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

A. Purpose

The Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) invites Sir Tony Redmond to conduct a Review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014 (the Act). The Review will not look at broader issues of local authority finances and sustainability.

B. Review objectives

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

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

C. Scope

The review’s scope is taken to include the objectives and context included in these terms of reference.

In practice, this means the review is likely to focus on the following questions;

- Have the financial savings from local audit reforms been realised?
- Is there a more accessible audit market and has there been an increase in audit providers?
- Have audit standards been maintained or improved, and not been compromised?
- Is there an ‘expectation gap’ in what external audit provides? What is the nature of the gap and how can it be filled?
- Are auditors properly responding to questions or objections by local taxpayers?
- Are auditors using their reporting powers in an appropriate way?
• Are audit recommendations effective in helping local authorities to improve their financial management?
• Are councils responding to auditor recommendations in an appropriate manner?
• Whether local authority accounts report financial performance including use of resources against budget in a manner that is transparent and comprehensible to council tax payers and the general public?
• Does the financial information provided in local authority accounts facilitate scrutiny by local taxpayers and by the local press?

The financial reporting and audit framework for Clinical Commissioning Groups, NHS Trusts and Foundation Trust and special trustees for hospitals is outside the scope of this Review. This is because these bodies have significantly different statutory bases and governance frameworks to other bodies covered by the Act.

D. Context

Local Government in England is responsible for 22% of total UK public sector expenditure. It is essential that local authority financial reporting is of the highest level of transparency to allow taxpayers to understand how their money is being spent.

The responsibilities for the framework within which local authority audits are conducted is the Local Audit and Accountability Act 2014. It gave effect to manifesto commitments to abolish the Audit Commission and its centralised performance and inspection regimes and put in place a new localised audit regime, refocussing local accountability on improved transparency.

Now the Act has been fully implemented, the Government is required to review its effectiveness. This review will meet MHCLG’s commitment to undertake a post implementation review of the audit framework and financial reporting elements of the Act. The Government wants to use this opportunity to step back and review the effectiveness of the local authority financial reporting and audit regime. Developments in the sector such as the growth of commercial investment activity have led to a perceived widening of the ‘expectation gap’; that is, the difference between what users expect from an audit and the reality of what an audit is and what auditors’ responsibilities entail. There may also be an expectation gap between the information that users of local authority accounts believe is needed and what is available to them through audited financial statements or other publicly available information.

Other elements of the Act, including openness transparency of council meetings, the local authority publicity code and intervention powers are outside the scope of this Review. MHCLG will undertake a post implementation review of those elements of the Act in house.

This Review has assumed greater significance due to developments elsewhere. BEIS commissioned Sir John Kingman in April 2018 to carry out a review into the role of the Financial Reporting Council and, in February 2019, Sir Donald Brydon to carry out a review into the quality and effectiveness of statutory audit (reporting in December 2019). In
addition, the Competition and Markets Authorities’ 18 April 2019 report recommends changes to the statutory audit market that will impact on local audit. Alongside this, there have been three recent PAC hearings on: the Financial Sustainability of Local Authorities (Nov 2018) