Residual Risk Score	Risk Response Category	Target Risk Level	Action Plan Description
SR5 Council services are disrupted and / or additional services are required and costs are incurred as a result of national emergencies (e.g. Covid) and the potential unknown impacts following the UK's withdrawal from the EU.	Mark Davies (Corporate Director Communities and the Environment)	9	Lancashire Resilience Forum	6	Accept	6	The Council's response to the COVID –19 crisis has shown its ability to respond to emergencies. This has been as a result of extensive emergency planning and practice. 
			Emergency plans				
			Business Continuity Plans				
			Government Planning				
SR6 The Council fails to reduce it's direct Co2 emissions to 'net zero' by 2030.	Mark Davies (Corporate Director Communities and the Environment)	16	Delivery plan in place	8	Accept	8	Deliver plan, based on 20/21 it is likely this will be delivered however the biggest risk is a change in strategy after the next local government elections. Hence higher score to follow. 
SR7 The Council fails to deliver its key priorities due to the lack of an underpinning strategy setting out expected delivery / outcomes.	Mark Davies (Corporate Director Communities and the Environment) Sarah Davies (Corporate Director Corporate Services) Kieran Keane (Chief Executive) Jason Syers (Director for Economic Growth and Regeneration) Paul Thompson (Financial Services Manager)	9	Funding the future	6	Reduce	4	Prosperity Plan
			Carbon Zero +				Local Development Plan
			Medium Term Financial Strategy (MTFS)				Community Wealth Building Strategy.
			Programme Management				No Change for FtF Strategy Cabinet and Exec team are undertaking an extensive programme to develop the corporate planning, budgeting and performance management of the Council (Circles) 

AUDIT COMMITTEE**Statement of Accounts 2019/20
25 November 2020****Report of Chief Finance Officer****PURPOSE OF REPORT**

This report seeks to provide Members with an update of the progress of the external audit of the Council's 2019/20 Financial Statements, outlining any issues raised to date.

This report is public.

RECOMMENDATIONS

The Audit Committee is recommended

- 1. To note the details progress of the audit of the Statement of Accounts for the year ended 31st March 2020 and the matters arising to date.**

1.0 INTRODUCTION

- 1.1 Members will recall the requirements and timelines for the approval of a Local Authority's 2019/20 Statement of Accounts have changed. Having considered the impact of the COVID-19 pandemic and in consultation with key stakeholders, the Ministry of Housing, Communities and Local Government (MHCLG) introduced the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 which have amended the Accounts and Audit Regulations 2015.
- 1.2 In accordance with the amended Regulations, the draft Accounts must now be published on the Council's website and submitted for audit by 31 August 2020 rather than 31 May 2020 and the timeline for the conclusion of the audit is now 30 November 2020 rather than 31 July 2020.

2.0 CURENT POSITION**Publication**

- 2.1 The draft Statement of Accounts 2019/20 were published on the Council's external website 28 August 2020, ahead of the required deadline. Although Members previously received notification of publication and a PDF version of the draft financial statements they can be viewed via the attached link <https://www.lancaster.gov.uk/the-council-and-democracy/budgets-and-spending/statement-of-accounts>

Member Training

2.2 Training on the statement of accounts has been provided in 2 sessions and was open to all Members.

Session 1 Setting the Scene

2.3 Held prior to the Committee meeting 27 August 2020 this initial session provided Members with a broad introduction to the financial reporting framework, the roles of the Chief Finance Officer, Those Charged with Governance and the External Auditor and the key elements of the financial statements.

Session 2 Interlinkages & Significant Items

2.4 The second session held 25 November 2020 delivered more detailed training focusing on the interlinkages between the various statements and their supporting notes, also significant balances, accounting adjustments and policies as well financial performance.

External Audit

2.4 Due to the COVID-19 pandemic the initial planning audit was halted mid-March as the Audit Team were forced to withdraw from the Town Hall in line with Government advice and Council staff were diverted to support other areas.

2.5 Following discussions with the External Auditor the following headline dates have been agreed to enable the audit to progress.

Planning Audit	26 October	-	13 November
Financial Statement Audit	24 November	-	18 December

2.6 The External Auditor will present their Audit Plan for the 2019/20 Financial Statements later, on this agenda.

2.7 The next Audit Committee meeting is scheduled for 24th March 2021. It is hoped the audit will be concluded ahead of this date and so to allow the External Auditor to present his Audit Finding Report (ISA260) and allow the Committee to formally review and approve the accounts an additional meeting may be required.

3.0 MATTERS ARISING

3.1 Although still at the early stages of the audit at the time of writing this report that only one significant issue has been raised by the External Auditor in relation to the 2019/20 Financial Statements.

Objection to the 2019/20 Financial Statements

3.2 The External Auditor has received notification of two formal objections to items contained within the 2019/20 Financial Statements from two electors.

3.3 The provisions of the Local Audit and Accountability Act 2014 and National Audit Office Code of Practice affords Local Government Electors, or their representatives an opportunity to make written objections to the External Auditor of an item(s) contain within the Council's accounts.

- 3.4 All objections raised with the External Auditor must be in writing and copied to the Council's s151 Officer and must state the facts on which the Elector relies, the grounds on which the objection is being made and particulars of
- i) any item of account which is alleged to be contrary to law; and
 - ii) any matter in respect of which it is proposed that the auditor could make a public interest report
- 3.5 As a result of the Council's classification of the objector and the processes it has put in place the s151 Officer has not formally received a copy of the objection.
- 3.6 The process by which the External Auditor must follow when considering objections and possible actions are set out within the National Audit Office's Audit Guidance Note 4 Auditors' Additional Powers and Duties (February 2018).
<https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2017/01/Auditor-Guidance-Note-04-Auditors-Additional-Powers-and-Duties.pdf>
- 3.7 Committee Members should be aware that the 2019/20 Audit Fee (£44,959) does not contain an amount for dealing with objections. Although it is hoped the initial review and consideration of the grounds of the objection will be quick and so any costs will be relatively contained, should the auditor accept the objection the resulting cost of any additional investigation will be borne by the Council and may be significant.

4.0 OPTIONS AND OPTIONS ANALYSIS

- 4.1 As the report is for noting no alternative options are put forward, but the Committee could make supplementary recommendations regarding any matters arising.

5.0 CONCLUSION

- 5.1 Members should note the progress and matters arising to date.

<p>CONCLUSION OF IMPACT ASSESSMENT (including Health & Safety, Equality & Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing):</p>
--

<p>No implications directly arising.</p>
--

<p>LEGAL IMPLICATIONS</p>

<p>S27 of the Local Audit and Accountability Act 2014 makes provision for an elector of the Council's area to make an objection to the local auditor in respect of the grounds set out at paragraph 3.4 of this Report. On receipt of an objection the local auditor must decide (a) whether to consider the objection, and (b) if the auditor does so, whether to take action within paragraph (a) and (b) of s27(1) in response.</p>
--

<p>In considering any objection, the auditor will need to have regard to the provisions of the 2014 Act and the code of audit practice applicable to the Council. The Local auditor must in carrying out functions under the 2014 Act, have regard to guidance issued by the Comptroller and</p>
--

Auditor General under paragraph 9 of Schedule 6 of the 2014 Act. This includes the Auditor Guidance Note 4.

An objector aggrieved by a decision of a local auditor not to consider the objection or not to apply for a declaration under s28 of the 2014 Act may within 6 weeks from notification of the decision require the auditor to provide written reasons for the decision and within 21 days from receipt of the written reasons may appeal against the decision to the court.

FINANCIAL IMPLICATIONS

There are no financial implication flowing directly from this report.
However, Member's should be aware of the potential for addition audit fee's that may accrue because of the objection to the financial statements.

OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services, Property, Open Spaces

No implications directly arising.

SECTION 151 OFFICER'S COMMENTS

This report forms part of the Chief Finance Officer's responsibilities, under his role as s151 Officer.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments

BACKGROUND PAPERS

27 August 2020 Draft Statement of Accounts
<https://committeeadmin.lancaster.gov.uk/documents/s77442/Statement%20of%20Accounts%202019-20%20Final.pdf>

Contact Officer: Paul Thompson
Telephone: 01524 582603
Email: pthompson@lancaster.gov.uk
Ref:

AUDIT COMMITTEE**External Audit Plan 2019-20
25 November 2020****Report of Chief Finance Officer****PURPOSE OF REPORT**

To receive details of the External Audit Plan 2019/20

This report is public.

RECOMMENDATIONS**The Audit Committee is recommended**

- To consider the Audit Plan and that any questions be raised with the Deloitte representatives who will be attending the meeting.

1.0 INTRODUCTION

- 1.0 Our external auditors have asked for the documents contained in the appendices to be included on the agenda for this meeting so that Members may give them due consideration.

2.0 DELOITTE DOCUMENTS

- 2.2 Representatives of Deloitte will introduce and explain the documents in the Appendices at the Committee meeting and will be able to answer any questions that Members may have on their contents
- 2.3 A copy of the Audit Plan is attached at Appendix A – Lancaster Council Audit Plan 2020

3.0 OPTIONS AND OPTIONS ANALYSIS

- 3.1 Not applicable – The report is for noting and so no decision is required

**CONCLUSION OF IMPACT ASSESSMENT
(including Health & Safety, Equality & Diversity, Human Rights, Community Safety,
Sustainability and Rural Proofing):**

No implications directly arising.

LEGAL IMPLICATIONS

There are no direct legal implications arising from this report

FINANCIAL IMPLICATIONS

There are no direct financial implications arising from this report

**OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services,
Property, Open Spaces**

No implications directly arising.

SECTION 151 OFFICER'S COMMENTS

The s151 Officer has authored this report in his capacity as Chief Finance Officer

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments

BACKGROUND PAPERS

Appendix A – Lancaster Council Plan 2020

Contact Officer: Paul Thompson
Telephone: 01524 582603
Email: pthompson@lancaster.gov.uk
Ref:



Planning report to the Audit Committee for the year ending 31 March 2020

Issued on 18 November 2020 for the meeting on 25 November 2020

Deloitte Confidential: Government and Public Services- For Approved External Use Only

Contents

01 Planning report

Director introduction	3
Responsibilities of the Audit Committee	5
Our audit explained	6
Scope of work and approach	7
Continuous communication and reporting	9
Materiality	10
Significant risks	11
Value for Money	16

02 Appendices

Fraud responsibilities and representations	19
Independence and fees	21
Fees	22
Our approach to quality	23

Director introduction

The key messages in this report:

I have pleasure in presenting our planning report to the Audit Committee for the 2020 audit. I would like to draw your attention to the key messages of this paper:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

COVID 19

The Local Government accounts timetable has been delayed in 2020 due to the impact of COVID – 19. Draft accounts were submitted in line with the revised 31 August date however, whilst the audit is underway, as reported at the previous meeting of the committee we do not currently expect to complete the audit by the revised deadline of 30 November. The implementation of IFRS 16 has also been delayed into the 21/22 Code due to COVID-19.

Scope of Our Work

Our audit work will be carried out in accordance with the requirements of the Code of Audit Practice ('the Audit Code') and supporting guidance published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General.

The Audit Code sets the overall scope of the audit which includes an audit of the accounts of the Council and work to satisfy ourselves that the Council has made proper arrangements to secure Value for Money (VfM) in its use of resources. There have not been any changes to the Audit Code itself and therefore the scope of our work is broadly similar to the scope of work set in the prior year.

Our responsibilities as auditor, and the responsibilities of the Council are set out in 'PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies' published by Public Sector Audit Appointments Limited.

Director introduction

The key messages in this report (continued):

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

Areas of focus in our work on the accounts

We summarise below the areas of significant risk we have identified to date.

- Valuation of properties – there is significant judgement over the inputs to the valuation. For the 19/20 statement of accounts, the Royal Institute of Chartered Surveyors issued guidance that COVID-19 introduced a material uncertainty over the valuations completed for years ending 31st March 2020. Consequently we anticipate including a emphasis of matter paragraph in our audit opinion in respect of these valuations.
- Cut-off of service line expenditure –there is a risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position. There is a risk that the Council may materially misstate expenditure through manipulating the year end position in order to report a more favourable outturn.
- Management override of controls – auditing standards presume there is a risk that the accounts may be fraudulently misstated by management overriding controls. Key areas of focus are: bias in the preparation of accounting estimates; inappropriate journal entries; and transactions which have no economic substance.

At the planning stage we have not identified the valuation of pension liabilities as a significant risk but we will keep this under review during the audit process once we receive the actuary's report, and as we are aware that there are ongoing legal cases that could potentially impact the level of the liability and could lead to us identifying this as a significant audit risk.

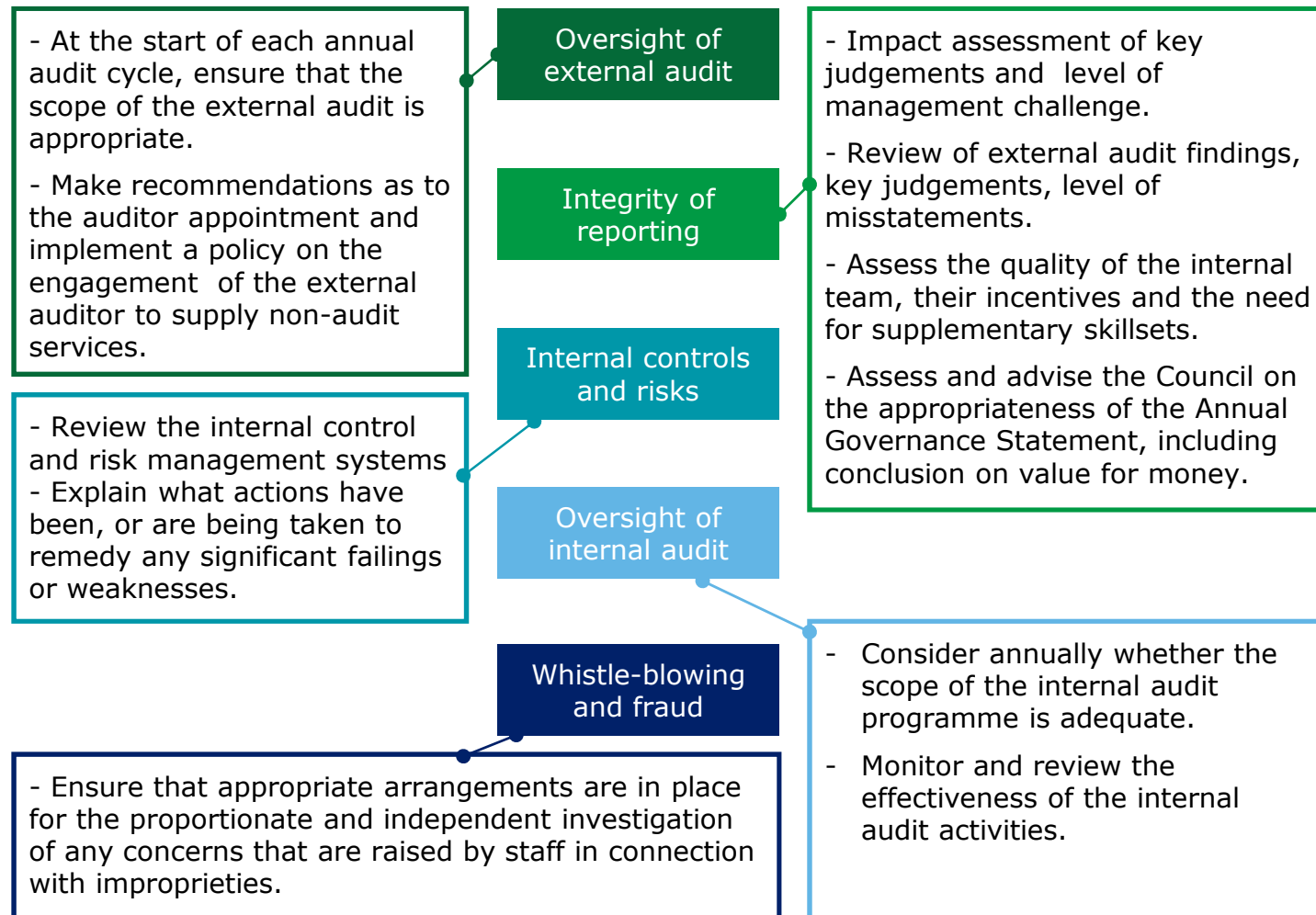
Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit Committee?

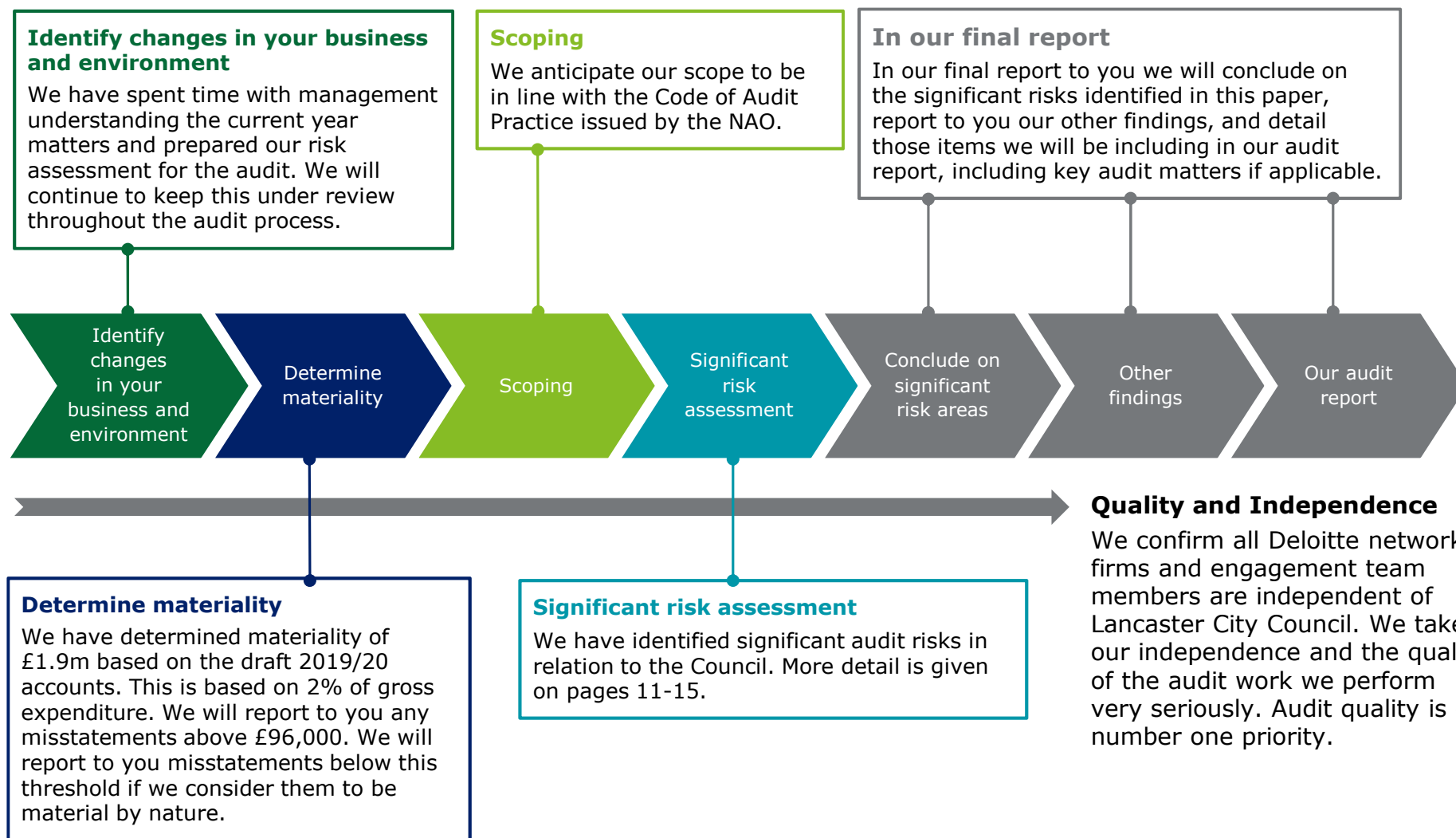


As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.



Our audit explained

We tailor our audit to your business and your strategy



Scope of work and approach

We have four key areas of responsibility under the Audit Code

Financial statements

We will conduct our audit in accordance with the Code of Audit Practice and supporting guidance issued by the National Audit Office ('NAO') and International Standards on Auditing (UK) ('ISA (UK)') as adopted by the UK Auditing Practices Board ('APB').

The Council will prepare its accounts under the Code of Practice on Local Authority Accounting ('the Code') issued by CIPFA and LASAAC.

We report on whether the financial statements:

- Give a true and fair view of the financial position and income and expenditure; and
- Are prepared in line with the Code of Practice on Local Authority Accounting ('the Code').

Opinion on other matters

We are required to report on whether other information published with the audited financial statements is consistent with the financial statements.

Other information includes information included in the Statement of Accounts, in particular the Narrative Report. It also includes the Annual Governance Statement which the Council is required to publish alongside the Statement of Accounts.

In reading the information given with financial statements, we take into account our knowledge of the Council, including that gained through work in relation to the Council's arrangements for securing value for money through economy, efficiency and effectiveness in its use of resources.

Whole of Government Accounts

The National Audit Office have issued guidance in respect of the Whole of Government Accounts. Based upon this guidance we expect that Lancaster City Council will be below the threshold for detailed testing. We will confirm this through our audit work and in our final report to Those Charged With Governance

Value for Money conclusion

We are required to provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We carry out a risk assessment to identify any risks that, in our judgement, have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. The risk assessment enables us to determine the nature and extent of further work which may be required.

We also consider the impact of findings from other inspectorates, review agencies and other relevant bodies on their risk assessment, where they are relevant and available.

Our responsibilities as auditor, and the responsibilities of the Council, are set out in 'PSAA Statement of Responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies' published by PSAA.

Scope of work and approach

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council complete the Code checklist during drafting of their financial statements.

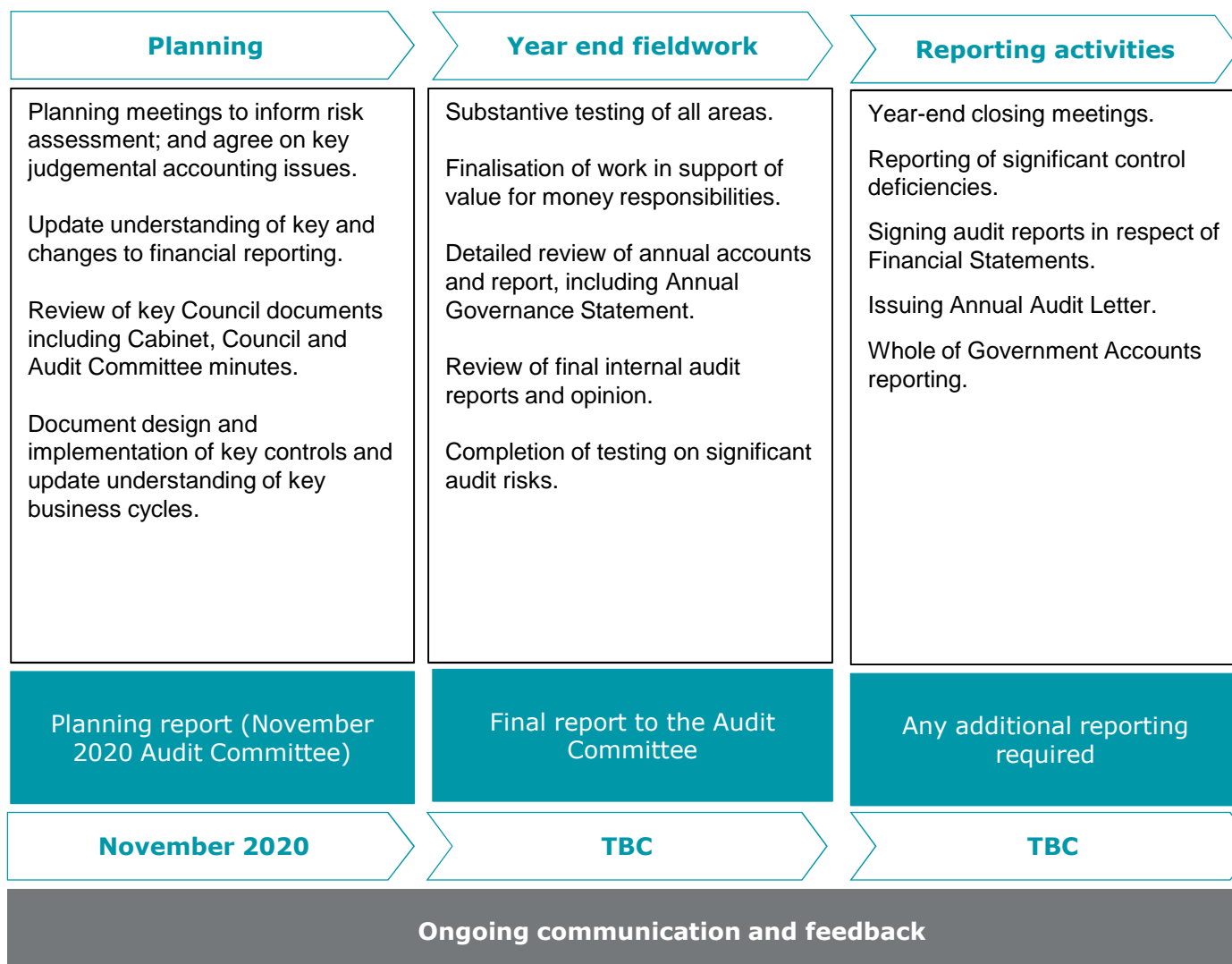
Value for Money and other reporting

The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.



Materiality

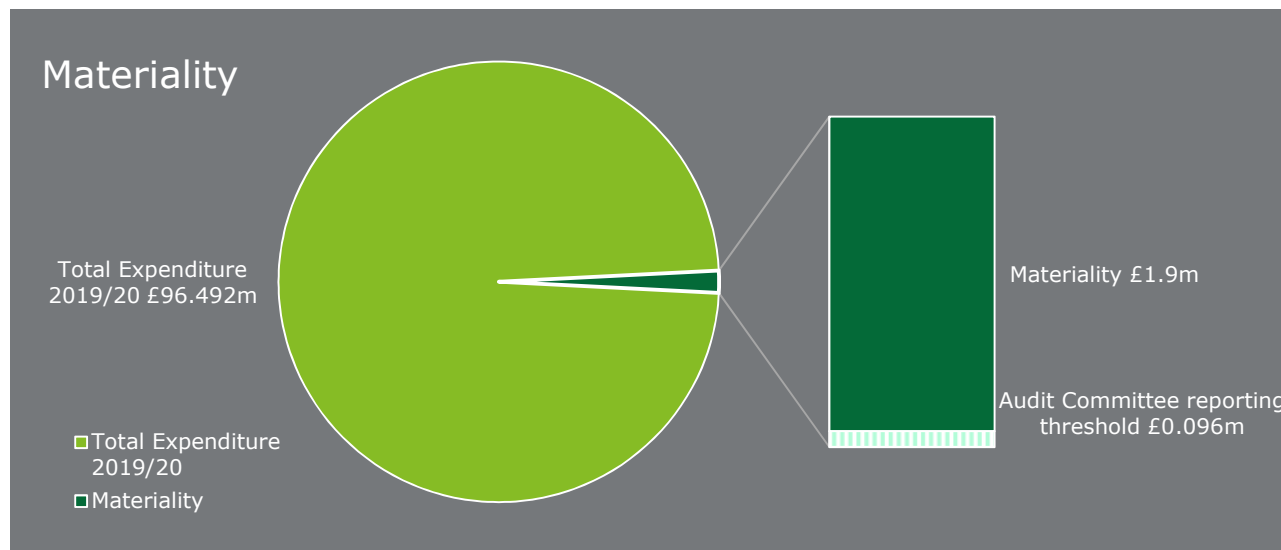
Our approach to materiality

Basis of our materiality benchmark

- The audit director has determined materiality as £1.9m, based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of Total Expenditure excluding expenditure on Taxation and Non-Specific Grant Expenditure based on the 2019/20 draft accounts as the benchmark for determining materiality.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £0.096m.
- We will report to you misstatements below this threshold if we consider them to be material by nature.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Significant risks

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality; and
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements.

The next page summarises the significant risks that we will focus on during our audit.

We note however that some of the items included within note 4 of the accounts may not meet the definition as set out in IAS 1 and we invite management to critically consider this disclosure. We further suggest that management consider whether the impact of COVID-19 be included in this disclosure.

Principal risk and uncertainties highlighted in the Annual Governance Statement

- Risk management and information governance

IAS 1 Critical accounting estimates (note 4)

- Property Valuations
- Property, plant and equipment depreciation
- Pension liabilities
- Fair Value Measurement
- Provision for NNDR Appeals
- Provision for debtors
- Impact of Brexit on asset values and pension liability













Changes in your business and environment

- Ongoing impact of COVID 19
- Local Government Reorganisation
- Internal Reconfiguration





Significant risks


Significant risk dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Management paper expected	Slide no.
Cut-off of service line expenditure			D+I			13
Property Valuations			D+I			14
Management Override of Controls			D+I			15

D+I: Assessing the design and implementation of key controls

 Low level of management judgement

 Moderate level of management judgement

 High level of management judgement

Significant risks

Risk 1 – Cut-off of service line expenditure

Risk identified

Under UK auditing standards, there is a presumed risk of revenue recognition due to fraud. We have rebutted this risk, and instead believe that a fraud risk lies with the completeness of service line expenditure manifest through early cut off of expenditure. We identify this as expenditure excluding payroll costs, depreciation and amortisation and housing benefit expenditure as this is grant backed and for which it is judged there is no incentive for manipulation.

There is an inherent fraud risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position.

There is a risk that the Council may materially misstate expenditure through manipulating the year-end position in order to report a more favourable outturn.

Our response

Our work in this area will include the following:

We will obtain an understanding of the design and implementation of the key controls in place in relation to ensuring appropriate cut-off of service line expenditure (excluding payroll, depreciation and amortisation, and expenditure which is grant backed);

We will perform focused testing in relation to the enforcement of cut-off of service line expenditure (excluding the areas set out above); and,

We will review and challenge the assumptions made in relation to year-end estimates and judgements to assess completeness and accuracy of recorded service line expenditure.

Significant risks

Risk 2 – Property Valuation

Risk identified

The Council held £238.4m of property assets at 31 March 2019 which, as set out in the draft financial statements increased to £239.0m as at 31 March 2020. Included within this increase are net adjustments due to valuations of £1.187m. In addition the authority hold £28.3m of investment properties which increased by £18k due to revaluations in the year.

The Audit Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years.

Furthermore the Council completed the valuation as at the 1 April 2019. Any changes to factors used in the valuation process could materially affect the value of the Council's assets as at year-end.

The level of judgement required in arriving at asset valuations, coupled with both the issues detected in the prior year and the impact of Covid – 19 on valuations completed as at 31 March 2020 leads us to conclude that there is a risk that that the value of property assets, including investment property, may be materially misstated.

Our response

We will test the design and implementation of key controls in place around the property valuation, and how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation;

We will review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;

We will use our valuation specialists, Deloitte Real Estate, to support our review and challenge the appropriateness of the Council's assumptions and judgements on its assets values.

We will test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts.

Using appropriate indices we will evaluate whether assets not revalued are stated at a value materially different to their fair value.

Significant risks

Risk 3 – Management override of controls

Risk identified

In accordance with ISA 240 (UK and Ireland) management override of controls is a significant risk for all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions. The key judgements in the financial statements include those which we have selected to be the significant audit risks, (completeness and cut-off of service line expenditure and the Council's property valuations) and any one-off and unusual transactions where management could show bias. These are inherently the areas in which management has the potential to use their judgement to influence the financial statements.

Our response

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

- We will test the design and implementation of key controls in place around journal entries and key management estimates;
- We will risk assess journals and select items for detailed testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest;
- We will review accounting estimates for biases that could result in material misstatements due to fraud; and,
- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

Value for Money

Risk assessment process

We are required to provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

The Code and supporting auditor guidance note require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk – if we do not identify any significant risks, there is no requirement to carry out further work.

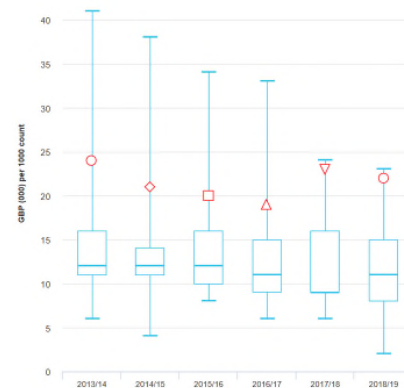
Our risk assessment procedures include:

- Reading the annual governance statement
- Considering local and sector developments and how they impact on the Council
- Reviewing the audit report from 2018/19
- Discussing issues such as the response to Covid - 19 with senior officers
- Reviewing reports issued by internal audit
- Reviewing other documentation of the Council including budget setting reports, financial and operational performance monitoring reports
- Understanding the arrangements in potential areas of significant risk
- Reviewing reports issued by regulators.

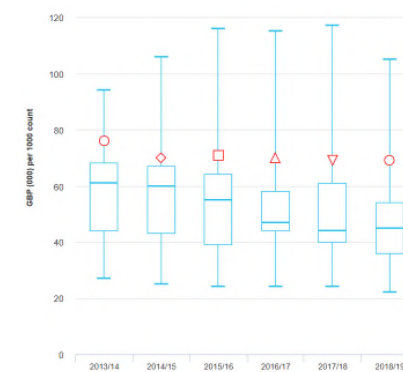
Whilst at this stage we have not identified any significant Value for Money risks certain areas of expenditure have been identified which we will investigate further as our evaluation of the risks develops. The metrics identified are;

- Total Expenditure on Council Tax Benefits and Housing Benefits Administration per head
- Total Expenditure on Culture and Sport per head

For each of these areas we will require management to provide an analysis of their understanding of the reason the Council is an outlier together with evidence that the level of spend can be considered commensurate with observed outcomes.



Council Tax Benefits and Housing Benefits Administration per Head



Expenditure on Culture and Sport per head

Use of Auditor Powers under Local Audit and Accountability Act

Objections to the financial statements

We are in receipt of two objections to the draft financial statements raised by electors.

Our work to date has confirmed that the objections are eligible under the terms of Auditor Guidance Note 03 and we are currently reviewing the substance of the objections to determine whether they should be accepted for further investigation.

We have made enquiries of your S151 officer, Monitoring Officer and Solicitor and will make further enquiries as necessary to conclude whether to accept these objections.

Guidance upon the process to be followed by the Appointed Auditor in respect of objections can be found in Auditor Guidance Note 04 published by the National Audit Office.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes our audit plan, including key audit judgements and the planned scope.

Use of this report

This report has been prepared for the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

Deloitte LLP

Newcastle | November 2020

Fraud responsibilities and representations

Responsibilities explained



Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.



Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in expenditure and management override of controls as key audit risks for your organisation.



Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Council:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- [We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.]
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

Internal audit



- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance



- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

Independence and fees



As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2020 in our final report to the Audit Committee.
Fees	Our audit fees are set out on the following page. There are no non-audit fees.
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Fees

The professional fees expected to be charged by Deloitte in the period from 1 April 2018 to 31 March 2020 are as follows:

	2019/20	2018/19
	£	£
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment	44,959	44,959
Overrun (as approved by PSAA)	-	37,534
Total audit	44,959	82,493
Total fees	44,959	82,493



Our approach to quality

AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our Audit Quality Monitoring and Measuring programme. In July 2019 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2018/19 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality. We have further transformed our internal review processes including a new focus for reviewing in progress audits, developing our Audit Quality Indicators ('AQI') which are monitored and reported to the firm's executive, and on enhanced remediation procedures.

Whilst we are pleased that overall our quality record, as measured by external inspections, has improved from 76% to 84%, we remain committed to continuous improvement and achieving as a minimum the 90% benchmark across all engagements. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions. We are also pleased to see the impact of our previous actions on impairment, group audits and contingent liability disclosures reflected in the audits under review and there being limited or no findings in those areas. These continue to be a focus in our training, internal coaching and internal review programmes.

We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

The AQR's 2018/19 Audit Quality Inspection Report on Deloitte LLP

"We assessed 84% of the firm's audits that we reviewed as requiring no more than limited improvements, compared with 76% in 2017/18. Of the FTSE 350 audits we reviewed this year, we assessed 75% as achieving this standard compared with 79% in 2017/18. We note that our inspection results show only modest improvements in audit quality."

"We had no significant findings arising from our firm-wide work on internal quality monitoring, engagement quality control reviews and independence and ethics."

"Our key individual review findings related principally to the need to:

- Exercise greater professional scepticism in the audit of potential prior year adjustments and related disclosures in the annual report and accounts.
- Strengthen the extent of challenge of key estimates and assumptions in key areas of judgement, including asset valuations and impairment testing.
- Improve the consistency of the quality of the firm's audit of revenue.
- Achieve greater consistency in the audit of provisions and liabilities."

"The firm has enhanced its policies and procedures during the year in a number of areas, including the following:

- Through the firm's global audit quality programmes, there has been an increased focus on consistency of audit work across the audit practice. For certain account balances, standardised approaches have been adopted, further use has been made of centres of excellence and delivery centres and new technologies embedded into the audit process to support and enable risk assessments, analytical procedures and project management activities.
- Further methodology updates and additional guidance and training for the audit practice covering group audits, accounting estimates, financial services (including the adoption of IFRS 9) provisions and contingencies and the evidencing of quality control procedures (including EQCR) on individual audits.
- Increased support for audit teams throughout the audit cycle including coaching programmes for teams and greater use of diagnostics to monitor progress.
- Continued focus on the approach to the testing of internal controls. The firm provided additional training and support to audit teams adopting a controls-based audit approach, increased focus on reporting to Audit Committees on internal controls and on the wording of auditor's reports."

This document is confidential and it is not to be copied or made available to any other party. Deloitte LLP does not accept any liability for use of or reliance on the contents of this document by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities).

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

AUDIT COMMITTEE**Financial Reporting Council
Major Local Audits – Audit Quality Local Inspection
25 November 2020****Report of Chief Finance Officer****PURPOSE OF REPORT**

This report seeks to provide Members with information on the recently released Financial Reporting Council (FRC) Major Local Audits – Audit Quality Local Inspection report.

This report is public.

RECOMMENDATIONS

The Audit Committee is recommended

- (1) **To note the report**

1.0 INTRODUCTION

- 1.1 The Financial Reporting Council (FRC) is the independent body responsible for monitoring the quality of Major Local Audits, as defined by the Local Audit (Professional Qualification and Major Local Audit) Regulations 2014.
- 1.2 The reviews are performed by the FRC's Audit Quality Review (AQR) team contributes to safeguarding and promoting improvement in the overall quality of Local Audit auditing in the UK.

2.0 BACKGROUND

- 2.1 The report sets out the principal findings arising from the 2019/20 inspection of the audit firms completing major local audits in England carried out by AQR. An audit qualifies as "major" if the Authority has total income or expenditure of more than £500M.
- 2.2 The report is based on a total of 12 reviews of 2018/19 audits across the whole of local government and three from the NHS, covering each of the appointed audit firms. The sample size is low, but the reviews did cover the firms' overall policies and procedures as they applied at each audit.

2.3 Currently there are seven audit firms contracted to undertake such audits and these are listed below with the corresponding number of reviews undertaken reflecting market share.

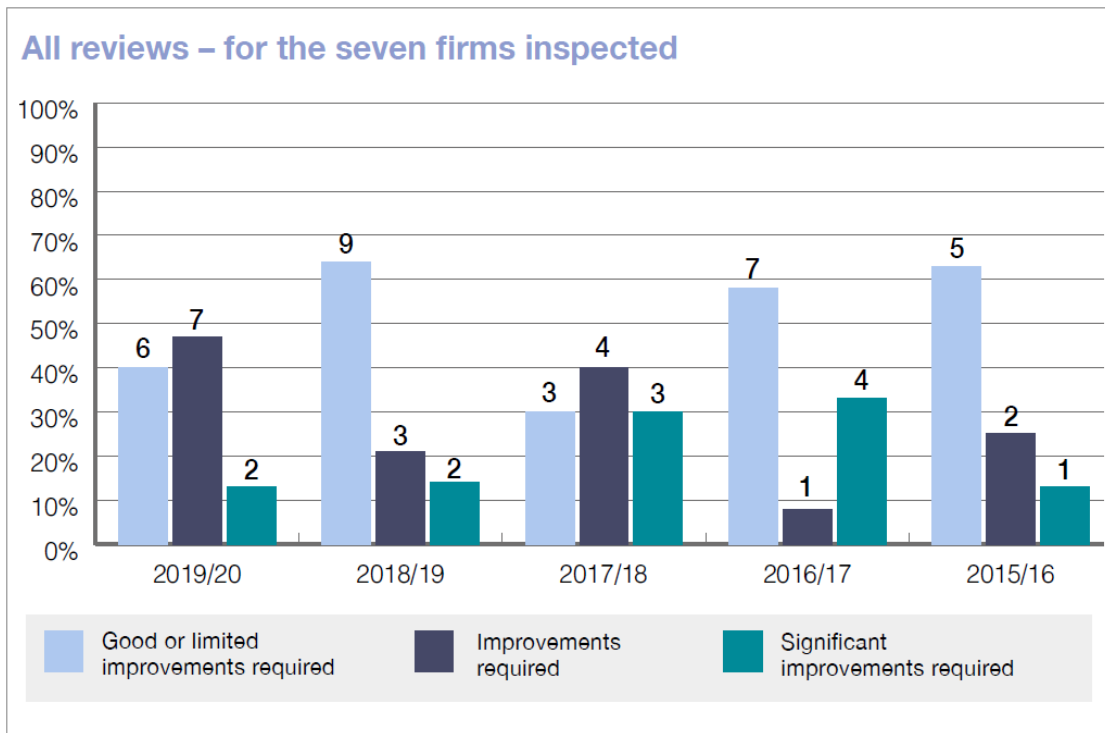
Audit Firms	Number of		Reviewed by
	Local Major	Market Share	
	Audits		AQR
Grant Thornton UK LLP	109	40.2%	6
Ernst & Young LLP	72	26.6%	3
Mazars LLP	42	15.5%	2
KPMG LLP	25	9.2%	1
BDO LLP	12	4.4%	1
Deloitte LLP	10	3.7%	1
PwC LLP	1	0.4%	1
	271	100%	15

3.0 SUMMARY OF FINDINGS

Financial Statements Audit

3.1 Only six of the 15 reviews concluded that the audit was good or required limited improvement with nine failing to reach an acceptable level.

Table 1



3.2 Grant Thornton and Mazars were identified for particular criticism and must now perform a Root Cause Analysis of the issues identified and put in place an audit quality action plan.

3.3 The key areas for attention in the financial statements audit were:

- Valuation of property (including investment property)
- Multi-employer pension deficits
- Occurrence and completeness of expenditure
- First year audit procedures
- The impairment of receivables
- The fraud risk assessment and responses.

3.4 Some of the key findings within the report are:

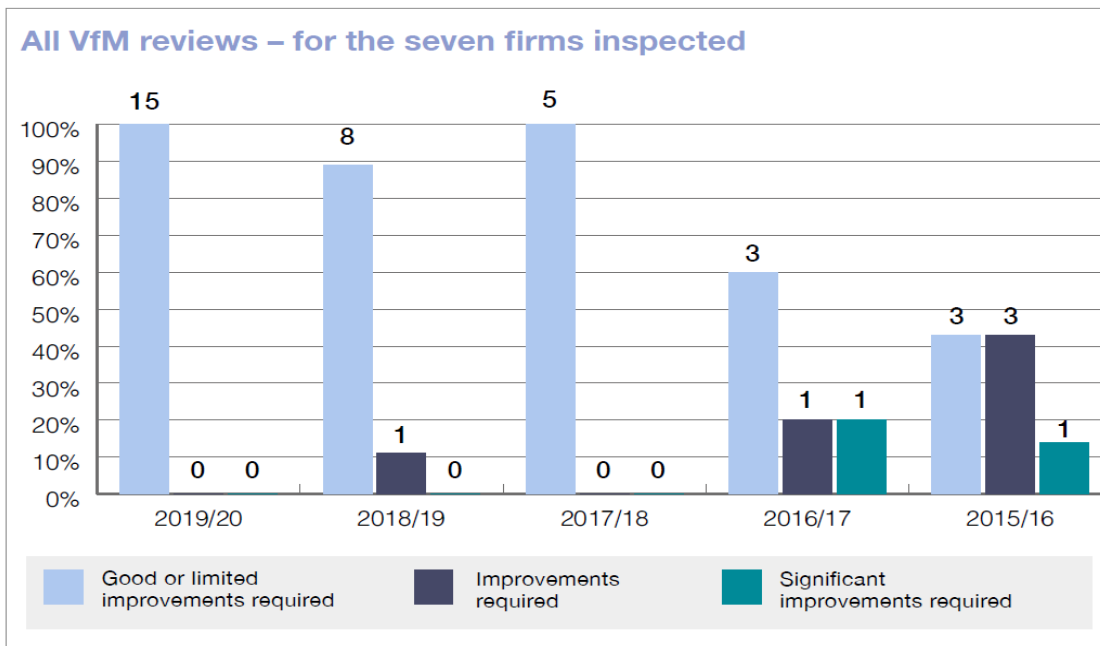
- Significantly strengthen audit procedures and challenge of management and their own valuation experts in the testing of property revalued in the year.
- Improve the level of evidence obtained over amounts receivable, particularly sample sizes and the assumptions used to value expected credit losses for financial receivables.
- Strengthen the audit response to the risk of fraud arising from management override of controls, particularly in relation to journal entry testing.
- Improve consideration of the risk of fraud in expenditure recognition and the extent of testing around the completeness and occurrence of expenditure.
- Design and execute appropriate audit procedures to assess the estimates used to determine liability provisions.
- Enhance the procedures over defined benefit pension arrangements, with improvements in the sufficiency of audit work performed over pension fund assets.
- Improve the evidence of judgements taken in the exercise of special reporting powers (statutory recommendation and public interest reports).

3.5 As the audit of the 2019/20 Financial Statements is currently underway, we expect challenge in these areas.

Value for Money (VFM)

3.6 Work on the VFM conclusion was graded good or requiring limited improvement at all 15 audits.

Table 2



- 3.7 Members will recall from the meeting 19 February 2020 that all audit firms will need to comply with the new National Audit Office (NAO) Code of Practice, which will be applicable for the 2020/21 Financial Statements. The new Code of Practice has changed the scope and auditors' work on VfM arrangements. AQR will continue to monitor VfM arrangements for one further inspection review before monitoring the audit of VfM arrangements under the new Code.
- 3.8 The FRC also undertake thematic inspections to supplement their annual process. Recent reviews have included the use of audit quality indicators, the use of technology in the audit, culture, and materiality. A copy of the Major Audits report is attached at Appendix A with further information on the thematic reviews and individual firms available on the FRC's website <https://www.frc.org.uk/auditors/audit-quality-review>

4.0 OPTIONS AND OPTIONS ANALYSIS

- 4.1 Not applicable – The report is for noting and so no decision is required

5.0 CONCLUSION

- 5.1 High quality audit is essential to maintain confidence by providing an independent, impartial view of the Council's financial statements and arrangements in place to secure value for money. Poor auditing may fail to alert management, the public and other stakeholders to material misstatements (including those arising from fraud) or financial control weaknesses, in those cases where management have not identified or appropriately amended them.

**CONCLUSION OF IMPACT ASSESSMENT
(including Health & Safety, Equality & Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing):**

No implications directly arising.

LEGAL IMPLICATIONS

There are no direct legal implications arising from this report

FINANCIAL IMPLICATIONS

There are no direct financial implications arising from this report

OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services, Property, Open Spaces

No implications directly arising.

SECTION 151 OFFICER'S COMMENTS

The s151 Officer has authored this report in his capacity as Chief Finance Officer

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments

BACKGROUND PAPERS

Appendix A - FRC-LA-Public-Report-30-10-20

Contact Officer: Paul Thompson

Telephone: 01524 582603

Email: pthompson@lancaster.gov.uk

Ref:

MAJOR LOCAL AUDITS

AUDIT QUALITY INSPECTION

OCTOBER 2020

The FRC

Our purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them.

transparency



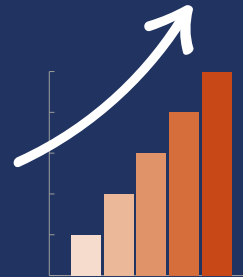
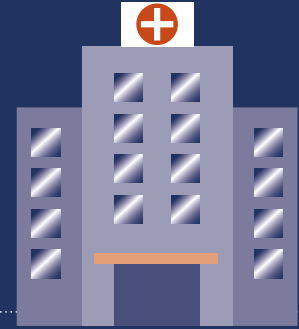
We have responsibility for the public oversight of statutory auditors.

The FRC engages with key Local Audit stakeholders, such as MHCLG, NAO, ICAEW, CIPFA and PSAA in order to contribute to sector-wide initiatives and governance.

Engage

AQR

We monitor the quality of the larger Local Audits ("Major") including health and local government bodies.



We promote continuous improvement in audit quality.

Our team of over 50 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms completing local audits.

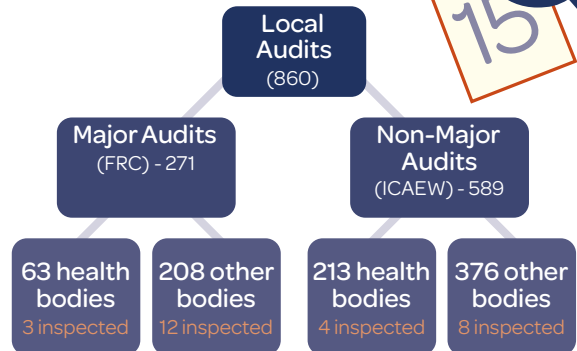


The Firms

Audit firms undertaking local audits	Number of Major Local Audits (within the scope of AQR inspection) ¹	Market Share %	Reviewed by AQR in 2019/20
Grant Thornton UK LLP	109	40.2%	6
Ernst & Young LLP	72	26.6%	3
Mazars LLP	42	15.5%	2
KPMG LLP	25	9.2%	1
BDO LLP	12	4.4%	1
Deloitte LLP	10	3.7%	1
PwC LLP	1	0.4%	1
Total	271		15

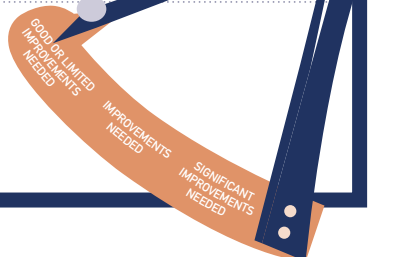
¹ From data provided by the firms to the FRC in Q1 2019

Our inspection process



We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

We assess the overall quality of the audit work inspected.



The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

We consider all reviews assessed as requiring improvements or significant improvements against the Regulated Framework for Auditing and under the Auditor Regulatory Sanctions Procedure (<https://www.frc.org.uk/auditors/audit-quality-review/auditor-regulatory-sanctions-procedure>). Where findings indicate that the Registered Auditor has failed to comply with the Framework, the FRC Enforcement Committee can sanction an audit firm for such breaches under the procedures or may refer the conduct in question for consideration under the FRC Accountancy Scheme or the disciplinary procedures of the relevant RSB.

Financial Reporting Council

Major Local Audits

Audit Quality Inspection

Contents

1	Overview	4
	Introduction	6
2	Review of individual firms	13
3	Other matters	22
	Appendix 1: Key local audit information	23
	Appendix 2: Firms' internal quality monitoring and ICAEW results	25

The FRC is the independent body responsible for monitoring the quality of Major Local Audits¹, as defined by the Local Audit (Professional Qualification and Major Local Audit) Regulations 2014. This monitoring is performed by the FRC's Audit Quality Review ('AQR') team. Our reviews of individual Major Local Audit engagements are intended to contribute to safeguarding and promoting improvement in the overall quality of Local Audit auditing in the UK. Audit firms are required to audit the financial statements and Value for Money ("VfM") arrangements conclusion and exercise their statutory reporting powers, as required, in accordance with the Local Audit and Accountability Act 2014.

This report sets out the principal findings arising from the 2019/20 inspection of the seven audit firms completing major local audits in England ("the firms") carried out by AQR. We conducted the inspection between December 2019 and September 2020 ("the time of our inspection"). From 2019/20 onwards we are responsible for inspecting all firms involved with major local audits and will report publicly on our findings, annually.

Our report focuses on the key areas requiring action across the firms, in relation to major local audits, to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the various firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the various firm's policies and procedures which support and promote audit quality.

High quality audit is essential to maintain stakeholder confidence by providing an independent, impartial view of a major local audit body's financial statements and arrangements in place to secure value for money. Poor auditing may fail to alert management, the public and other stakeholders to material misstatements (including those arising from fraud) or financial control weaknesses, in those cases where management have not identified or appropriately amended them.

The combination of management not meeting their responsibilities in this respect and poor auditing could potentially put resources and jobs at risk. We have commented upon our engagement with Audit Committee Chairs on page 8. High quality audit matters and we will drive all audit firms to implement the necessary changes to reach the required standards.

Of the 15 audits and VfM arrangements conclusions that we reviewed in the year across all firms, three were health bodies, two were other bodies and ten related to Local Government Authorities. This included: London Boroughs – 4, County Councils – 3, and 1 each of City, Borough and Metropolitan Borough Councils. We paid particular attention to the following areas of focus: valuation of property (including investment property), multi-employer pension deficits, occurrence and completeness of expenditure, first year audit procedures, the impairment of receivables and the fraud risk assessment and response thereto.

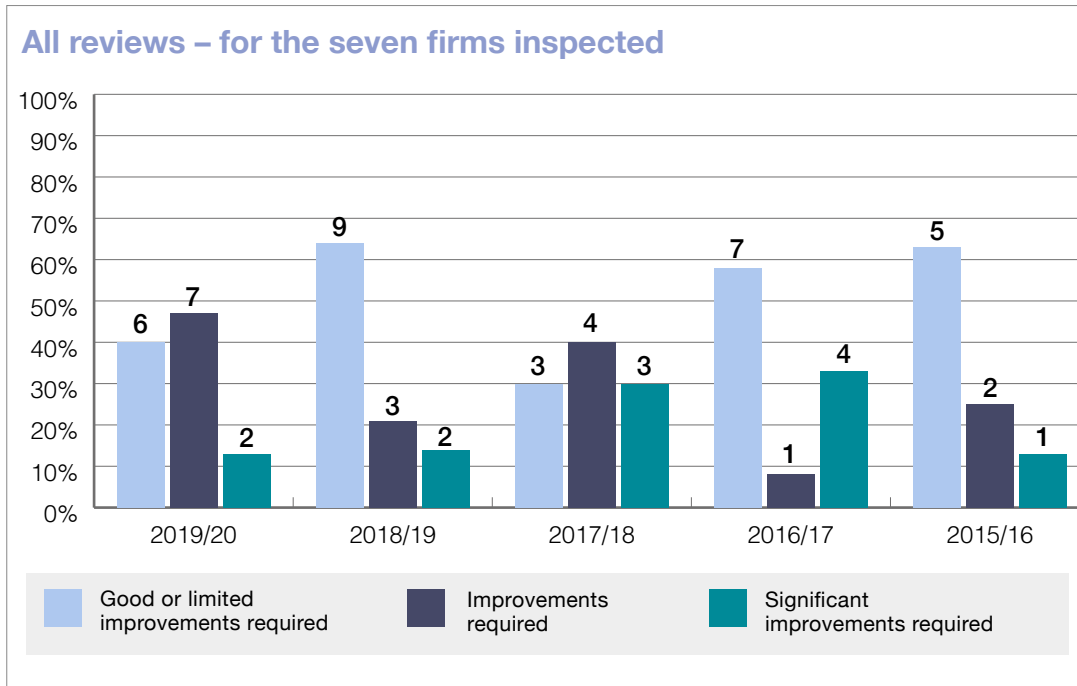
¹ The definition of a major local audit is one which meets the following criteria:

- Total income or expenditure of at least £500 million; or
- For a Local Authority pension scheme, at least 20,000 members or gross assets in excess of £1,000 million.

1 Overview

Our assessment of the quality of audits reviewed

Financial statements audit



An audit is assessed as good or limited improvements required where we identified either no or only limited findings or concerns to report. Improvements required indicate that more substantive improvements were needed in relation to one or more key findings. Significant improvements required indicate we had significant concerns, typically in relation to the sufficiency or quality of audit evidence or the appropriateness of key audit judgements. The quality results for 2015/16 to 2018/19 above and in the VfM chart below include local audit inspection work completed by the FRC on a consistent basis to 2019/20, but under contract to Public Sector Audit Appointments Limited (PSAA) and reported publicly by them.

The purpose of the annual financial statements is to give members of the public, electors, those subject to locally levied taxes and charges, elected members, employees and other interested parties clear, reliable information about a local audit body’s finances. This allows users to understand the financial position of the Body and have confidence in the Body’s stewardship of public money and that it has been used and accounted for in an appropriate manner.

The overall results for our inspection of 15 financial statement audits across the seven firms are concerning, with just 40% of audits requiring no more than limited improvement (64% in 2018/19).

Urgent action is required from some of the firms to take appropriate action to respond to our findings to ensure improvements are made in audit quality, given the deterioration in quality in the year.

There were nine audits (60%), that required improvements, which is unacceptable. Furthermore, from our firmwide work, we identified that the proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit. These are extremely high levels and all firms need to consider the causes of this and what changes in their audit approach might be required.

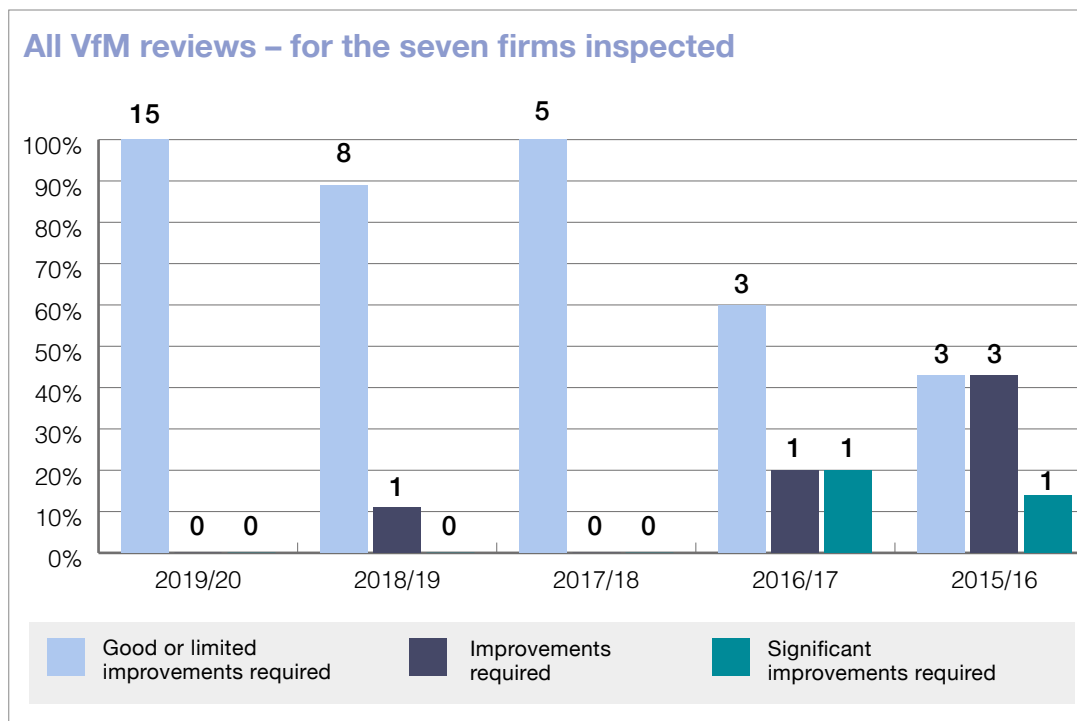
The audits of the local audit bodies’ 31 March financial year end accounts are reviewed in the subsequent financial year’s FRC inspection cycle (i.e. 31 March 2019 year ends were reviewed by the FRC in the 2019/20 inspection cycle.)

The results of our reviews at some individual firms have been encouraging with no more than limited improvements identified.

We completed 15 audit reviews in 2019/20, more than in previous years. However, resourcing pressures meant that we did not meet our target of 20 reviews.

Changes to the proportion of audits falling within each grading category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our inspections are also informed by the areas of focus referred to above. For these reasons, and given the sample sizes involved, our inspection findings may not be representative of audit quality across a firm’s entire major local audit portfolio; nor do small year-on-year changes in results necessarily indicate any overall change in audit quality at the firm. Nonetheless, any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.

Value for Money Arrangements Conclusion



Based on our reviews, the quality of VfM conclusion work across all firms remains high. All 15 reviews were assessed as either good or requiring limited improvements and, unlike the prior year, no reviews were graded as requiring improvement. Over time, we have raised few findings over the firms’ work in this area.

Audit firms will need to comply with the new National Audit Office (NAO) Code of Practice, applicable for the first time to 31 March 2021 year-end financial statements, which has changed the scope and auditors’ work on VfM arrangements. AQR will continue to monitor VfM arrangements for one further inspection review before monitoring the audit of VfM arrangements under the new Code.

Introduction

Under a new local audit monitoring regime implemented by the Local Audit and Accountability Act 2014, the monitoring of audits of all local bodies has now fully transitioned from the PSAA to the FRC and Recognised Supervisory Bodies.

The FRC has a statutory responsibility for monitoring the quality of major local audits, in England and does so through its AQR team. The monitoring of the audits of non-major local bodies is the responsibility of the accountancy bodies recognised for these purposes by the Secretary of State under statute.

The transition of monitoring of major local audits from PSAA to the FRC started on 1 April 2017, in two phases: initially only for health bodies in respect of financial years ending 31 March 2018; and then for all local audit bodies (largely local government bodies) in respect of their 31 March 2019 financial year end.

This is therefore the first time the FRC has reported publicly on major local audit quality, arising from its inspection activity of financial years ended 31 March 2019.

²Reviews by Recognised Supervisory Bodies are overseen by the FRC's Professional Oversight Team, and such oversight activity is reported on separately.

Scope of AQR Audit Quality Inspections

Our scope included reviewing both the audit of the financial statements and the conclusion on arrangements to deliver value for money for each audit selected in 2019/20. We report on this work in the following section.

Our selection of audits for review provided coverage of each audit firm and considered various other risk factors including: the results of previous inspections, the financial position/reserves and activities of certain bodies, results from inspections by other regulatory bodies and issues identified in a body's financial statements, including auditor opinions.

We aim to cover the population of major local audits with the same average frequency as our other Companies Act inspection activities.

Overview of our inspection work

Six (40%) of the 15 audits reviewed in our 2019/20 inspection cycle, across the seven firms, required no more than limited improvements. The number of audits requiring improvements, nine (60%), is unacceptable.

Furthermore, from our firmwide work, we identified that the proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit. These are extremely high levels and all firms need to consider what caused the adjustments and what changes in their audit approach might be required.

² Details of the scope and results of the ICAEW inspections are presented in Appendix 2

Overall, some firms are still not consistently achieving the necessary level of audit quality and therefore need to make further progress. For two firms, GT and Mazars, the level of audit quality requires significant improvement, and those firms should perform a detailed Root Cause Analysis (“RCA”) of the issues we have identified and put in place an audit quality action plan across local audits.

Over the past five years, most of the findings leading to reviews requiring more than limited improvements have been in the areas of: property and pension valuation; completeness and occurrence of expenditure; fraud risk assessment and the associated audit response to those risks; engagement quality control review and audit testing over material balances such as deferred income, PFI arrangements and amounts receivable. These findings often related to insufficient challenge of, and standing up to, management in areas of complexity and forward-looking judgement.

At a firmwide level, some firms have made improvements and we have observed good practices such as, increased use of internal specialists for property and pension valuation, improved workpapers to record evidence of challenge of management and better VfM risk assessments.

We have also seen some instances of good practice from our 2019/20 inspections, and we have seen an example where an audit team delayed its reporting where there were significant concerns over areas of audit judgements. Firms’ senior management need to be clear that taking difficult decisions is an appropriate response to improving audit quality. The tone from the top needs to support a culture of challenge and back auditors making tough decisions.

We are also able to report positively that the VfM quality assessment across all firms has continued to improve and all audits reviewed were assessed as requiring no more than limited improvements. This is a pleasing aspect to the firms’ work, providing assurance to stakeholders around the VfM conclusions.

We take robust action for all reviews assessed as requiring improvements or significant improvements and will consider all audits assessed as requiring improvements or worse, for consideration of possible enforcement action.

As part of our strategy to improve audit quality, we are increasing our focus on proactive supervision of the largest seven audit firms alongside an enhanced programme of audit inspections. We will identify those priority areas to improve audit quality, request the firms to implement suitable actions to achieve them and hold the firms accountable for delivery.

We wrote to the major audit firms in December 2019³ setting out elements that we observe consistently on high quality Companies Act audits, especially on high risk engagements. The hallmarks of such audits apply equally to local audits and specific areas of focus should include:

- Significant involvement of partner and other senior team members.
- Good use of specialists.
- Consultation on complex areas.

3 [https://www.frc.org.uk/news/december-2019-\(1\)/letter-to-audit-firms-on-high-quality-audits](https://www.frc.org.uk/news/december-2019-(1)/letter-to-audit-firms-on-high-quality-audits)

- Challenge of management leading to changes where assumptions are too optimistic.
- Robust quality control procedures.
- Clear and timely communication to Audit Committees.

We are moving ahead with plans to increase the transparency of our audit quality assessments through publishing the scope and key findings of each of our individual audit inspections subject to statutory restrictions on disclosure without consent of confidential information. We aim to publish our first set of these reports next year alongside the annual report on local audit.

We recognise the challenges posed currently by the Covid-19 pandemic, both in relation to the level of uncertainty surrounding reliable external valuations and forward estimates, assessment of going concern, inability to carry out physical procedures (for example, stocktakes and other audit work) and assessing management's medium term budgeting plans and savings in order to ensure appropriate arrangements are in place to deliver value for money. We are aware that the National Audit Office has published guidance to auditors for going concern and VfM arrangements and we will consider such matters carefully during our 2020/21 inspection cycle.

Engagement with those charged with governance

We aim to engage in a two-way process to assist those charged with governance in ensuring the highest levels of audit quality and holding their auditors to account.

AQR met with or spoke to all Audit Committee Chairs, or other persons responsible for governance, for all 15 audits selected for review. Initial discussions focused on the role of the Chair, areas of risk they focus upon and any concerns over the audit process. Following our reviews, we sent a private report to each Chair and we plan to meet the Chair again where the quality of the audit was assessed as requiring more than limited improvement.

Audit selections

In 2019/20 we selected for inspection an increased number of audits with higher risk attributes. We define audits as higher risk where the Body: is a higher-risk category or geographic location; is experiencing financial difficulties or reducing levels of financial reserves; has balances with high estimation uncertainty; or the auditor has identified governance or internal control weaknesses. Higher-risk engagements frequently require audit teams to assess and conclude on complex judgemental issues.

We accept that our increased focus on higher-risk audits means that the grade profile of our inspection findings may be less representative of audit quality across the whole portfolio of an audit firm. The change in our approach to audit selection over time also means that historical comparisons of results need to be treated with care.

Reviews of individual audits

Our key findings covered a variety of areas of the firms audits, including audit work over both balance sheet and income and expenditure line items and the response to fraud, effectiveness of Engagement Quality Control review and use of reporting powers. The areas for improvement are set out below:

1.1 Financial statement audit

Significantly strengthen audit procedures and challenge of management and their own valuation experts in the testing of property revalued in the year

Local audit properties are usually the largest asset on a balance sheet and their accurate valuation helps to ensure consistency for the Whole of Government Accounts (WGA), provides a measure of the governance and management of property assets and enables effective medium term property decisions to be made for the benefit of stakeholders.

The quality of audit work over property valuations continues to be our area of greatest concern and where all firms must focus on improvement, some urgently. This covers all of Council dwellings, specialised and investment properties. Improvements are needed in the audit work over completeness and appropriateness of council dwelling beacon valuations, the challenge and corroboration of valuation assumptions and properties not revalued in the year.

We also identified instances where audit teams did not test the completeness and accuracy of the source data provided to, and used by, management's expert when valuing property.

Improve the level of evidence obtained over amounts receivable, particularly sample sizes and the assumptions used to value expected credit losses for financial receivables

The calculation of expected credit loss in local government bodies involves significant management judgement and estimation uncertainty, with the aggregate amount for impairment loss representing a material proportion of gross receivables. Auditors need to perform additional procedures to conclude that the credit losses were complete and accurate, together with source data used by management.

Strengthen the audit response to the risk of fraud arising from management override of controls

Journal entry testing is a key audit procedure to address the risk of fraud. Auditors should undertake appropriate procedures to assess the risks and design procedures to test a sample of journals for fraud risk characteristics. We identified audits with insufficient evidence supporting: the sufficiency of fraud risk characteristics when profiling and testing journals; the rationale for not testing certain types of journals and how audit teams were able to conclude that testing a small number of journals was sufficient to address the fraud risk.

Improve the consideration of the risk of fraud in expenditure recognition and the extent of testing around the completeness and occurrence of expenditure

In the public sector, auditors should focus on the risk of fraud and error on expenditure. The validity of recorded expenditure is of importance to users of the accounts as financial planning, including savings plans, will be based upon it.

Improvements are required in teams' understanding of the nature of expenditure and, as a result, ensuring they perform sufficiently large sample testing. Furthermore, several audits failed to test appropriately the completeness of expenditure and testing of transactions in a suitably long post year end period.

Importantly, the CIPFA/ LASAAC Code of Practice on Local Authority Accounting requires properties to be held on the balance sheet on a valuation basis. Consequently, and as a result of the judgemental nature of revaluations, auditors need to perform sufficient testing in order to conclude that financial statements show a true and fair view, within the materiality applied.

Virtually all local audit bodies are assessed, by their auditors, as having a significant audit risk over the valuation of property.

Improve the robustness of the Engagement Quality Control (“EQC”) review processes

The EQC reviewer is required to evaluate objectively the significant judgements made and conclusions reached by the engagement team. We noted deficiencies in the EQC review on five audit reviews.

Design and execute appropriate audit procedures to assess the estimates used to determine liability provisions

Recognition and measurement of provisions and contingent liabilities is judgemental and involves key assumptions and estimates, which might be impacted by reporting bias. Auditors should perform appropriate procedures to assess the completeness, accuracy and reasonableness of assumptions and estimates used to calculate provisions and we identified deficiencies in some testing performed by teams.

Enhance the procedures over defined benefit pension arrangements, with improvements in the sufficiency of audit work performed over pension fund assets

Most Local Government bodies are members of various multi-employer defined benefit pension schemes, with each member body including a share of the scheme liability on its own balance sheet. We identified required improvements in the levels of assessment or evaluation of the Pension Fund Auditor’s work over the valuation of the pension scheme assets, in the testing of source data for pension liabilities and the audit challenge over harder-to-value pension assets (those categorised as Level 3).

Where appropriate, improve the evidence of judgements taken by auditors in their exercise of special reporting powers (statutory recommendation and public interest reports)

The Local Audit and Accountability Act 2014 (“the Act”) imposes reporting powers and obligations on auditors to report instances of unlawful expenditure or activity of health service bodies which are likely to cause a loss or deficiency. In two audits we identified limited evidence of the audit team’s assessments and conclusions on issued special reports.

Good practice observations

We identified particular examples of good practice in six of the fifteen audits reviewed, including the following areas:

- **Testing of property valuations in audits of a limited number of firms:** there was corroboration of key valuation assumptions and comparison of valuation movement to independent valuation indices of Gerald Eve and the RICS BCIS index.
- **The extent and timing of involvement by the Engagement Leader in the audit:** we saw detailed involvement in all aspects of the audit and importantly upfront time spent in reviewing the planning and response to audit risks, ensuring that work programmes fully reflected the required levels of testing.
- **Extensive work performed over the completeness of accruals in a health body:** the team compared accruals to detailed historical trends and balance of accruals to determine that there were no material suppliers excluded from the current year accruals listing.

- **Use of internal specialist to assist with the audit of pension liabilities and property valuations:** while not all firms have the use of internal specialists, where they are available, we have seen their insight enhance the team's audit evidence over these higher risk areas.
- **For the VfM conclusion, performing benchmarking of reserves for a Council and other similar bodies, to inform the evidence over financial resilience.**
- **Robust challenge to delay the sign-off of the auditor's report until the Authority responded with additional information and reconciled balances.**
- **The design and execution of a bespoke approach to the testing of capital project additions:** this provided the audit team with assurance for both the financial statement and VfM arrangements conclusion.
- **Improvements in the way audit firms have audited the calculation of an individual local audit body's share of the overall defined benefit pension scheme.**

1.2 Value for money arrangements conclusion

In our review of the VfM conclusion work of auditors, there were no key findings giving rise to any audit being assessed as requiring more than limited improvement.

Review of firm-wide procedures

This year, our firm-wide work across all seven firms focused primarily on the following areas:

1.1 First year audits and prior period adjustments

There were a total of 215 first year audits in 2019/20, with 90 relating to major local audits. This was an unusually high number of first year audits, resulting from the first year that PSAA appointed auditors to relevant principal local government authorities that had opted into its national scheme. Audit appointments were made for a five year period. Five of the seven firms issued audit opinions on financial statements containing a prior period adjustment. The proportion of major local audit financial statements containing a prior period adjustment was 36% when the engagement was an initial audit and 12% for a continuing audit.

Our key recommendations are that all firms should:

- Perform greater levels of self-review of their audits where they have been auditor for an extended period to ensure that the audit approach remains sceptical and challenging.
- On any future first year audits, enhance their initial audit procedures and enquiries of management and the Audit Committee to cover the potential risk of a prior period adjustment.
- Improve the challenge of management over complete and accurate financial statements, to minimise the number of financial statements containing a prior period adjustment.

1.2 Engagement Quality Control (“EQC”) review

The scoping of EQC reviewers across the seven firms saw some variation. Four of the firms assigned an EQC reviewer to all of their major local audits. The remaining three firms appointed an EQC reviewer dependent on risk characteristics. At one firm no major local audits were assigned an EQC reviewer. In aggregate, 32% of major audits had EQC reviewer involvement. Our key findings were:

- Each firm should consider mandatory allocation of EQC reviewers to all major local audit, as such audits would benefit from the rigour and challenge applied.
- Improvements to the process of identifying EQC reviewers, as we noted instances where EQC reviewers had, in the recent past, been engagement leaders on audits assessed as requiring more than limited improvements.
- The EQC process should ensure consistent high quality. AQR has identified some reviews which were allocated an EQC reviewer yet were assessed as needing more than limited improvements.

1.3 Partner and staff matters

Our inspection across the firms included an evaluation of each of the seven firms’ policies and procedures and we had no specific findings relating solely to Local Audit. Overall key findings were:

- Improve monitoring of the staff appraisal process and consideration of audit quality in relation to relevant metrics in staff appraisals.
- Enhance the significance of quality in determining local audit partners’ and directors’ performance ratings and remuneration.

1.4 A&C procedures

The firms all have detailed policies and procedures relating to acceptance and continuance decisions for audited entities. We had no specific findings relating solely to Local Audit. Findings included:

- Enhance controls on continuance decisions to prevent teams undertaking work prior to approval.
- Strengthen the continuance approval process, in particular the evidence to record and explain the conclusions reached.

Firms’ internal and ICAEW quality monitoring results

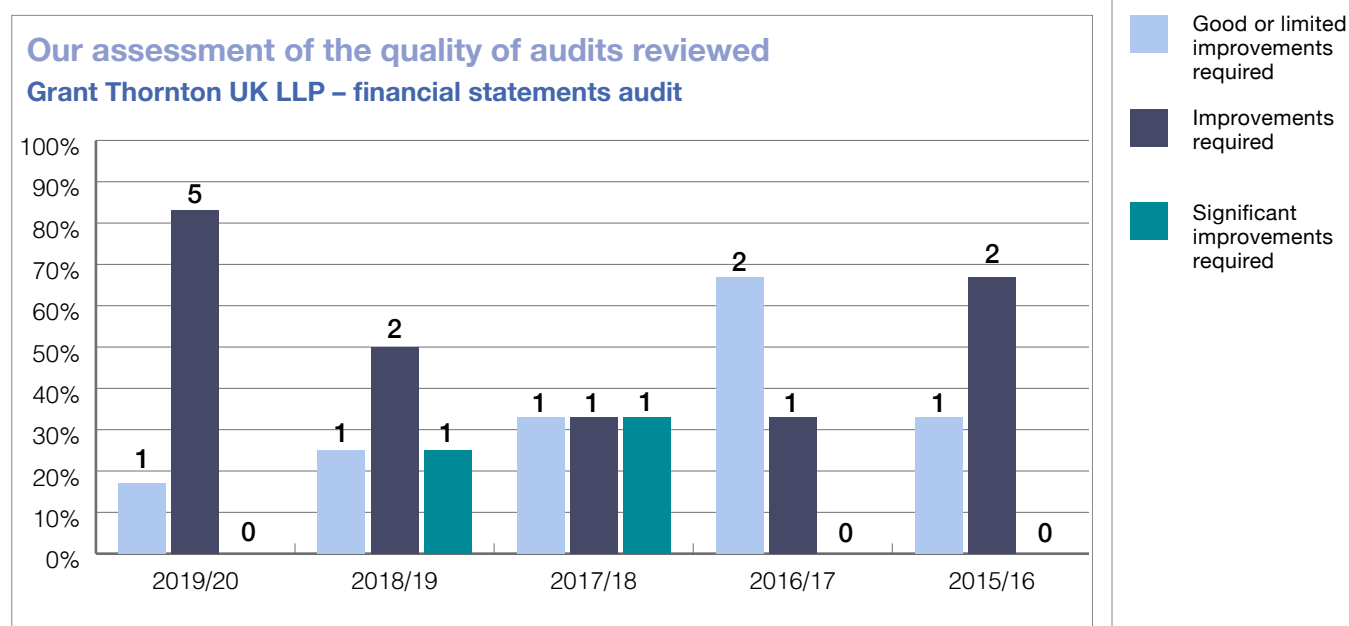
This year we have included, in each of our public reports, summary results of the firms’ internal inspection results, together with those of the ICAEW’s latest quality monitoring. We consider that these results provide additional relevant information in relation to the assessment of the firm’s audit quality.

The results of the firms’ internal inspection results, together with those of the ICAEW’s latest quality monitoring, are set out in appendix 2.

2 Review of individual firms

We have presented an assessment for the three firms with the largest shares of major local audits: Grant Thornton UK LLP (six audits reviewed), Ernst & Young LLP (three audits reviewed) and Mazars LLP (two audits reviewed).

We completed one audit review at each of the other four firms (BDO LLP, Deloitte LLP, KPMG LLP and PwC LLP) and these four results have been aggregated into one graphical summary and also presented below.



The audit quality results for our inspection of the six audits are unacceptable, with five audits assessed as requiring improvement, although no audits were assessed as requiring significant improvement.

The firm should update its ongoing action plan with the findings and required actions from this inspection cycle. At least two key findings were identified on all audits requiring improvement and therefore areas of focus are the audit of property valuation, assessment and subsequent testing of fraud risks, audit procedures over the completeness and accuracy of expenditure and EQC review procedures. A full RCA for each audit reviewed by AQR should be completed and together with the RCA on the firm's own quality monitoring results should help establish the reasons for poor audit quality and how quality might be restored.

AQR will assess the firm's local audit quality action plan and will then determine whether any additional procedures or increased audit reviews will be required in the scope of our 2020/21 inspection programme for Grant Thornton.

VfM arrangements conclusion – all six reviews were assessed as requiring no more than limited improvement.

Firm's response:

Grant Thornton are absolutely committed to audit quality and we welcome all areas of the review work performed by the FRC. We recognise that we need to make improvements and are investing to do so. We are mindful, when performing our work, that local auditors have wider roles and responsibilities to commercial auditors, and that users of the local authority and NHS financial statements, including citizens as taxpayers and users of public services, have different priorities from corporate shareholders. We strive to bring an appropriate balance to our responsibilities under the National Audit Office Code.

We are disappointed by the FRCs findings on Property, Plant and Equipment (PPE) and take the FRCs findings seriously. Following the 2017/18 FRC inspections we implemented a Quality Investment Plan which responded to the FRCs points on PPE. Inevitably these actions – including the widespread use of external valuation experts - would not have fully impacted on the 2018/19 audits. These actions are fully implemented for 2019/20 audits. We note that there were only five other areas in which key findings were identified across six financial statements reviews. We will address all these findings in our future audit work.

We are pleased with the Value for Money results awarded by the FRC. Value for Money audit is a significant and important measure used by NHS bodies and local government to inform their own understanding of their performance.

Financial statements

We have undertaken extensive work over the past eighteen months to respond to previous comments made by the FRC and to implement our Quality Investment Plan. We have introduced a revised audit approach, enhanced training programmes, revised guidance and support for our teams, and mandated the use of auditor's experts for valuations on all major audits. This will impact fully on 2019/20 audits. It was not possible due to the timing of reviews to have these fully in place for 2018/19 audits. We will continue to drive further improvement in this area as part of our commitment to quality and to address the FRC findings.

As highlighted above, we are disappointed by the FRCs findings on PPE and take these findings seriously. Indeed the investments referred to above have focused on considerably expanding and we hope improving our work in this area of the accounts. We have prioritised our response in this way because the feedback from the FRC on individual engagements makes it clear that PPE is the major driver of our file scores. We will continue to focus on PPE, as required by accounting standards and the requirements of an ISA audit and in line with the FRC's focus in this area. Looking ahead, however, we also note the comments of Sir Tony Redmond in his recent inspection that *'valuations of non-investment properties are a potential distraction from the things that really matter to local taxpayers, notably financial resilience'*.

Whilst the recommendations of Sir Tony Redmond are not yet in force, the firm notes the significance of the Redmond review for the sector as a whole, and also notes that Sir Tony's comments in this area very much accord with the views the sector has expressed to us. Notwithstanding the commitment we have made to increase significantly the scope and nature of our work on PPE under current standards, we will therefore work with CIPFA to help it develop alternative ways that local authority accounts can be presented.

The FRC also highlighted EQCR, fraud risk factors and completeness of expenditure as its other key findings. We have summarised the FRCs findings below.

EQCR was raised as a finding on two audits. EQCRs provide a second engagement lead review on complex audits. The principle issues raised by the FRC were that the time charged did not support an effective and thorough review and that the reviewer failed to discuss significant matters with the engagement partner. We have issued revised guidance to all EQCRs.

Completeness and accuracy of expenditure was raised by the FRC on two audits and fraud risks raised on three audits. A common issue in each case was that the auditor needed to evidence better their risk assessment and conclusions. In respect of fraud the FRC highlighted the need to improve on the sufficiency of testing including sample sizes. For expenditure, the FRC highlighted the need to disaggregate debits and credits and ensure the completeness of the populations. We are addressing all these points in our ongoing training.

We will continue to develop and improve our audit approach and provide appropriate training for the other areas identified by the FRC in this year's inspections. We currently apply Root Cause analysis to all internal and external files that require significant improvement. We will ensure that we respond to any underlying issues in a systematic manner, through our Quality Investment Plan. We will also undertake a Root Cause review on all reviews. We will capture the learning from these including what went well, such as the ICAEW reviews (see appendix 2), and how we can build on this further.

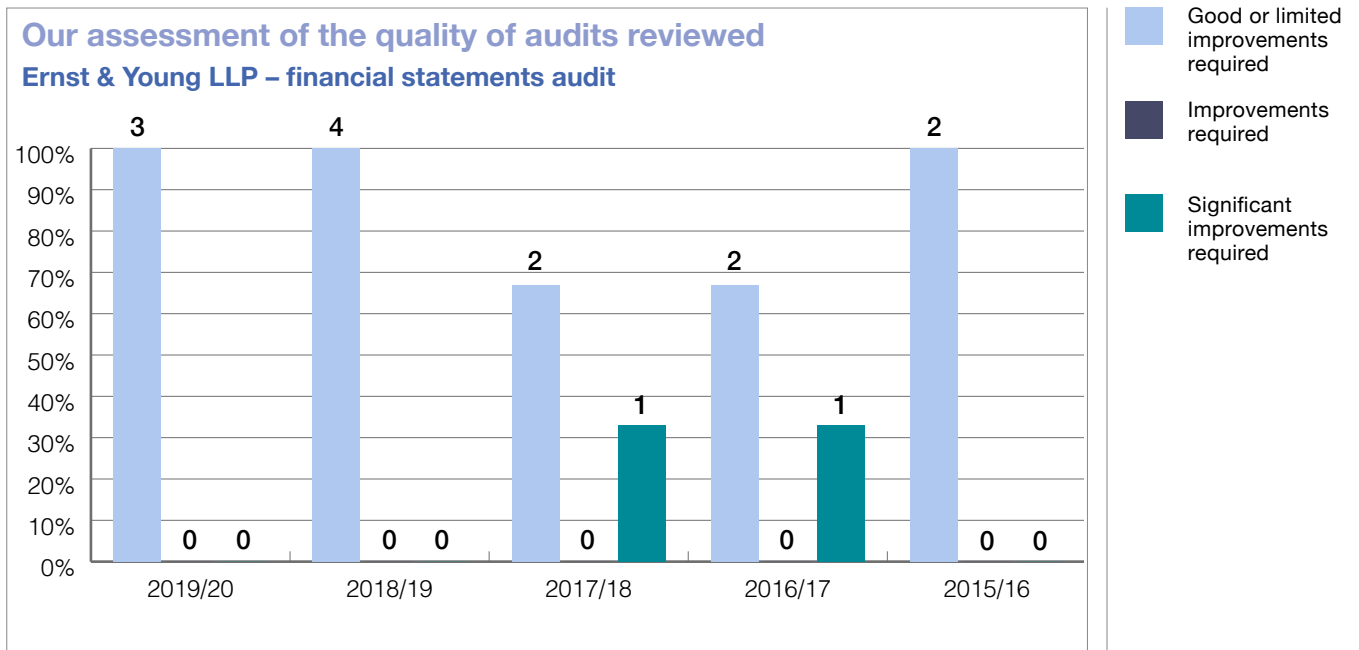
Economy, efficiency and effectiveness

Under the NAO Code in place for 2019/20, auditors are required to issue a conclusion on Value for Money (VfM) at all principal authorities. The FRC reviewed six of our audits, assessing all six as Good or Limited improvement only. The ICAEW assessed all files reviewed at the top level. These are excellent results, and we are proud of the work we have delivered.

In his report of September 2020, Sir Tony Redmond, stated that: *"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... 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."*

We consider that VfM audit is at the centre of local audit. We take VfM work seriously, invest time and resources in getting it right, and give difficult messages where warranted. In the last year, we have issued a Report in the Public Interest at a major audit, Statutory Recommendations and Adverse VfM Conclusions.

The inspection results illustrate our strength in VfM audit, in common with other firms in the sector. With the new Code coming into effect for 2020/21, we have already updated and revised our approach. We will be training all our people in the new approach in the autumn.



All audits reviewed by AQR were assessed as requiring no more than limited improvement and there were no key findings.

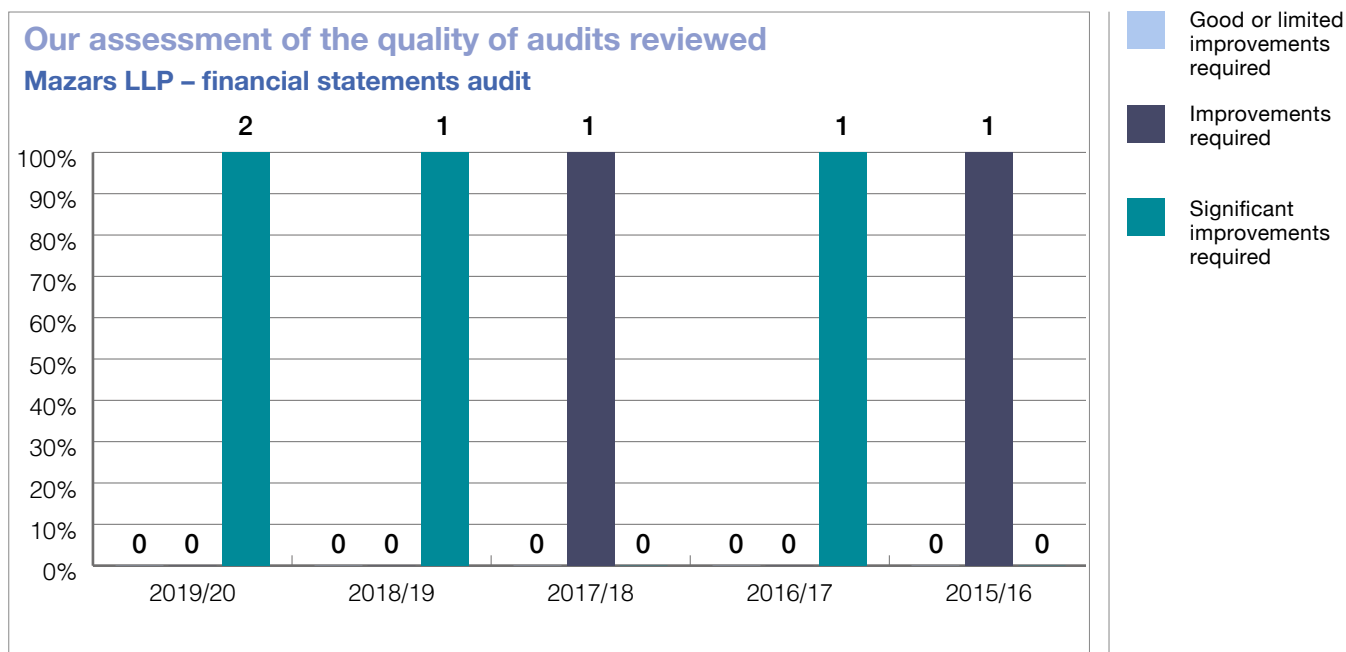
The firm has increased both local audit training and the rigour in its audit methodology. These actions have contributed to the improvements in the firm’s quality results since 2017/18.

A number of the areas of good practice referred to in our report were from Ernst & Young LLP local audits and we have seen the firm take the lead in its use of internal specialists for both property and pension valuations.

VfM arrangements conclusion – all three reviews were assessed as requiring no more than limited improvement.

Firm’s response:

We are pleased with the good FRC inspection results achieved for both our financial statement opinion and value for money conclusion reviews in the last 2 years. We continue to invest in audit quality with both local training for our public sector audit teams and audit quality initiatives and training for all auditors across the UK firm. We are pleased that the changes we made to our pensions guidance to address previous inspection findings have been reflected in these results. We value the feedback received from the FRC and will ensure we respond to all findings from FRC inspections to continue to drive improvements in audit quality across the practice.



Both audits reviewed by AQR were assessed as requiring significant improvement. This is clearly unacceptable and follows a trend of poor inspection results.

Following its poor results over the past five years, the firm needs to commit to an action plan for local audit quality improvement. Key areas of quality focus for the firm include the audit of property valuations, group audit oversight, the sufficiency of audit testing over income and receivables and expenditure, and EQC review procedures. The firm should submit to AQR a full RCA for each audit and should also undertake RCA over the firm's own quality monitoring programme and the inspections performed by ICAEW to establish how audit quality can be restored.

AQR will assess the firm's local audit quality action plan and will then determine whether any additional procedures of increased audit reviews will be required in the scope of our 2020/21 inspection programme for Mazars.

VfM arrangements conclusion – both reviews were assessed as requiring no more than limited improvement.

Firm's response:

Our commitment to audit quality is at the core of our values and we are dedicated to the continuous improvement of our audit work and the service we provide to our audit clients. Whilst we are pleased with the results of the AQR's reviews of our work on Value for Money conclusions (which show only limited improvements identified for a number of years), we are disappointed with its findings on our work on the audit of the financial statements at 2 of our local audit clients. The firm will robustly respond to the findings and has plans in place to improve the quality of our local audit work.

We have prepared a Local Audit Quality Plan, which is a sector-specific element of our firm-wide Audit Quality Plan. These draw together information on risks to audit quality from a range of sources including quality monitoring findings, changes to auditing and financial reporting standards, and feedback from auditors. The Local Audit Quality Plan has also taken account of the AQR's findings and emerging audit quality risks arising from the update of Practice Note 10 and the National Audit Office's Code of Audit Practice. This plan will be maintained by the firm's Audit Quality Team and subject to oversight from our Audit Board.

Root cause analysis (RCA)

Our Audit Quality Team has undertaken a detailed RCA project to identify and understand the drivers of poor audit quality in some of our local audit work. The RCA project has focused on all local audits where the need for improvements or significant improvements have been identified either by the AQR, ICAEW or our internal Quality Monitoring Team.

A report on the findings of the RCA project was considered by our Audit Quality Board in August 2020 and our Local Audit Quality Plan will be refreshed to ensure key findings from the RCA are addressed. Our next RCA project cycle, which is due to commence in October 2020, will consider the two files reviewed by the AQR for audit years ended 31 March 2019.

Engagement Quality Control Review (EQCR)

Prior to the AQR findings, we had recognised a need to increase our capacity in relation to engagement quality control reviews. We have made investments in this area by increasing the number of individuals with detailed knowledge of local audit who are licensed to undertake this key role. We have also targeted our engagement quality control reviewer resources more effectively for the March 2020 year-end audits, focusing on those local audits that are of a significant scale, complexity, or which present additional risks to audit quality.

We recognise that our engagement quality control reviewers need a broad understanding of the particular complexities and nuances of the local government and NHS sectors, as well as emerging audit and financial issues relevant to those sectors. Therefore, from the March 2021 year-end audits, all engagement quality control reviewers who do not have significant sector expertise will attend a mandatory sector briefing, provided by the Audit Quality Team.

We have also undertaken a thematic review of our firm-wide engagement quality control review processes during 2020 in order to identify potential improvements. The report will be presented to the Audit Board in its October meeting. The findings and recommendations will help us improve the impact of our engagement quality control reviews upon audit quality.

The audit of property valuations

The nature of property valuations makes it a complex area which involves the application of a high degree of management judgement, which must be appropriately challenged by auditors. We are disappointed that the AQR has identified a need for improvements in respect of our work on property valuations.

We have developed a comprehensive suite of guidance to auditors over recent years. This has been refreshed during early 2020 to ensure that our teams are clear on the level of testing that is required in key areas such as the accuracy and completeness of source data, the challenge of management and expert judgements, and the assessment of potential risks of material misstatement arising from rolling valuation programmes. In response to the latest reviews, use of a sector-specific audit testing programme will be mandated from our 2020/21 audits onwards (having been strongly recommended for the 2019/20 audit year).

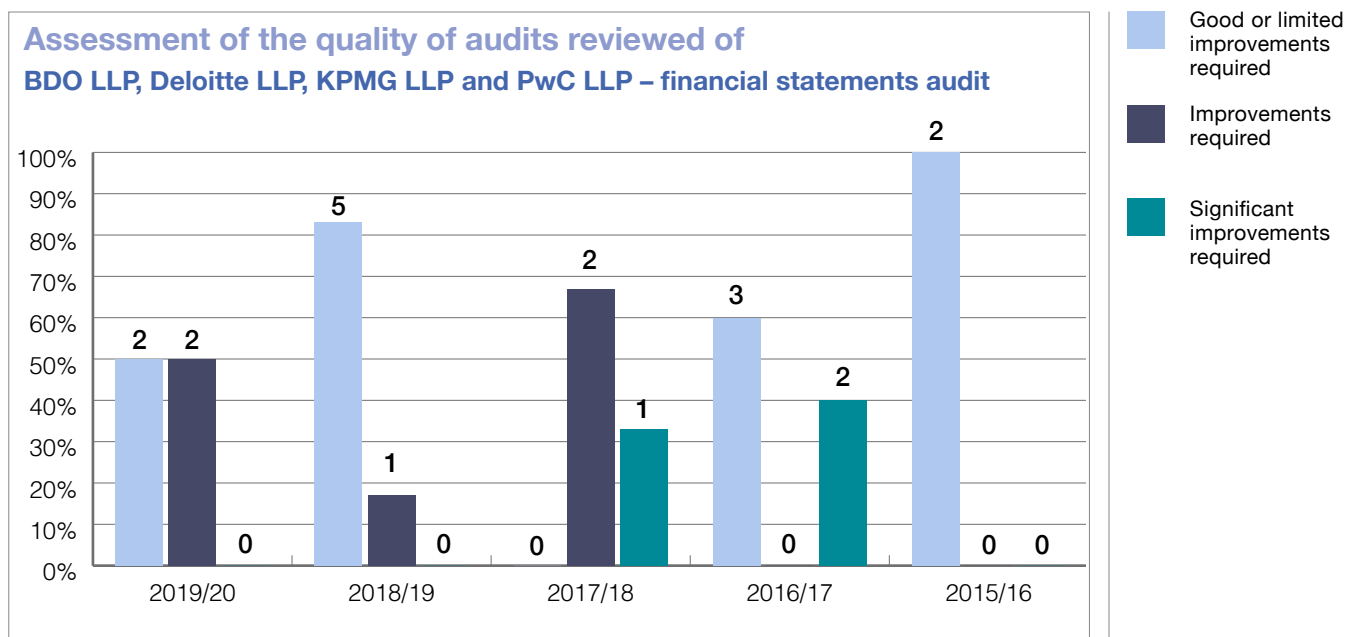
To further respond to the complexity associated with the audit of some property valuations, we have re-visited the arrangements in place for auditors to access valuations expertise to support their audit work, where required. This support is being used extensively during the audit of 2019/20 financial statements.

Group audit oversight

Our audit approach is fully compliant with underlying auditing standards. To support auditors in meeting the requirements in respect of group audit oversight, a range of mandatory templates is in place. A briefing from our Audit Quality Team to Key Audit Partners reminded them of the importance of documenting how they have exercised appropriate oversight of the group audit through, for example, their direction, supervision and review of the work of component auditors.

The audit of income and expenditure

Sector-specific briefings have reminded local auditors of the importance of fully documenting their judgements relating to the testing of income and expenditure. Such judgements include those made in determining the appropriate period before and after the year-end which should be subject to cut-off and completeness testing.



The above graph aggregates the financial statement audits reviewed for these four inspected firms. Not all of the four firms were inspected in each of the years 2015/16 to 2018/19.

With two of the audits being assessed as requiring improvement, all firms will need to consider the implications of this on their remaining audits and methodology.

All audits had AQR findings but only two had key findings. The key findings related to property valuation, completeness and accuracy of expenditure, insufficient procedures following up limitation in the work of the pension fund auditor, deficiencies in the audit work performed over payroll costs and insufficient testing of journals with higher fraud risk characteristics.

Each firm needs to consider these findings and ensure the actions committed to are completed, such as increased training, changes to methodology or mandated procedures/testing. The two firms with audits requiring improvement should submit a full RCA to AQR. All firms need to consider the results from their internal monitoring and of inspections performed by ICAEW to establish if there are any other areas of concern.

AQR will assess the two firms' local audit quality action plans and will then determine whether any additional procedures or increased audit reviews will be required in the scope of our 2020/21 inspection programme.

VfM arrangements conclusion – each firms' review was assessed as requiring no more than limited improvement.

Firm's response:**BDO**

The key findings reported relate to similar issues that have been reported over a number of recent years. Our audit approach and supporting training, both general and sector specific, for all of our teams, over the last few years has included focus on further enhancements to our work on valuations, pensions, the completeness of expenditure and our testing of journals. This includes issuing guidance on identified best practice in challenging of property valuations, revisiting and developing our pensions auditor assurance scope and further enhancing data analytics scope and functionality.

Deloitte

Audit Quality is our number one priority. We welcome the challenge provided by the AQR inspections and thank them for their insight and comments. We perform root cause analysis on all our external AQR inspections and take actions to address any matters identified and to share best practice. We note the areas of findings highlighted by the AQR and we have taken wider actions within our audit practice to address these. This includes enhanced training and guidance on reporting from specialists (for example property) and updated risk assessment guidance for pensions assets supported by our Pensions Centre of Excellence. In addition, we share all inspection findings as part of training to staff involved and to our internal quality reviewers.

KPMG

We have strengthened the foundations of audit quality as a result of our significant investment over the past three years. Our focus is on achieving consistent application of our new procedures. We have completed root cause analysis over any AQR findings in this cycle and will continue to invest to maintain a standard of audit rightly expected by the AQR. Further investment is planned for 2020 to help ensure this.

PwC

Our Programme to Enhance Audit Quality (PEAQ) was launched in June 2019. This three year programme includes a wide-ranging and fundamental package of measures, with the single objective of delivering consistently high quality audits. We have made significant progress since the start of the programme and remain committed to continued focus and investment in this programme over the next two years.

We have a limited number of Local Audit engagements, which are all performed by Responsible Individuals with a significant focus on this industry specialism within their portfolios. During 2019/20, a sample of our Local Audits was inspected by the AQR and through our own internal quality monitoring programme.

As set out in our response to the AQR's July 2020 inspection report on the firm, as part of the PEAQ a revised approach to root cause analysis (RCA) was approved by the Audit Executive in February 2020. In July 2020, we created a dedicated team specialising in Continuous Improvement activities across inspection, review and other audit quality activities. This team performs RCA on identified issues and prepares an action plan to address those findings, using intelligence from both audit quality findings and best practice examples. The nature of the findings raised in this report across all firms was discussed with the inspection team earlier this year and was shared with our Local Audit RIs as part of our continuous improvement activities.

3 Other matters

FRC engagement with annually inspected firms and other stakeholders to improve audit quality

We have increased engagement with Government Departments and other key Local Audit and Accountability Act 2014 (“LAAA”) stakeholders during 2019/20, to ensure an awareness of the risks in the sector and that risks and audit quality matters are communicated back to stakeholders. These discussions and meetings with stakeholders have included NAO, CIPFA, ICAEW and PSAA, together with participation in Ministry of Housing, Communities and Local Government (MHCLG) Delivery Board meetings.

The Local Audit Sub-Group, chaired by the FRC to deal with audit related issues arising from the new regime, met once in 2019. The MHCLG commenced formal meetings during 2019 on Local Audit matters and this has effectively replaced the Sub-Group.

The MHCLG Local Audit Delivery Board has met quarterly and the FRC has been represented at all meetings. The FRC has two members on the delivery Board, one from the Professional Oversight Team and one from AQR. Other members of the Board comprise key stakeholders responsible for delivery of aspects of the Local Audit and Accountability Act 2014 (the Act), such as the National Audit Office (setters of the Audit Code for Local Auditors), CIPFA (responsible for the Accounting Code), PSAA (selected by most local government bodies to appoint auditors and negotiate audit fees on their behalf; formerly responsible for monitoring audit quality) and the Local Government Association.

Registered audit firms conducting local audits are not permitted on the Board. At an audit firm level, the FRC has continued regular engagement with all seven firms conducting major local audits. This has included planning meetings before scoping the 2019/20 inspection cycle and regular updates during the inspection process. We have met all firms to discuss the initial audit quality findings ahead of the 31 March 2020 year end for Local Audit bodies to ensure firms can develop their own plans to improve quality on those areas of concern. Discussions with the firms continue in the wake of sector-specific matters following the COVID pandemic.

Developments in Local Audit

At the end of 2019, MHCLG announced that Sir Tony Redmond (former CIPFA President) would conduct a review of local authority financial reporting and external audit (the Redmond Review).

The Redmond Review was extended beyond a post-implementation review to consider the quality of the audit of local authorities, whether auditors were using their reporting powers correctly and if councils were heeding recommendations to help improve the financial management of their accounts.

One key purpose of the Review was to consider the structure and oversight arrangements for Local Audit and, consistent with the recommendations of the Kingman review, whether a single body should be created to oversee Local Audit. The recommendations arising from this review were published on 8 September 2020 (<https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>)

Appendix 1: Key local audit information

Identifying major local audits

An analysis of available local audit data for 2019 identified 271 major local audits within AQR scope. This number changes annually as the definition of a major local audit is dependent upon meeting one of the following criteria:

- Total income or expenditure of at least £500 million; or
- For a Local Authority pension scheme, at least 20,000 members or gross assets in excess of £1,000 million.

The following table sets out the total number of Local Audits by sector, along with those assessed as meeting the major local audit definition. The audits for Local Government and other non-health bodies were principally awarded to five audit firms in five tiered tranches, following a full tender process conducted by PSAA in its capacity as an appointing person under the LAAA. These audit appointments were made to cover five accounting periods commencing with 31 March 2019. The table also sets out the number of major local audits subject to audit inspection by AQR.

No Local Authority pension fund audits were selected for review in 2019/20, but pensions accounting, and its associated disclosure were selected as an area of focus in 11 of our 12 non-health reviews completed. Furthermore, AQR has previously reviewed a sample of Local Authority pension fund audits, without significant findings. We are planning to select some pension fund audits as part of our 2020/21 inspections programme.

Category	Total Population	Major Local Audits	Reviewed by AQR in 2019/20
Health Bodies (NHS Trusts and Clinical Commissioning Groups)	286	63	3
Local Government Bodies	361	130	10
Police and Crime Commissioners (PCC)	74	9	1
Other Bodies (inc fire and waste)	59	3	1
Local Authority Pension Funds	80	66	0
Total	860	271	15

Audit firms completing local audits

There were seven audit firms that completed at least one audit of a major local body for the financial year ended 31 March 2019. The three firms with the largest market share of major local audits were Grant Thornton, EY and Mazars, with a collective share of 82%. All the firms involved, including the number of audits they completed, and their respective market shares were as follows:

Audit firm	Number of Local Audits	Market Share %	Number of Major Local Audits	Market Share %	Reviewed by AQR in 2019/20
Grant Thornton UK LLP	323	37.6%	109	40.2%	6
Ernst & Young LLP	222	25.8%	72	26.6%	3
Mazars LLP	111	12.9%	42	15.5%	2
KPMG LLP	109	12.7%	25	9.2%	1
BDO LLP	55	6.4%	12	4.4%	1
Deloitte LLP	36	4.2%	10	3.7%	1
PwC LLP	4	0.4%	1	0.4%	1
Total	860		271		15

Appendix 2: Firms' internal quality monitoring and ICAEW results

Results of Firms' own monitoring

Background

This appendix sets out aggregated information relating to the seven firms' internal quality monitoring for individual audit engagements. It should be read in conjunction with each firm's transparency report, which provides further detail of the internal quality monitoring approaches and results, and the firm's wider system of quality control. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results.

Due to differences in how inspections are performed and rated, the results of the firms' internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

Firms approach to internal quality monitoring

The firms' internal inspection programs generally consider the full population of both major and non- major local audits performed. The programs are varied but are usually risk-based as well as structured to cover Responsible Individuals ("RIs") over a fixed period of time. Audit files are selected for review based on a number of criteria, including risk and public interest. Reviews are supervised and reviewed by the firms' own internal quality teams.

Scope

The seven firms' Internal Quality Monitoring ("IQM") program, relating to local audit, covered 29 individual audits, of which 12 related to major local audits.

The aggregate number of major local audits covered by the firms' own IQM was less than that of the AQR and amounted to:

Coverage of all local audits 3.4%

Coverage of major local audits 4.4%

Furthermore, not all firms reviewed the VfM arrangements conclusion work on each audit selected for review.

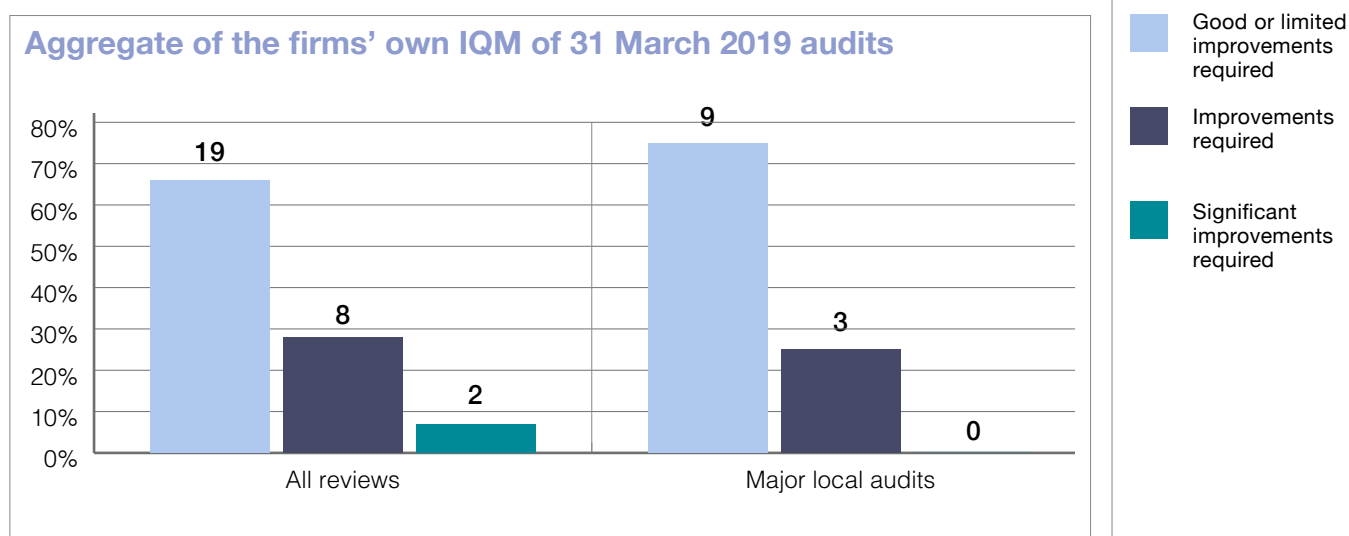
One firm did not select any local audit files for review.

