

Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England

Response from South Northamptonshire Council.

The response below is submitted on behalf of South Northamptonshire Council in response to the call for views from the Government on the matter.

Chapter 1 – Definitions of Audit and Users of Accounts

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

The primary users of accounts are central government, statisticians and technical analysts. The complexity of the accounts makes their use by the public difficult.

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

Individuals and groups who represent, or purport to represent, local stakeholders such as service users, council taxpayers and business ratepayers, require a high level of technical expertise to understand the accounts and this can lead to misinterpretation and misrepresentation of the local authority's financial position.

Q3. What level of financial literacy/familiarity with accounts and audit is it reasonable to expect the primary users of accounts to have and what implications does this have for the information presented in accounts and/or the information that should be subject to external audit?

The level of financial literacy required to understand the accounts is way in excess of the level that it is reasonable to expect most people to have. It is important that a clear and concise summary of the Council's financial performance and position is included alongside the accounts. This should mirror the financial reporting to elected members during and at the end of the financial year.

The focus on creating a set of accounts that mirror those produced in the private sector creates unnecessary complexity and results in core statements that are not very useful for the majority of potential users of the accounts, especially given the need to reverse out lots of transactions in order to ensure that there is no impact on council taxpayers.

The only really useful piece of information included in the accounts relates to the reserves as this shows what has happened in overall terms to the Council's financial position between years in 'real' cash terms. This should be developed to show comparisons to previous years.

Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

The external audit has a heavy focus on the technical aspects of the accounts that do not impact on the Council's real financial position. For example, a significant amount of auditor time (and therefore cost) is spent in reviewing the valuation of fixed assets and the consequent revaluation gains and losses that are posted to the Consolidated I&E. Whilst this is a real issue in the private sector, it is less of an issue for local authorities given that these are reversed out to the Capital Adjustment Account and therefore has no real impact on the Council's finances and no impact on the Council Tax payer.

Essentially, these are just notional accounting entries that have no real impact. However, the auditors can spend an inordinate amount of time agreeing these values and accounting entries and will often levy additional charges for this time. These additional audit fees are 'real' and do impact on the bottom line which is a nonsense. Time spent looking at a notional, artificial issue leads to extra real costs being incurred.

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it? No, it is not a relevant consideration for local authorities and should be removed.

Chapter 2 – The Expectation Gap

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

Local Authorities are not the same as private sector organisations and the audit focus should be adapted accordingly. The key issue of interest to local stakeholders, i.e. current and potential service users, local taxpayers and residents is the delivery of the highest possible quality within the funding available. Whilst auditors do not test the performance of the local authority, they should ensure that their audit of the financial statements recognise these stakeholder interests.

Auditors should review the local authority's level of expenditure compared to budget to check that the necessary controls are in place to ensure that costs are controlled and also that significant underspends against budget are not a result of services not being delivered to the planned level.

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

The VFM opinion should be changed or renamed. It is misleading at present as it often refers to historic issues rather than current VFM issues. To truly offer an opinion on VFM then auditors would need to look at performance and service delivery as well as financial statements.

Q8. What is your view on the scope of an external audit engagement as described in Chapters 1 and 2 of this Call for Views? If it is different from your expectations, does this have implications for the reliance you place on external audit work?

No strong views

Q9. Should the external audit engagement be extended? If so, which additional areas/matters are most important for external auditors to look at? What would be the cost implications of extending the engagement to the areas/matters you consider to be most important be?

In our opinion the scope of the audit should be changed rather than extended. This is likely to result in a cost reduction.

Chapter 3 – Audit and Wider Assurance

Q10. Should the scope of the vfm opinion be expanded to explicitly require assessment of the systems in place to support the preparation of some or all of the reports that statute requires to be presented to full Council? If you do, which reports should be within scope of the external audit vfm engagement? If not, should these be assessed through another form of external engagement? If you believe that the vfm opinion should be extended to cover these reports will there be implications for the timing of audit work or auditor reporting?

No, this should not be part of the role of External Audit. The Council's statutory officers provide assurance as part of these reports. MHCLG monitors key statistical returns to highlight authorities at risk of failure.

Q11. Should external auditors be required to engage with Inspectorates looking at aspects of a local authority's service delivery? If you believe that this engagement should happen, how frequent should such engagement be and what would be the end purpose of doing so?

They should be aware of the work of other inspectorates in forming their opinions on the Council. However, they shouldn't be required to engage it should be part of their normal operating practice.

Chapter 4 – The Governance Framework for the Audit System

Q12. Does the current procurement process for local authority audit drive the right balance between cost reduction, quality of work, volume of external audit hours and mix of staff undertaking audit engagements?

No. Whilst there may have been a reduction in scale fees, the auditors are prone to extend the scope of their work such that the total fees rise significantly. Often this is due to the poor quality of the audit work undertaken initially. The audit firms do not have enough staff with a knowledge and understanding of local government and often approach the audit as if we were a private company, for example asking to see a profit and loss account.

Q13. How should regulators ensure that audit firms and responsible individuals have the skills, experience and knowledge to deliver high quality financial and vfm audits, whilst ensuring the barriers to entry do not get too high?

One member of our audit committee expressed the view that "we should go back to the Audit Commission, they were much better and had a certain status where they

were taken seriously” and that “Audit Commission reports used to be really useful and valuable”. The disparate nature of the present audit provision means that there is often a lack of staff with the necessary skills, experience and knowledge.

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

No strong opinion on the metrics to use but they should ensure consistency in assessment and delivery of audit services across the sector. The regulators also need to ensure they have the right mix of skills, knowledge and experience when assessing appropriate quality.

Q15. Do you agree with the Independent Review of the Financial Reporting Council’s findings and recommendations; and why do you agree/not agree? If you agree with the recommendations do you think the ‘single regulatory body’ should be the “successor body to the FRC” or a sector specific entity? If you do not agree with the recommendations are there any other changes you would make to the regulatory framework for local authority audit?

We agree with the thrust of the recommendations. The regulatory body should be a resurgent Audit Commission or a completely new body which has the requisite skills and expertise to carry out their role effectively.

Chapter 5 – Audit Product and Quality

Q16. Do external audit firms have enough understanding of the local authority regulatory framework to focus audit work on the right areas? How do they/should they demonstrate this? Who should regulate this work?

No, as noted above firms do not have the right mix of staff, and they do not understand the difference between local authorities and private sector organisations. Scarce audit resources affect the quality of the audits being carried out.

Additionally, audits have been carried out very late leading to statutory deadlines not being met as a direct consequence of there being insufficient audit resource to conclude the audit work on time.

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

No opinion

Q18. Do audit firms allocate sufficient resources to deliver high quality and timely audits? How is consistency and quality maintained in external audit work? To what extent is there consistency in audit teams year on year? What more can be done to ensure consistency between firms?

No. Our experience is that insufficient resource has been allocated to recent audits.

The focus on reducing costs leads to a poor-quality mix of staff allocated to the audit. Changes in staff from year to year leads to a repetition of questions, which are sometimes irrelevant anyway. There is inconsistency between years.

Q19. To what extent are senior audit staff, particularly the responsible individual signing the audit certificate, visibly involved in audit work? Who do senior audit staff meet with?

The partner is not involved in the detailed audit work but does attend most Audit Committees and has a clear understanding of the issues being faced by the Council. He is accessible, responsive and will meet senior officers and audit committee members as and when required.

Q20. Should external auditors consider financial resilience as a key factor when designing their vfm work programme? If so, what factors do they/should they consider as indicative of a lack of financial resilience?

Yes, definitely.

They should consider levels of balances and performance against budget. They should also devise an early warning system for those local authorities that are showing signs of financial stress so they can provide independent advice or assurance to Audit Committee members, or Council, as required.

Q21. Does the Code of Audit Practice provide enough guidance on how much work needs to be done to support the vfm opinion? If not, what should it cover?

No opinion

Q22. Do auditing standards provide appropriate guidance on quality standards for vfm audits? If not, is guidance needed and should it be included in the Code of Audit Practice or elsewhere?

No opinion

Q23. What is the current relationship between external and internal audit? How should that relationship be developed to add most value to local authorities and local residents?

It varies from organisation to organisation. Ideally, the relationship should be an independent but complementary one between the two parties.

Q24. What should happen when a regulator finds that a local authority audit has not met quality standards? Where should the balance between ensuring effective enforcement action against auditors and maintaining participants in the audit market lie?

The should initially receive a warning and if they continue to fail to meet quality standards then they should lose that particular contract. External audit is held in a lower regard now than the Audit Commission was previously as standards have slipped but no action has been taken to address the recently experienced shortcomings.

Chapter 6 – Auditor Reporting

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

It is in a standard format and doesn't provide much useful information. It should cover budget variances, issues raised by other inspectorates and any other issues relating to the authority that they are aware of such as major projects and how these are being managed and governed.

Q26. Do you think the vfm opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate?

No. The opinion should be a rounded assessment of the authority. Reports from other inspectorates should be considered but a rounded view is essential.

Q27. Do you think that the vfm opinion is presented at the right point in a local authority's annual financial management and budgeting cycle? If not when do you think it would be most useful?

No opinion

Q28. Where auditors have identified significant issues, audit certificates and reports have often been delayed? Why do you think this is and can changes be made to the framework to encourage earlier reporting of significant issues?

When significant issues are identified, auditors do not have enough resource and flexibility to deal with these quickly and effectively. Often the issues are not significant but are a result of a lack of auditor understanding. Delays of their own making are used by auditors as a reason for charging additional fees.

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

One member of the audit committee expressed the view that "auditors used to do Public Interest reports that were treated seriously. They [the auditors] seem to be less effective and have fewer teeth these days."