Results

In aggregate, the firms reported that across the 29 local audits reviewed, 19 (65.5%) were of a good standard or limited improvement standard. There were eight audits assessed as requiring improvement and two audits needing significant improvement.

For the firms' major local audits, 12 were reviewed and nine (75%) were assessed as either good or requiring limited improvement and there were no audits assessed as requiring significant improvement.

The results of the firms' financial statement opinion reviews for 31 March 2019 local audits are set out below.



The firms' various IQM programs generally use the same grading categories as AQR but where this is not the case, decisions on grading are aligned as closely as possible to those that would result from the AQR process.

Results of ICAEW monitoring

Background

All firms completing local audits are subject to annual independent monitoring by ICAEW. ICAEW reviews local audits outside the FRC's population. ICAEW does not undertake work on the firms' firm-wide controls as it places reliance on the work performed by the FRC.

Scope

ICAEW's reviews are risk-based, with the aim of reviewing a representative sample of a firm's local audit portfolio over a six year cycle. ICAEW adopts a cyclical approach to the monitoring of registered local auditors. Audit monitoring under the Local Audit and Accountability Act 2014 had a phased implementation. In the first year, the scope of monitoring was limited to a firm's portfolio of local health body audits of years ended 31 March 2018. In this, the second year, the scope of monitoring was extended to include local audits (health and local government bodies) of years ended 31 March 2019.

ICAEW reviews are designed to form an overall view of the quality of the audit. Where applicable, both the financial statement opinion audit and work to support the VfM conclusion are reviewed. ICAEW assesses the audits it reviews as either 'satisfactory/ acceptable', 'improvement required' or 'significant improvement required'. Visit [icaew.com/auditguidance](https://www.icaew.com/auditguidance) for further information about ICAEW's audit monitoring process including its approach to assessing audits.

In 2019/20 ICAEW planned to review 14 standard-scope engagements, but because of sector-wide challenges, some audits of years ended 31 March 2019 were unavailable for review during this review cycle. Reviews of at least two of these audit opinions will be deferred until 2020/21.

ICAEW has completed its 2019/20 monitoring and the report summarising its audit file review findings and any follow-up actions proposed by the two firms that were inspected (GT and EY) will be considered by ICAEW's audit registration committee in November 2020.

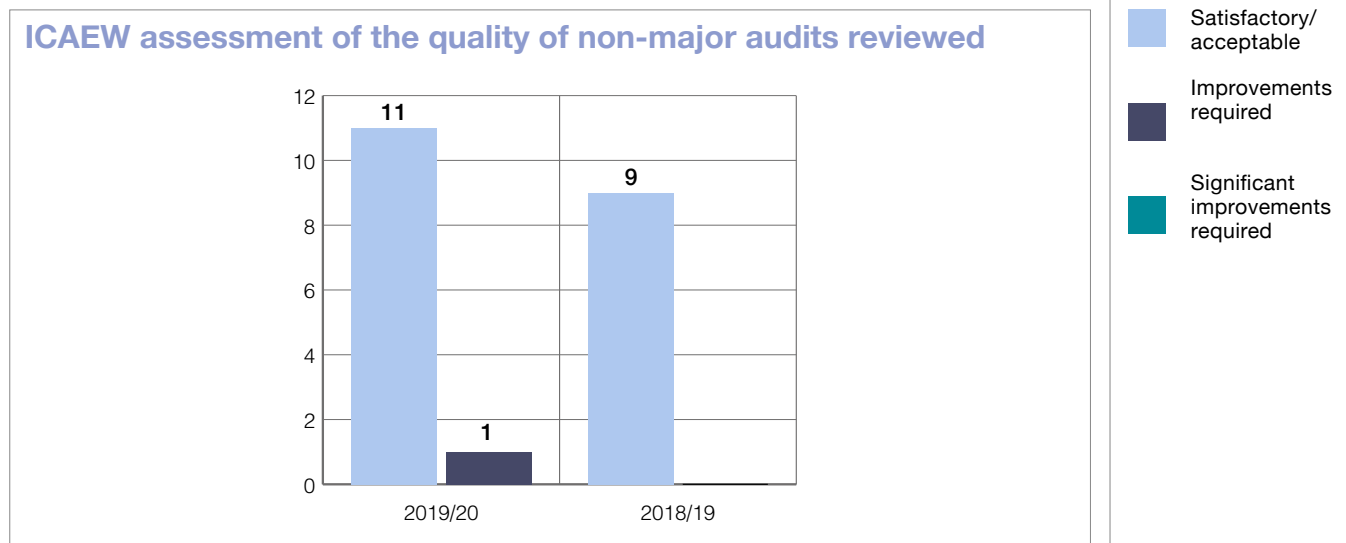
Results

The audit work reviewed for 2019/20 was generally of a good standard. 11 reviews were satisfactory/acceptable, with one requiring improvement. The work to support the VFM conclusion was satisfactory on all files reviewed.

ICAEW assessed one audit as needing improvement due to weak substantive analytical review of pension scheme assets. Other findings included weaknesses in audit testing of Property, Plant and Equipment in four audits, and other isolated aspects of audit evidence and documentation.

Assessing an audit as needing improvement or significant improvement does not mean that the audit opinion was incorrect or that the financial statements were materially misstated.

Results of ICAEW's financial statement opinion reviews for the last two years are set out below.



Given the sample sizes, number of audit firms reviewed and mix of local audit bodies inspected changes from one year to the next, the proportion of audits falling within each category cannot be relied upon to provide a complete picture of the firms' aggregate performance or overall change in audit quality.

Firm's response:**GT**

For 2018/19, the ICAEW selected seven of our audits for review of the financial statements audit. Of these, six audits were assessed as satisfactory/acceptable. Only one audit had improvements required, and we have already taken action to address the issues raised. The ICAEW also reviewed five Value for Money Conclusions. All five were assessed as satisfactory/acceptable. We are delighted with the results, which in our opinion evidence the hard work and investment we have made in audit quality in recent years. As reflected elsewhere in this report, these efforts are yet to significantly impact our AQR scores to the levels expected by the FRC and we will continue to work hard to ensure that our efforts more clearly translate to improved AQR scores in future. We are undertaking Root Cause reviews to identify what we got right, and any scope for further improvement.

The firm's internal monitoring showed similar results to the ICAEW reviews. Of eight local audit files selected, seven had good or limited improvements. Only one file had improvements required and we have now completed the Root Cause review and identified and responded to all learning points. Four of the five Value for Money files selected showed Good or limited improvements required, and only one had improvements required. As above, we are capturing the learning and will build on this for 2019/20 and beyond.

EY

We are pleased with the good results achieved in EY's ICAEW quality assessments, achieving 100% satisfactory/acceptable in both the 19/20 and 18/19 inspections. This reflects the results of our internal inspections of health and local government audits performed in September 2019, our 2020 public sector internal inspections are scheduled for September 2020.

We continue to invest in audit quality with both local training for our public sector audit teams and audit quality initiatives and training for all auditors in the UK firm. We welcome feedback from our regulators and the lessons learnt from both internal and external inspections will be included in upcoming training for public sector auditors.

Mazars

We operate a robust quality monitoring review programme which mirrors the challenge shown by the AQR in its reviews of audit quality. We are proud of an uncompromising approach to quality monitoring as a key part in driving improvements in audit quality.

Our quality monitoring arrangements for local audit work form an integrated part of our firm-wide programme for review, overseen by our Director of Audit Standards. The local audit work of all of our Key Audit Partners is reviewed at least every two years as part of this programme. These reviews cover the work undertaken on both the audit of the financial statements and the conclusion on Value for Money arrangements. Our quality monitoring programme for 2018/19 audits included reviews of 9 (7.7%) local audit files. Of these, 5 (11.1%) were reviews of major local audits.

Findings from quality monitoring reviews, together with responses to the key themes and findings from our Audit Quality Team, are reported three times a year to the Audit Board alongside the key findings from our root cause analysis projects. The frequency of reporting means that responses can be put in place quickly to address significant findings at a firm-wide level, where required.

BDO

In relation to the results of the ICAEW reviews of non-major audits we consider that given the small sample size and the fact that all firms are not reviewed annually, caution should be exercised in drawing overall conclusions on any trends.

In relation to the overall firms' IQM results again comparisons can be difficult given that the approach to internal reviews across all firms varies. We would note that in relation to our internal review results, we use root cause analysis where appropriate to determine the causes of any points raised and to drive actions undertaken across the sector.

Our audit approach and supporting training, both general and sector specific, for all of our teams, over the last few years has included focus on further enhancements to our work on valuations, pensions, the completeness of expenditure and our testing of journals. This includes issuing guidance on identified best practice in challenging property valuations, revisiting and developing our pensions auditor assurance scope and further enhancing data analytics scope and functionality.

Deloitte

The firm includes both major local audits and local audits within our annual IQM processes. The selections are risk based and ensure that there is coverage of all responsible individuals over a three year period for local audit work. The firm undertakes Root Cause Analysis ("RCA") for any improvement required or non-compliant engagement inspections, as well as on positive results to identify factors to support audit quality. The firm performs retrospective remediation of all high and medium findings, and prospective remediation on all findings in the subsequent year's audit. We communicate any thematic findings from engagement reviews to the practice. Further information on our IQM processes can be found within our annual transparency report.

KPMG

Our QPR programme for local audit mirrors that of our wider audit practice and is designed to hold audit teams to quality levels that assess not only compliance with auditing standards but also adherence to internal requirements such as the performance of specified procedures or completion of specific mandated consultations. As such teams that perform audits that are very substantially compliant with auditing standards may receive a rating other than satisfactory in our internal reviews. Accordingly, it is difficult to make direct comparisons between the results of our internal and external inspection processes.

In order that we learn from the internal and external inspections process we perform root cause analysis to consider the details of findings from across the full spectrum of reviews to identify remedial actions. We also consider findings from a range of inspections to ensure that we develop robust remedial actions. We have a series of actions in place focussed on enhancing our coaching, reviewing and project management capabilities. We have also continued to expand our Second Line of Defence team.

PwC

As set out in our response to section 2, we have a limited number of Local Audit engagements, which are performed by Responsible Individuals with a significant focus on this industry specialism within their portfolios. During 2019/20, a sample of the firm's local audits was inspected through our own internal quality monitoring programme – the Engagement Compliance Review (ECR).

As set out in our response to the AQR's July 2020 inspection report on the firm, our ECR programme considers the full population of audits performed and is designed to cover both the firm's responsible individuals ("RIs") and specific categories of audit clients, including Local Audit. Our ECR programme involves a post-signing review of an audit engagement for each RI at least once every three years, and twice in any six-year period for audits identified by the firm as having a high public profile. Findings and best practice examples from any ICAEW inspections and ECR reviews are incorporated into our continuous improvement programme.

This report has been prepared for general information only. The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2020
The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368.
Registered Office: 8th Floor, 125 London Wall, London EC2Y 5AS

**FINANCIAL REPORTING COUNCIL
8TH FLOOR
125 LONDON WALL
LONDON EC2Y 5AS**

+44 (0)20 7492 2300

www.frc.org.uk

AUDIT COMMITTEE**Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting
(The Redmond Review)****25 November 2020****Report of Chief Finance Officer****PURPOSE OF REPORT**

This report seeks to provide Members with information on the recently released Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting

This report is public.

RECOMMENDATIONS

The Audit Committee is recommended

(1) **To note the report**

1.0 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. The Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting (the Review) undertaken by Sir Tony Redmond examined the effectiveness of local audit under the new regime.

2.0 BACKGROUND

2.1 The purpose of the Redmond Review was to examine the impact of External Audit activity in local government and how it helps to demonstrate public accountability, particularly to service users and council taxpayers. In addition, the Review covered 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.

- 2.2 The current framework for local audit encompasses procurement, contract management and delivery, the code of audit practice and regulation and accountability for performance. All these aspects of local audit were examined.
- 2.3 Whilst the focus of the Review was on local audit and public accountability there are several related factors which have contributed to the shape and nature of the findings. These included:
- The breadth and complexity of International Financial Reporting Standards (IFRS).
 - The role of the sponsoring government department (MHCLG); and,
 - The current state of the local audit market as administered by Public Sector Audit Appointments Ltd (PSAA).

3.0 SUMMARY OF FINDINGS

- 3.1 The Review promises no immediate fixes for the local audit framework, apart from a push to increase audit fees to the levels that the audit firms ought to have bid at in order for a standards-compliant audit to be properly resourced. Most of the other proposals will take time to have any impact.
- 3.2 The main recommendations of the Review are:

External Audit Regulation

- 3.3 The establishment of a new Office of Local Audit and Regulation (OLAR) which will:
- Regulate the local audit sector
 - Draft the code of audit practice
 - Take over the responsibilities of PSAA for procuring and managing audit contracts
 - Monitor and review audit performance
 - Produce an annual report on the state of local audit
- 3.4 To this end the involvement of PSAA, ICAEW, FRC and the NAO in the framework will cease.
- 3.5 OLAR will not actually carry out audits and it unclear if there is a role public audit as previously undertaken by the Audit Commission's Audit Practice and so assumes work will be contracted out in its entirety to private firms.
- 3.5 Local authority governance arrangements to be reviewed with the purpose of:
- Full Council receiving an annual report from the External Auditor at the first meeting after 30 September, even if the audit is not certified as closed.
 - Appointment of a suitably qualified independent member to the Audit Committee.
 - Formalising meetings of the Chief Executive, Monitoring Officer and the Chief Finance Officer with the audit partner at least annually.
- 3.6 All auditors should have the requisite skills and training enable them to audit a local authority.
- 3.7 Audit quality to be consistent with the highest standards of audit within the revised fee structure. OLAR to have scope to apply proportionate sanctions to audit providers in the event of serious, or persistent breaches.

- 3.8 No audit firm with the requisite capacity, skills and experience will be excluded from bidding for contracts.
- 3.9 The role of Internal Audit to be recognised as a key area of support for External Audit. Although traditionally auditing standards regarding audit planning and risk identification and assessment (ISA UK 315) and using the work of internal audit (ISA UK 610) has involved a significant amount of work for both parties, this area has not been fully utilised in the past.
- 3.10 Consideration to be given to moving the date for publication of audited accounts back to 30 September.
- 3.11 Changes to the arrangements for VFM auditing made in the 2020 Code of Audit Practice to be endorsed. Members will recall these require the External Auditor to report on and making recommendations in relation to financial sustainability, governance and improving economy/efficiency/effectiveness.

Financial Resilience

- 3.12 MHCLG will review its framework for seeking assurance about the sustainability of individual authorities.
- 3.13 Auditors to share key concerns with other regulators such as Ofsted, Care Quality Commission, etc, before completing their annual report.

Transparency of Financial Reporting

- 3.14 An audited statement of service information and costs together with budget comparisons to be presented alongside the Statement of Accounts.
- 3.15 CIPFA/LASAAC to be required to review the requirements for the statutory accounts in the light of the information to be covered in the statement of service information.
- 3.16 A copy of the full review is provided at Appendix A of this report.

4.0 OPTIONS AND OPTIONS ANALYSIS

- 4.1 Not applicable – The report is for noting and so no decision is required

5.0 CONCLUSION

- 5.1 The overall conclusion of the Review (Section 9 Para 9.1) copied below provides a clear summary of the report's findings.
- 5.2 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.
- 5.3 Whether the recommendations put forward by the Review address the short comings and concerns identified will be seen over the forth coming years.

**CONCLUSION OF IMPACT ASSESSMENT
(including Health & Safety, Equality & Diversity, Human Rights, Community Safety,
Sustainability and Rural Proofing):**

No implications directly arising.

LEGAL IMPLICATIONS

There are no direct legal implications arising from this report

FINANCIAL IMPLICATIONS

There are no direct financial implications arising from this report

**OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services,
Property, Open Spaces**

No implications directly arising.

SECTION 151 OFFICER'S COMMENTS

The s151 Officer has authored this report in his capacity as Chief Finance Officer

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments

BACKGROUND PAPERS

Appendix A – The Redmond Review

Contact Officer: Paul Thompson
Telephone: 01524 582603
Email: pthompson@lancaster.gov.uk
Ref:

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

Sir Tony Redmond
September 2020



© Crown copyright, 2020

Copyright in the typographical arrangement rests with the Crown.

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence visit

<http://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/>

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:

Ministry of Housing, Communities and Local Government
Fry Building
2 Marsham Street
London
SW1P 4DF
Telephone: 030 3444 0000

For all our latest news and updates follow us on Twitter: <https://twitter.com/mhclg>

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.

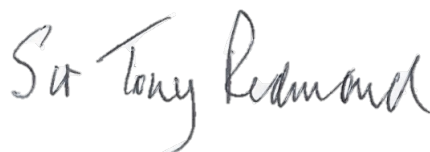
As I conducted my work, it became clear that the local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in 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

Contents

Executive Summary.....	3
Recommendations.....	5
1. Introduction	8
2. The direction and regulation of local audit.....	10
3. Procurement of local audit.....	19
4. Audit performance	26
5. Governance arrangements in place for responding to audit recommendations	39
6 Audit work on the financial resilience of local authorities	46
7. Financial reporting in local government	56
8. Smaller authorities	64
9. Conclusions.....	72
10. List of Annexes.....	75
Appendix – Glossary of Key Terms, Acronyms and Abbreviations.....	76

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.

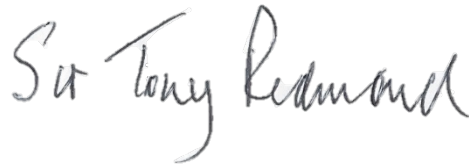
23. JPAG be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered:
- Whether “Section 2 – the Accounting Statements” should be moved to the 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.

A handwritten signature in black ink that reads "Sir Tony Redmond". The signature is written in a cursive, flowing style.

Sir Tony Redmond

2. The direction and regulation of local audit

2.1 Introduction

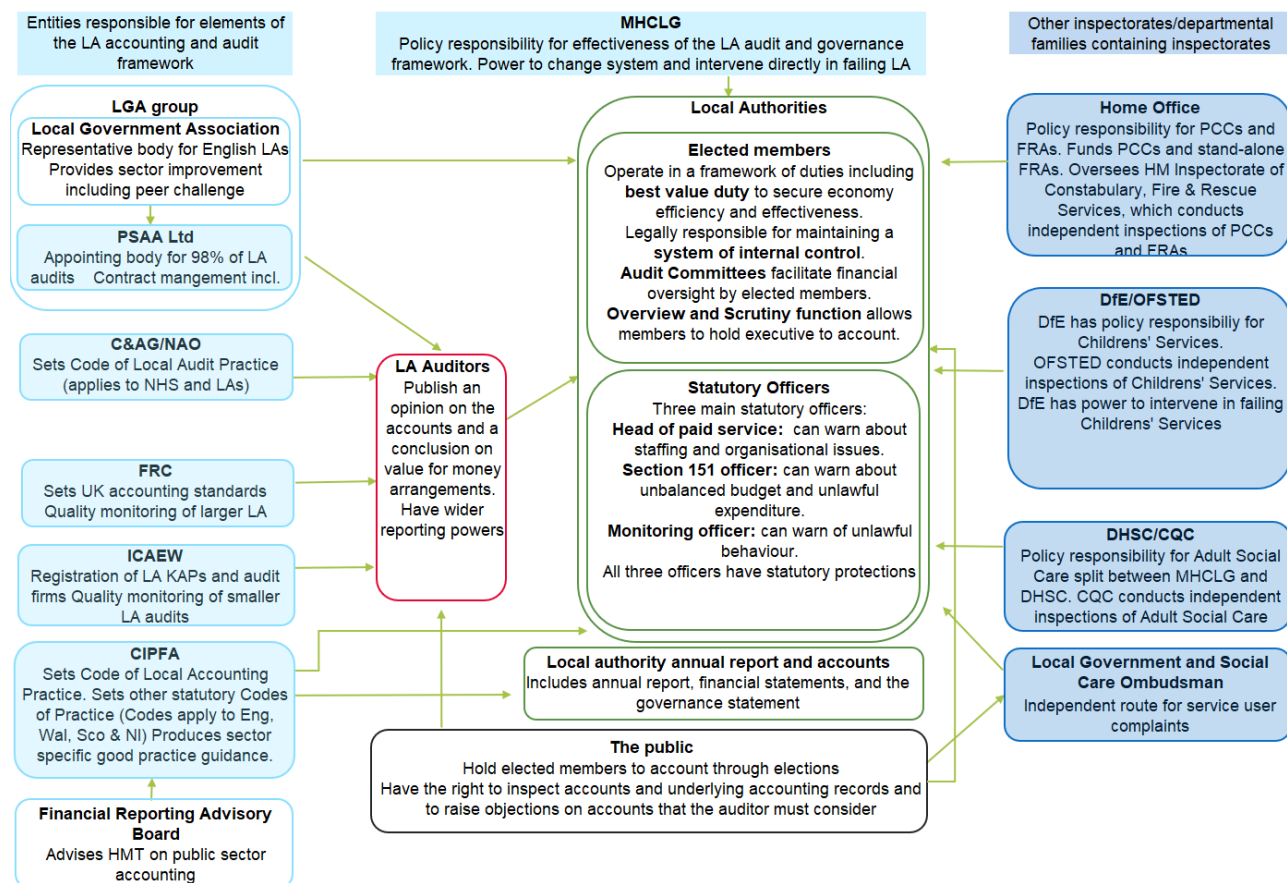
- 2.1.1 The direction and regulation of local audit must be structured as to enable public accountability to be served. Each stage of the local audit process must adhere to this and remain consistent throughout. Ultimately, the direction and regulation of audit must be coherent, consistent in quality 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**

- Adapted from Figure 1 in NAO report *Local Authority Governance* (Jan 2019)
- There are other statutory officers in local authorities, but between them, the three listed have overall responsibility for effective governance
- Arrows show the influences on local authority governance arrangements
- 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
- Audit Committees are mandatory in PCCs, stand-alone FRAs and mayoral combined authorities. They are not mandatory for other LAs.
- 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.
- 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 Authorities¹ 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 responsibilities² 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/ukxi_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 FRC's 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.