Q30. Statistics demonstrate that very few Public Interest Reports and Statutory Recommendations have been issued. Why do you think this is? Does it indicate an issue with the framework or common behaviours? If you think this is an issue, what can be done to incentivise more frequent and timely reporting of significant issues?

It is probably an indication that the auditors do not have the resource to do this type of work effectively any longer.

Q31. Does a publication summarising the results of local authority audits add value? If so who should publish it and what information would they need to have access to to perform this function effectively?

Yes. This would be a useful publication. It would make sense if this was produced by the National Audit Office.

Chapter 7 – The Framework for Responding to Audit Findings

Q32. To whom should external auditors present audit reports and findings; is it the audit committee, to full council or equivalent or another committee? If findings are not presented to full council or equivalent what information (if any) should full council or equivalent receive?

Reports should be considered by audit committee initially, but where there are significant issues they should also be reported to full council. There should be a requirement for the report to be accompanied by a management action plan to resolve the issues raised.

Q33. In your authority, what is the membership of the audit committee (number of members, how many are independent etc) and which officers typically attend?

Audit Committee comprises of 6 members, all of whom are elected councillors. The Chairman of the Committee is an Independent Councillor and not part of the administration. Meetings are typically attended by the Chief Finance Officer or deputy along with other officers who may have reports going to the Committee. A representative from the organisation providing internal audit services and external audit attend most meetings.

Q34. How should local authorities track implementation of recommendations made by internal audit, external audit and relevant statutory inspectorates? What should the external auditors do if recommendations are not being implemented?

Implementation should be monitored by the audit committee. All internal audit recommendations are formally tracked by the Committee. Previous external audit recommendations are followed up to check on implementation when their next audit is carried out.

Q35. Should there be a role for an external body in tracking action taken in response to modified audit opinions and/or statutory recommendations and public interest reports? If so should that responsibility sit with MHCLG, the sector specific oversight body recommended by the Independent Review of the Financial Reporting Council or another body?

There is no requirement for a further external body to carry out this role. It should be monitored by the Audit Committee as well as internal and external audit who should then report their findings back to the Committee.

Chapter 8 – The financial Reporting Framework

Q36. Do local authority accounts allow the user to understand an authority's financial performance and its financial resilience? If not, how could they be revised to be more understandable? What information could be presented to enable users of the accounts to understand whether the financial position of a specific LA is getting better or worse?

As noted in the response to question 3, local authority accounts in their current form are not easily understood by users. In order to be more understandable, they should only show the costs and income that impact on the local authority's real financial position.

Q37. The UK Government is committed to maintaining IFRS based accounting for the UK public sector. Given this, how would you recommend resolving the mismatch between the accruals and funding basis to improve the understandability of local authority accounts?

This is an unresolvable issue. In order to make the accounts understandable they should be based on a code that is fit for that purpose, rather than one based on IFRS. The current accounts are not only less meaningful and understandable, but also expensive to produce. Significant time is spent by Finance staff to calculate and account for depreciation charges and asset revaluations, which are then reversed out in order to not impact on funding. A summary of the true financial position should be required right at the start of the accounts with summarised information and comparison to previous years.

Q38. Do you think that summary financial information should be reported in the annual report section of the accounts? If so, on what basis and should this information be covered by the financial audit opinion?

If local authorities continue to be required to produce IFRS based accounts, then these should be accompanied by a meaningful statement of income and expenditure compared to budget, consistent with reports that are made to Cabinet at the year end. The audit opinion should focus on the accuracy of this reported position, rather than spending time on the transactions that are reversed out of the CIES.

Q39. If you think that summary financial information should be reported in the annual report section of the accounts, should it be presented with performance information? If so, what performance information would be of most interest to stakeholders?

Summary performance information should be included, setting out how the local authority performed against its targets, as well as a summary of the achievements against corporate plan objectives and the financial performance of the Council.

Chapter 9 – Other Issues

Q40. For larger authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner? If not, how should the regime be modified?

No, it is often used by residents or groups with a grudge against the council and these should often be treated as complaints rather than objections to the accounts. Guidance should be produced for Auditors to enable them to quickly assess whether or not “objections” are real.

Q41. Is more guidance needed to help auditors assess the impact of significant changes to common business models? If so is this guidance needed to support the financial audit, the vfm audit or both?

It is for auditors to be aware of emerging business models in order for them to discharge their responsibilities effectively. More guidance should not be required for them to be able to do this.

Q42. Is the financial reporting and audit framework for larger category 2 authorities appropriate? If not, what additional information should be subject to audit/assurance and what would be the cost implications of this?

No opinion

Q43. For smaller authorities, does the inspection and objection regime allow local residents to hold their council to account in an effective manner and is the cost of processing and responding to objections proportionate? If not, how should the regime be modified?

No opinion

Martin Henry

Executive Director – Finance

12 December 2019