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 rating³. 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 (MHCLG) 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. KPMG does not currently hold any PSAA contracts.

3.1.3 There is a risk that the Competition and Markets Authority: Statutory Audit Services Market Study⁴ 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)			

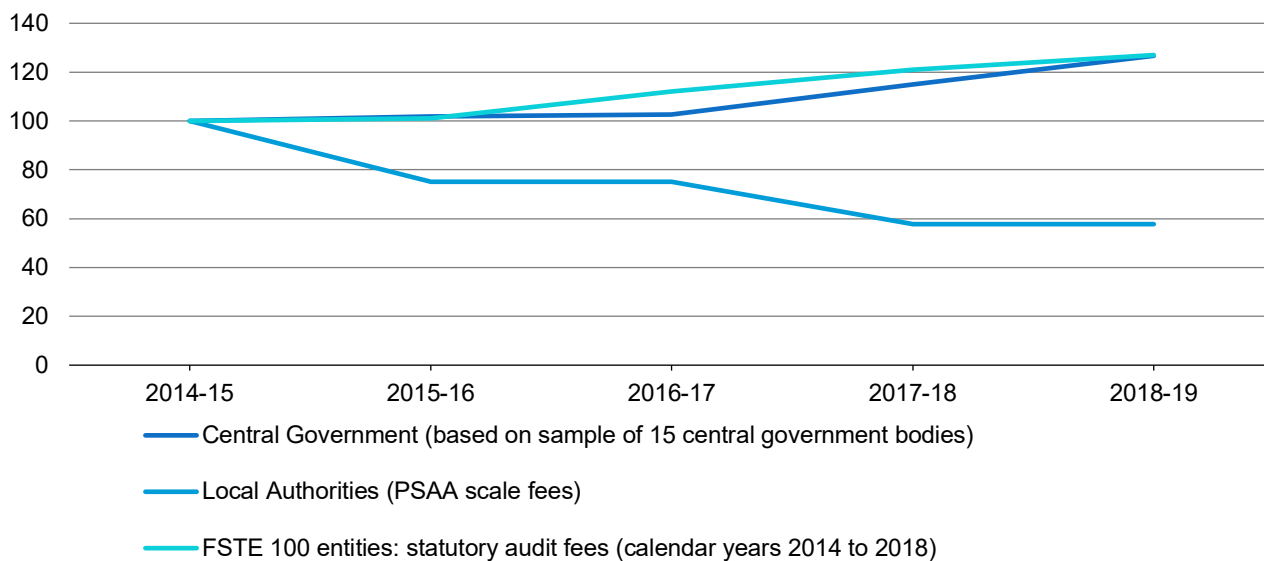
Questions 2.1, 3.1 and 4.1 are direct indicators of quality.

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

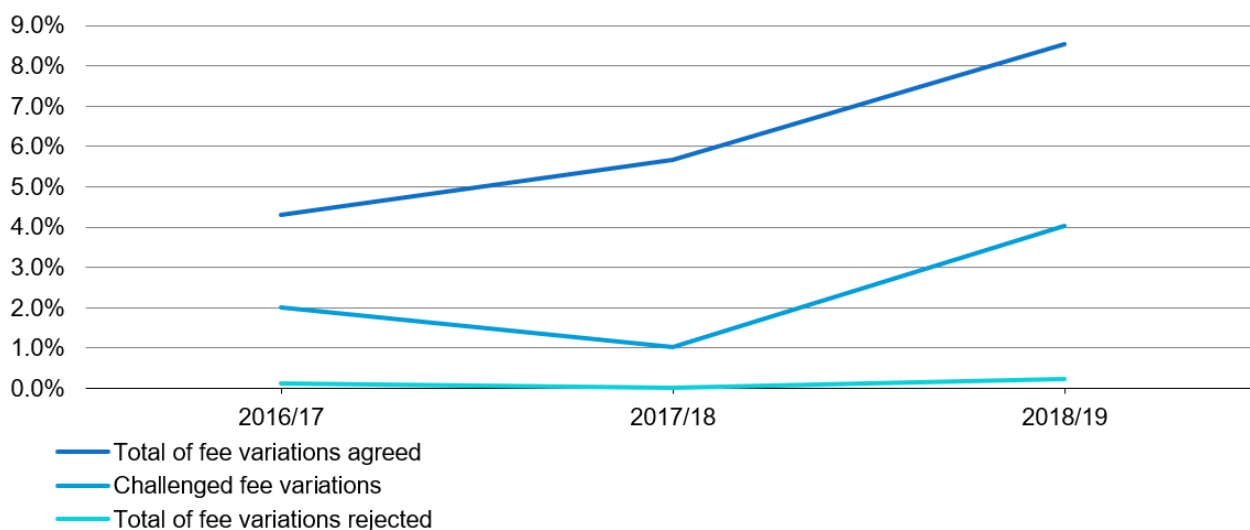
- 3.3.1 PSAA told the Review that the scale fee paid by individual LAs under the current contracts has been calculated by taking the total annual fee paid to external auditors under the contract and adding PSAA's margin; comparing the total amount paid to the total amount paid under the 2014 contracting 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 PSAA⁵. 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.psa.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.

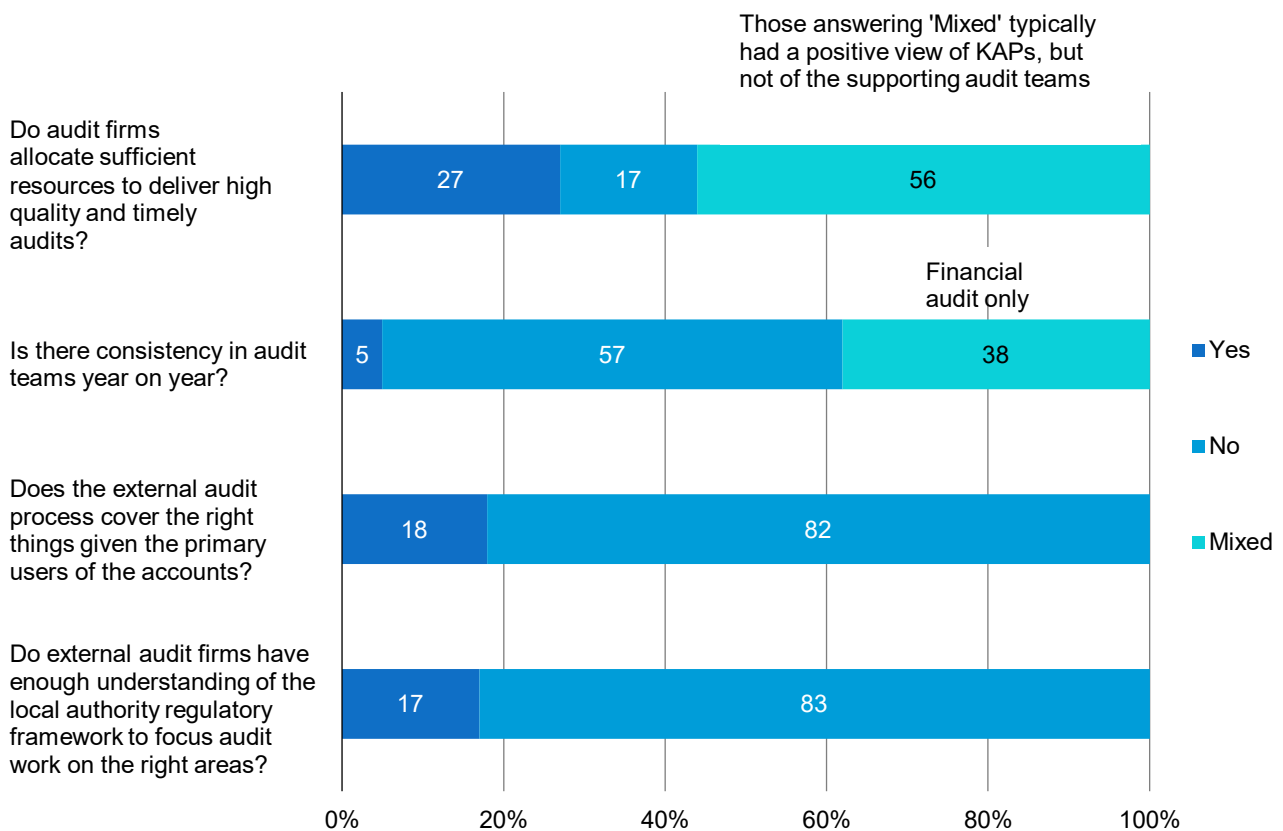
Knowledge, experience and continuity of audit staff

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, many 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



Local Authority Call for Views responses

- 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'd⁸ 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 whilst 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.

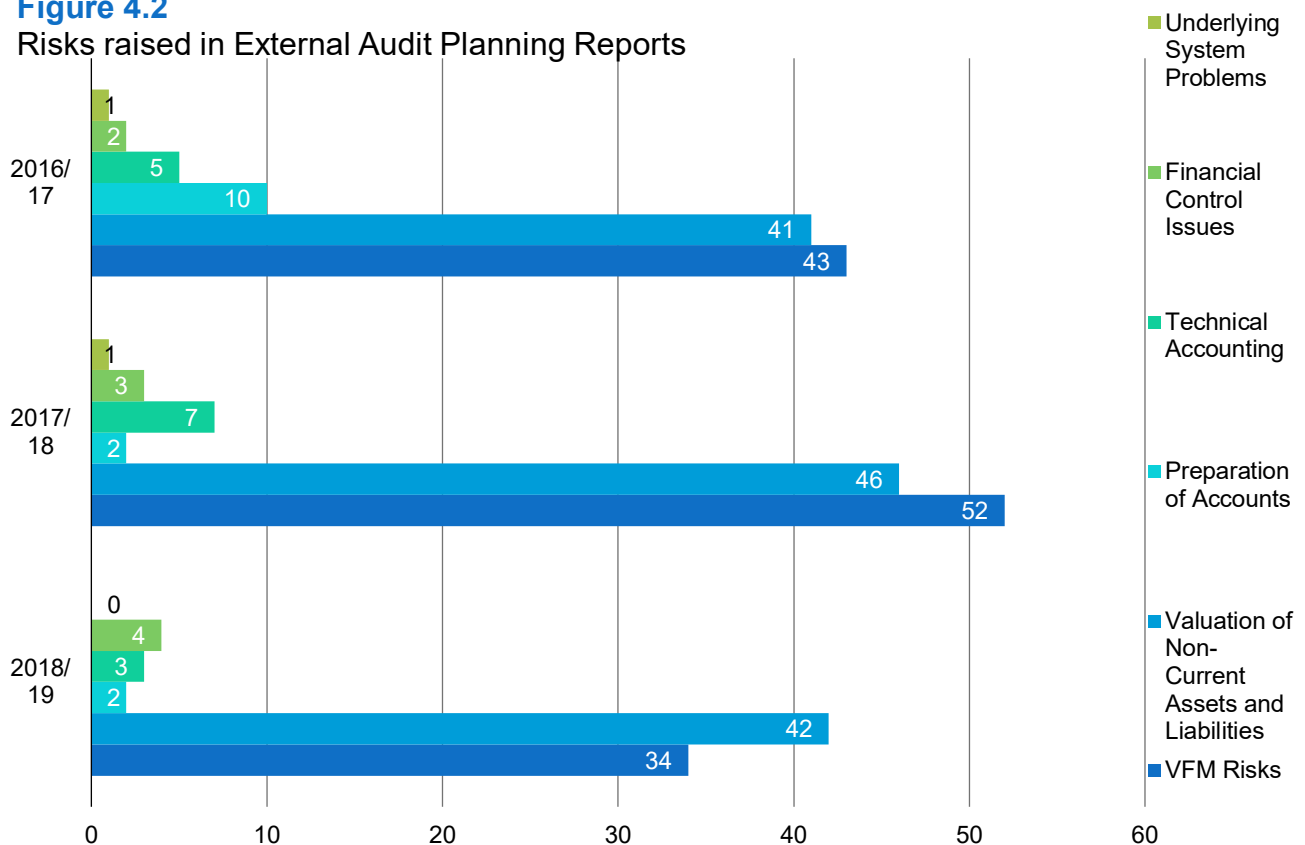
⁹ <https://www.psa.co.uk/wp-content/uploads/2020/03/PSAA-Future-Procurement-and-Market-Supply-Options-Review.pdf>

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

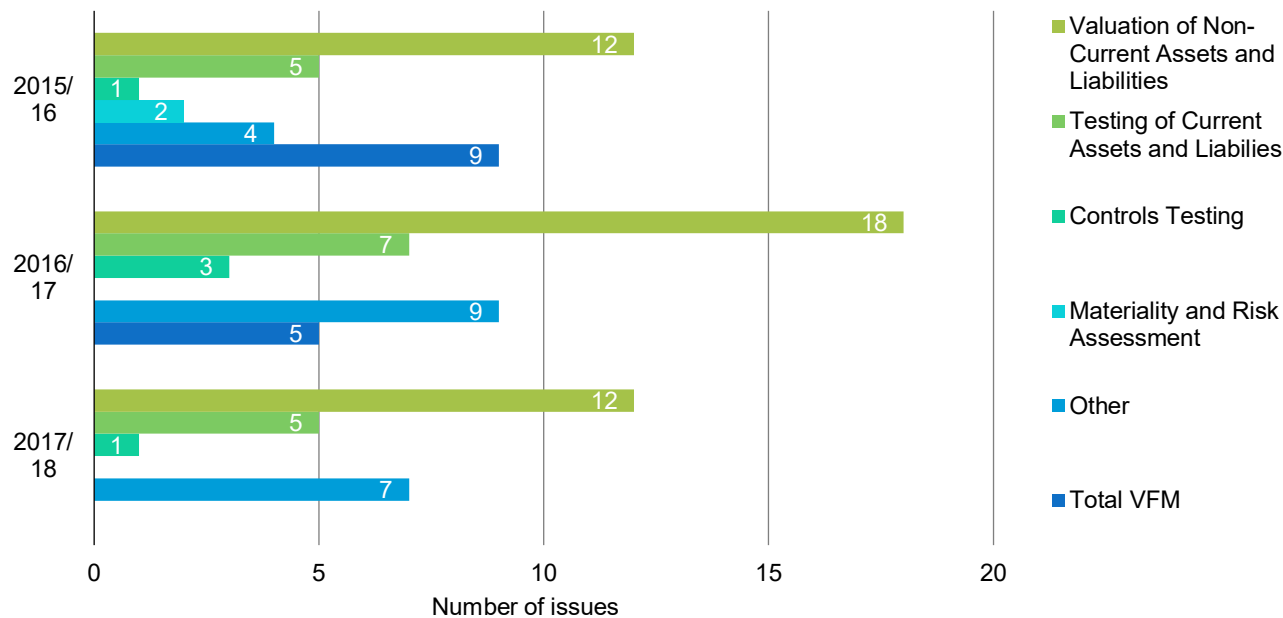
4.3.14 As demonstrated in **Figure 4.2**, valuation of non-current assets and liabilities have been the most common significant financial audit risk category identified in Audit Planning Reports. In addition, irrespective of the risk profile, the amount of detailed testing undertaken on these balances 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

Eight reviews were conducted in 15/16 and 16/17 and 6 were conducted in 17/18



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.

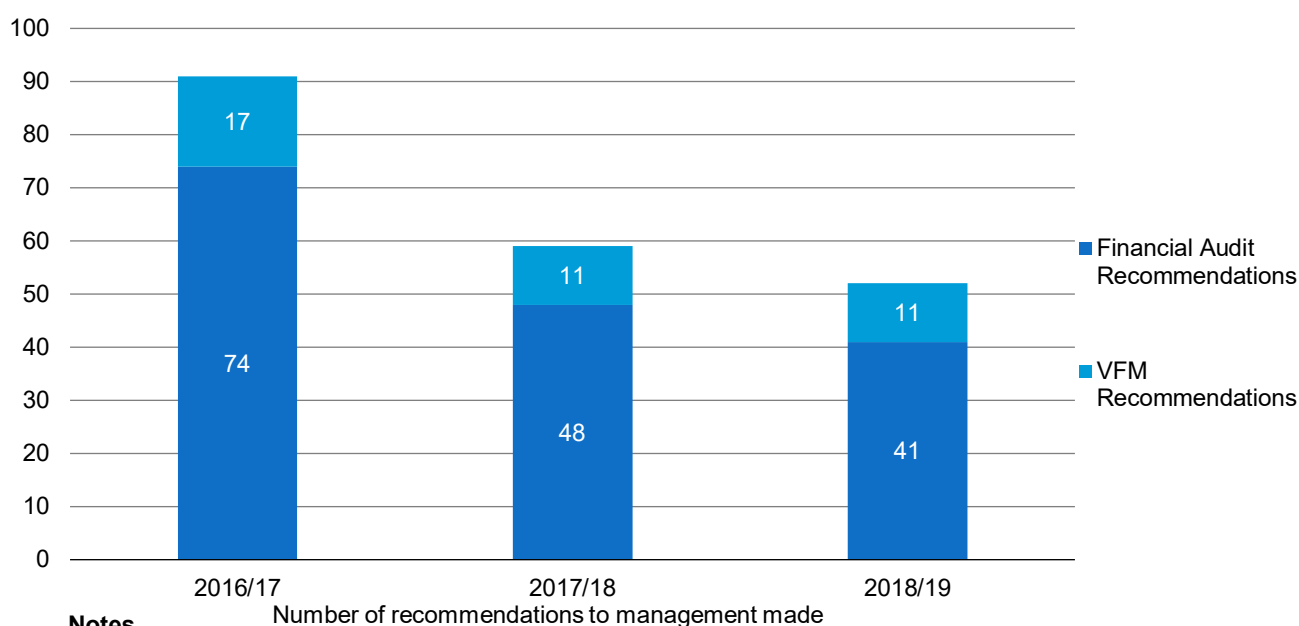
4.3.20 Firms have the power to request fee variations where the cost of the work is greater than allowed for by the contract fee. As discussed in **Chapter 3** the fee variation process is an ongoing and increasing source of tension, with auditors concerned that they are not always able to recover legitimate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



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, they 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

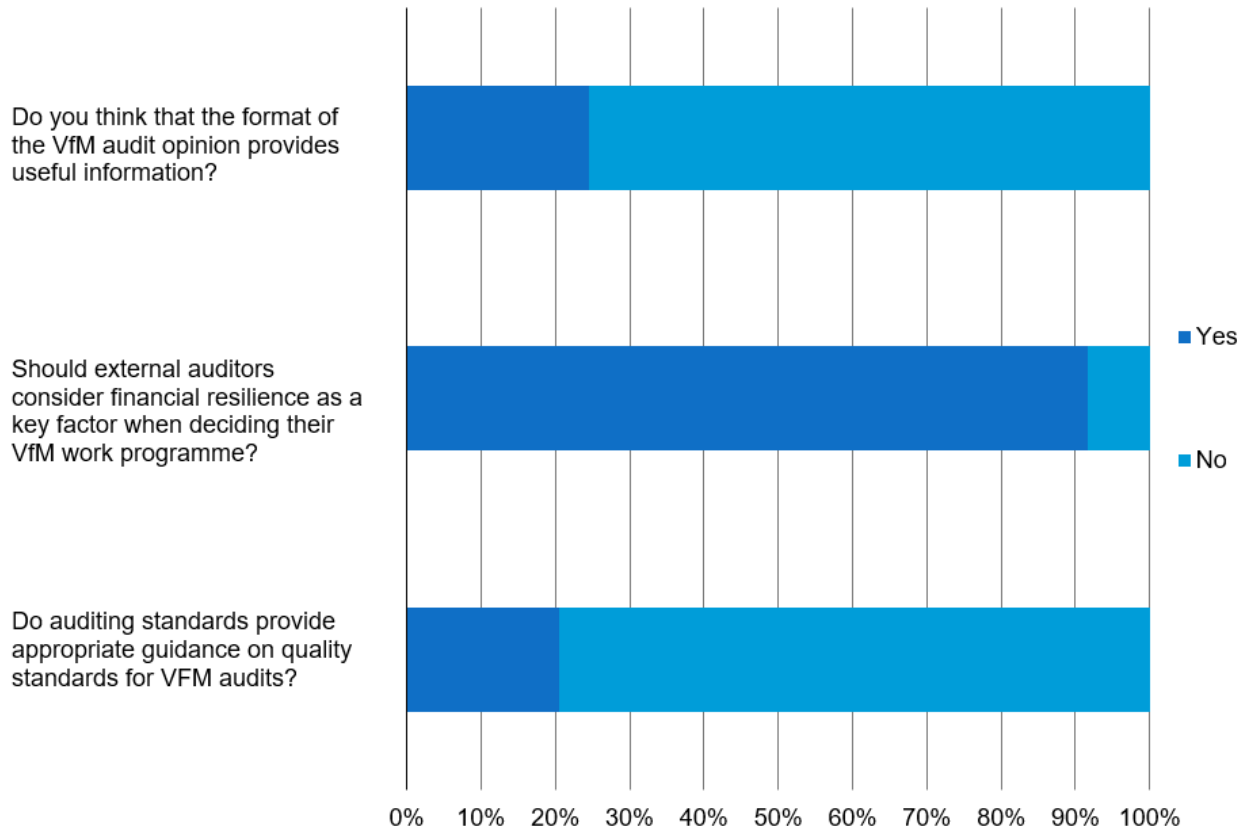
4.5.1 Whilst audit firms feel that the NAO's new code of practice resolves many of the VfM conclusion shortcomings, some local authorities believe that more significant changes need to be made. There is a large expectation gap between what local authorities

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 Authorities¹¹ 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

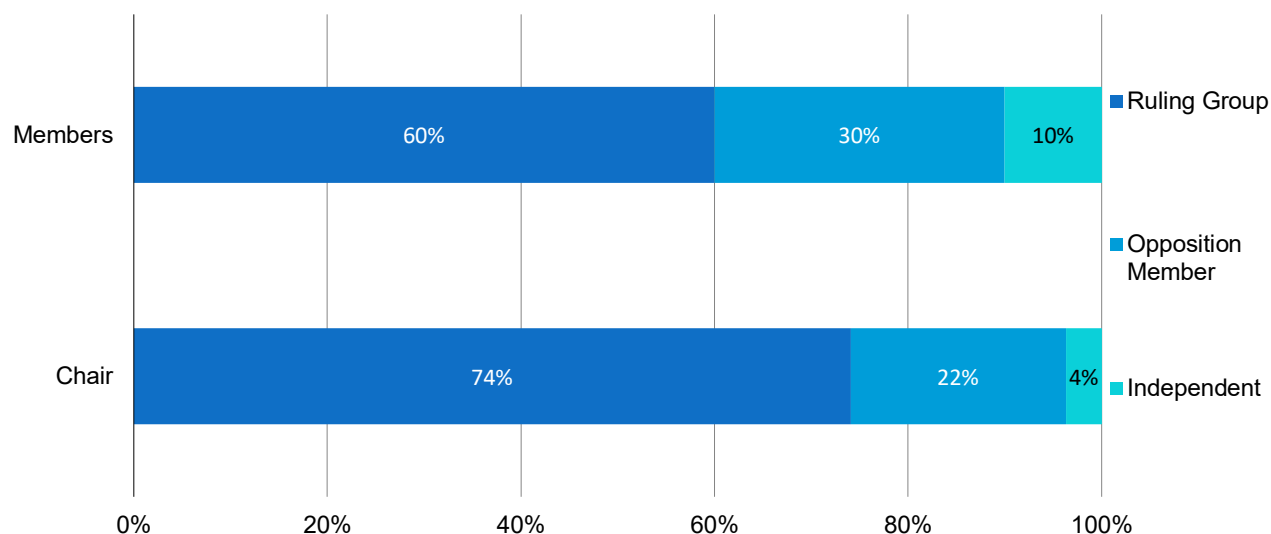
¹¹ Combined Authorities are statutory bodies made up of neighbouring local authorities that broadly cover a city-region that have agreed to work together. A Mayoral Combined Authority is where a mayor is the directly elected leader of the combined authority.

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:

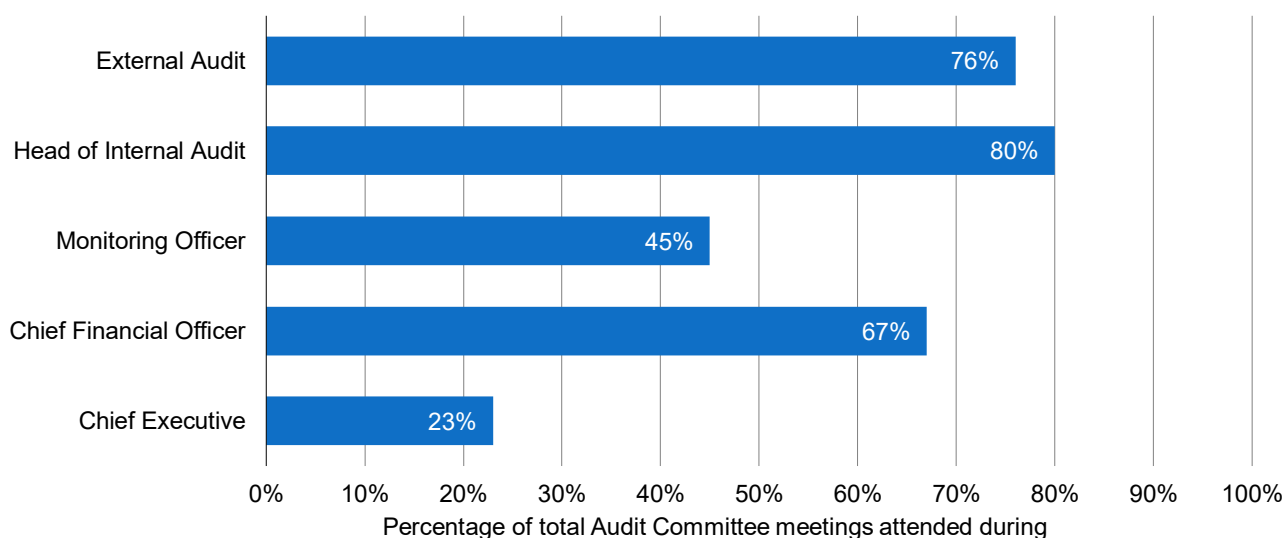
- The **Head of Paid Service** – typically the Chief Executive or Managing Director
- The **Section 151 Officer** – typically the Chief Financial Officer or Finance Director
- The **Monitoring Officer** – typically the Head of Legal Services

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 statute¹² 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](#)

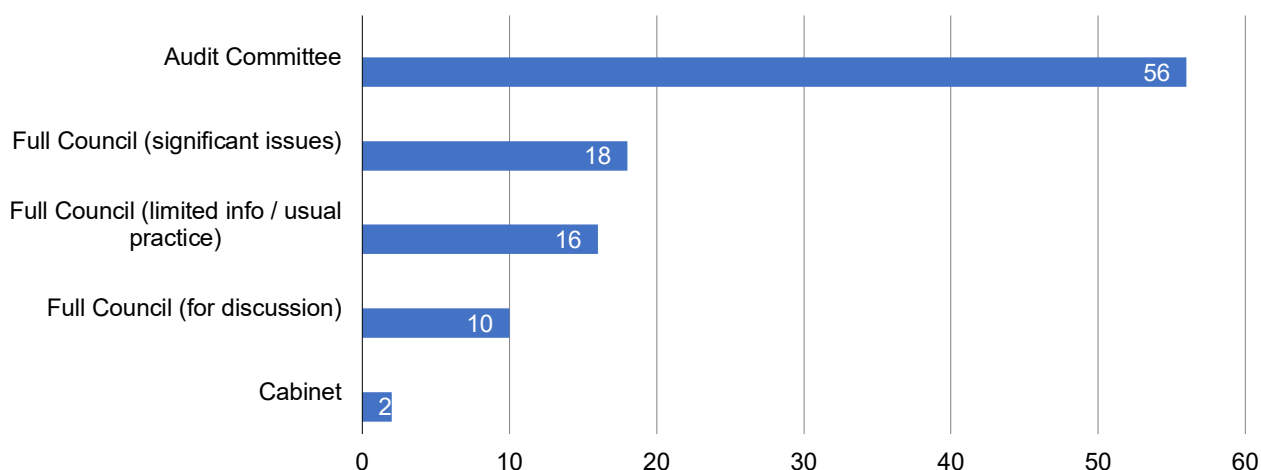
Committee is to review the comprehensiveness and reliability of assurances on governance, risk management, the control environment and the integrity of financial statements and the annual report. The Resources Committee will use financial projections and risk management information to take decisions 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 power¹⁶ 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.

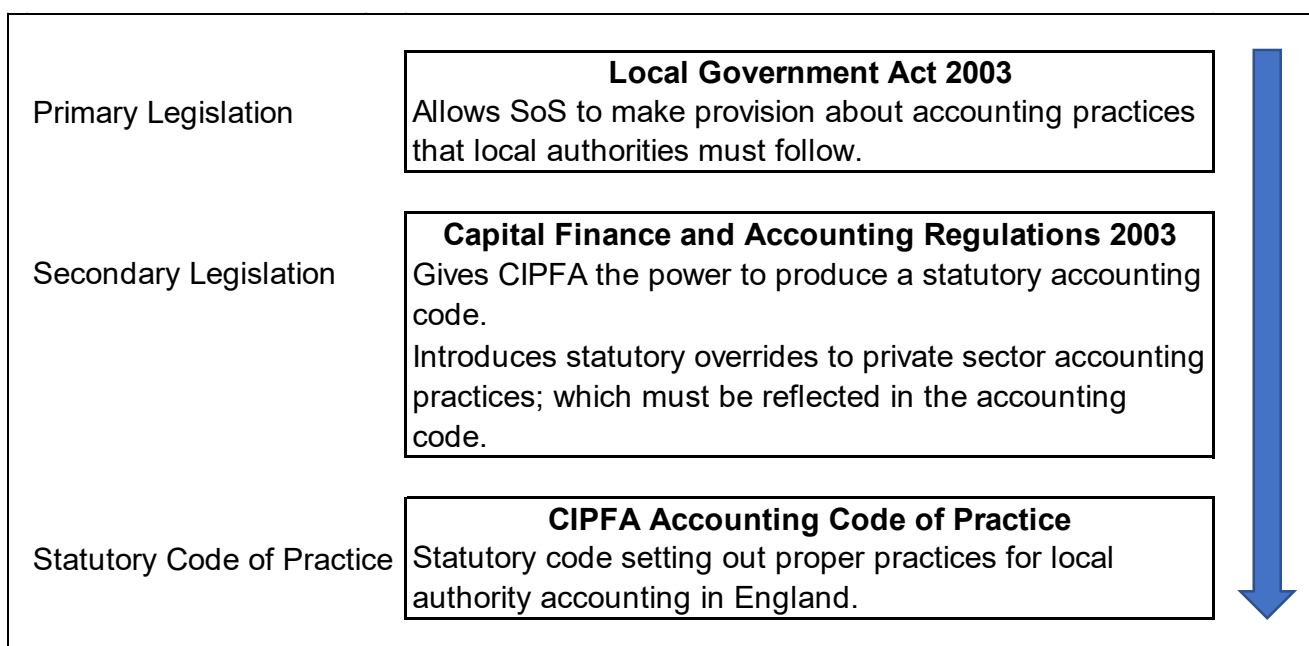
7.1.2 Local taxpayers and service users do not have the power to require a local authority to produce bespoke financial information for them. Instead, they have to rely on the financial statements. They can inspect the financial statements and the underlying accounting records for a 30-day period that 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



- 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* <ul style="list-style-type: none"> 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)* <ul style="list-style-type: none"> 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 accounting¹⁸ 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 auditor¹⁹.

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 8.1Table of audit thresholds and associated requirements for smaller authorities²⁰

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 processes²¹. 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

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)

2015 <https://www.legislation.gov.uk/uksi/2015/234/made#:~:text=5.,internal%20auditing%20standards%20or%20guidance.>

by council tax referendum rules²² 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 legislation²³ 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 Code²⁴ as principal authorities. Exempt authorities are subject to a specific smaller authority Transparency Code²⁵, 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 Government²⁶, 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 chooses 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.

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 objection²⁷ 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 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 comprises 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.

AUDIT COMMITTEE**25 November 2020****Annual Review of Audit Committee Performance****Report of Internal Audit and Assurance Manager****PURPOSE OF REPORT**

Annual Review of Audit Committee Performance

This report is public**RECOMMENDATIONS**

- (1) That the Audit Committee considers CIPFA's Self-Assessment of Good Practice at Appendix 1 and agrees the areas identified where further improvement is considered beneficial.**

1.0 Background

- 1.1 Audit Committees are a key component of an authority's governance framework. Their function is to provide a high-level focus on assurance and the organisation's arrangements for governance, managing risk, maintaining an effective control environment, reporting on financial and non-financial performance and supporting standards and ethics.
- 1.2 An Audit Committee's effectiveness should be judged by the contribution it makes to, and the beneficial impact it has on, the authority's business.
- 1.3 Evidence of effectiveness will usually be characterised as 'influence', 'persuasion' and 'support'. A good standard of performance against recommended practice, together with a knowledgeable and experienced membership, are essential for delivering effectiveness.
- 1.4 Authorities are encouraged not to regard meeting the recommended practice as a tick box activity and are reminded that achieving recommended practice does not mean necessarily that the Audit Committee is effective. To help give a more rounded opinion of the Committee's effectiveness, further guidance is provided in CIPFA's Audit Committee publication in respect of a knowledge and skills framework.
- 1.5 This is the first review of the Audit Committee's performance using CIPFA's Self-Assessment of Good Practice. Future annual reviews have now been scheduled in the Audit Committee's work programme.

2.0 Purpose of Report

2.1 To consider CIPFA’s Self-Assessment of Good Practice contained within CIPFA publication ‘Audit Committees - Practice Guidance for Local Authorities and Police 2018’ and identify the actions necessary to ensure that the Audit Committee meets best practice guidance and provides value to the authority.

3.0 Details of Consultation

3.1 The self-assessment at Appendix 1 has been completed by the Internal Audit and Assurance Manager and ratified by the Head of Finance (Section 151). Members will be asked to contribute to a discussion at the remote meeting with a view to ensuring the Audit Committee are meeting the requirements of CIPFA’s ‘Self-Assessment of Good Practice’ and agree the areas that have been identified as requiring attention (highlighted in bold).

4.0 Options and Options Analysis (including risk assessment)

4.1 There are no alternative options identified.

5.0 Conclusion

5.1 It is timely and appropriate to conduct a review of the Audit Committee’s performance and approve an improvement plan in accordance with CIPFA’s recommended guidance. The outcome of this review can be used as a source of evidence in the Council’s Annual Governance Statement to demonstrate that an effective Audit Committee is in place and working as intended.

CONCLUSION OF IMPACT ASSESSMENT (including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)	
Not applicable	
FINANCIAL IMPLICATIONS	
None directly arising from this report	
SECTION 151 OFFICER’S COMMENTS	
The Section 151 Officer has been consulted and has no further comments	
LEGAL IMPLICATIONS	
None directly arising from this report	
MONITORING OFFICER’S COMMENTS	
The Monitoring Officer has been consulted and has no further comments	
BACKGROUND PAPERS	Contact Officer: Joanne Billington
Audit Committees Practical Guidance for Local Authorities and Police 2018 Edition	Telephone: 01524 582028
	E-mail: jbillington@lancaster.gov.uk
	Ref:

CIPFA Self-Assessment of Good Practice – November 2020

Good practice questions	Yes	Partly	No	Comments
Audit Committee purpose and governance				
1 Does the authority have a dedicated Audit Committee?	✓			The Audit Committee has been in place since pre 2001.
2 Does the Audit Committee report directly to Full Council?	✓			<p>A periodic report is submitted to Full Council with the last report being considered 11 April 2018.</p> <p><u>Action</u> A periodic report for 2019/20 needs to be completed and submitted to Full Council for approval.</p>
3 Do the terms of reference clearly set out the purpose of the committee in accordance with CIPFA's Position Statement?	✓			The terms of reference, last approved in 19 February 2020 accurately reflects CIPFA's guidance 'Audit Committee's – Practical Guidance for Local Authorities and Police 2018.
4 Is the role and purpose of the Audit Committee understood and accepted across the authority?		✓		Most of the current membership have all received training on the role and purpose of the Audit Committee. However, following the Annual Meeting in May 2020 several new members have joined the Audit Committee and owing to the on-going pandemic, training has not been given to these new members.

				<p><u>Action</u></p> <p>New Audit Committee members will receive training on the execution of their terms of reference. This may be virtual training, given the current working arrangements.</p>
5	Does the Audit Committee provide support to the authority in meeting the requirements of good governance?	✓		The Audit Committee provide assurance on the adequacy of internal control, risk management, the integrity of financial reporting, and the annual governance processes.
6	Are the arrangements to hold the Audit Committee to account for its performance operating satisfactorily?	✓		The first annual review of effectiveness was completed in November 2020 by the Internal Audit and Assurance Manager and ratified by the Head of Finance (Section 151 Officer). An improvement plan is identified of any issues that need attention. Future annual reviews of effectiveness have been scheduled in the Audit Committee work programme for November.
Functions of the Committee				
7	<p>Do the Audit Committee's terms of reference explicitly address all the core areas identified in CIPFA'S Position Statement?</p> <ul style="list-style-type: none"> ▪ good governance ▪ assurance framework ▪ internal audit ▪ external audit ▪ financial reporting ▪ risk management ▪ value for money or best value ▪ counter-fraud and corruption ▪ supporting the ethical framework 	✓		The Audit Committee's terms of reference are in accordance with CIPFA's 'Audit Committees - Practical Guidance for Local Authorities and Police 2018'.

8	Is an annual evaluation undertaken to assess whether the committee is fulfilling its terms of reference and that adequate consideration has been given to all core areas?	✓			Although the self-assessment has been completed by the Internal Audit and Assurance Manager and ratified by the Head of Finance (Section 151 Officer), the annual review of effectiveness gives the Audit Committee the opportunity to assess if it is fulfilling the terms of reference.
9	Has the Audit Committee considered the wider areas identified in CIPFA's Position Statement and whether it would be appropriate for the committee to undertake them?	✓			<p>The Audit Committee already participate by considering governance and risk. The Committee also consider compliance to the Regulations of Investigatory Powers Act (RIPA).</p> <p>The Code of Practice on Treasury Management requires a body to be nominated and responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Council has nominated the Budget and Performance Panel to execute these functions.</p>
10	Where coverage of core areas has been found to be limited, are plans in place to address this?	N/A	N/A	N/A	There have been no instances where coverage of core areas has been found to be limited.
11	Has the Audit Committee maintained its non-advisory role by not taking on any decision-making powers that are not in line with its core purpose?	✓			The Audit Committee does not take on any decision making powers that are not documented within its terms of reference.
Membership and support					
12	Has an effective Audit Committee structure and composition of the Committee been selected?				Whilst individual Members of the Audit Committee may also serve on

	<p>This should include:</p> <ul style="list-style-type: none"> ▪ separation from the executive ▪ an appropriate mix of knowledge and skills among the membership ▪ a size of committee that is not unwieldy ▪ consideration has been given to the inclusion of at least one independent member (where is it not already a mandatory requirement). 	✓		✓	overview and scrutiny the Audit Committee's Terms of Reference stipulates that the Chair and Vice Chair must not be a member of the Cabinet or any overview and scrutiny committees.
13	Have independent members appointed to the committee been recruited in an open and transparent way and approved by the Full Council.			✓	The Audit Committee membership does not contain any independent members.
14	Does the Chairman of the Audit Committee have appropriate knowledge and skills?	✓			The current Audit Committee Chairman was first appointed in May 2019. He has extensive risk management skills, is a maths teacher and is also the Assistant Head Teacher at Settle College.
15	Are arrangements in place to support the Audit Committee with briefings and training?	✓			Training is provided to the Audit Committee in accordance with their scheduled Audit Committee Work Programme. In addition, the Audit Committee members will receive briefings as part of the Audit Committee agenda as and when required.
16	Has the membership of the Audit Committee been assessed against the <u>core</u> knowledge and skills framework and found to be satisfactory?	✓			<p>The induction training in June 2019 covered the core areas of the knowledge and skills framework.</p> <p>On-going regular attendance will ensure members complete the work programme thereby continually enhancing their knowledge and skills.</p>

					It should be noted that during 2020, all but one meeting (19 February) has been held remotely via TEAMS and it is intended that until further notice, all future committee meetings will be held in this way.
17	Does the Audit Committee have good working relations with key people and organisations, including external audit, internal audit and the Chief Financial Officer?	✓			Both the Head of Finance (Section 151 Officer) and the Internal Audit and Assurance Manager attend every Audit Committee meeting. In addition, a representative from the Council's External Auditors are frequently in attendance.
18	Is adequate secretariat and administrative support to the Audit Committee provided?	✓			Each meeting (including virtual meetings) are attended by an officer from the Council's Democratic Services Team. The meetings are minuted and published on the Council's Internet.
Effectiveness of the Committee					
19	Has the Audit Committee obtained feedback on its performance from those interacting with the committee or relying on its work?	✓			Both the Head of Internal Audit and Assurance and the External Auditors have the opportunity to provide feedback to the Audit Committee at their annual private discussions.
20	Are meetings effective with a good level of discussion and engagement from all members?	✓			Members routinely ask questions and will ask for further explanations and updates following audit reports where a minimal assurance opinion has been given.
21	Does the Audit Committee engage with a wide range of leaders and managers, including discussion of		✓		Following the receipt of a final audit report, the Audit Committee can call

	audit findings, risks and action plans with the responsible officers?				in Directors / Managers to challenge them on audit findings, outstanding actions or any associated risks.
22	Does the Audit Committee make recommendations for the improvement of governance, risk and control and are these acted on?	✓			The Audit Committee regularly request more updates on the progress of embedding risk management across the organisation and the progress in implementing the actions raised following the production of the Annual Governance Statement.
23	Has the Audit Committee evaluated whether and how it is adding value to the organisation?	✓			During their induction in June 2019 the Audit Committee Members were given examples of where and how the AC could add value to the organisation. The Audit Committee will be invited to discuss this further as part of their annual review of effectiveness.
24	Does the Audit Committee have an action plan to improve any areas of weakness?	✓			Actions contained within this checklist are highlighted in bold and will be implemented prior to the next annual review.
25	Does the Audit Committee publish an annual report to account for its performance and explain its work?	✓			A periodic report is submitted to Full Council with the last report being considered on the 11 April 2019. The report explains the work of the Audit Committee and more specifically details the reports that been submitted during the year. See action required at Q2.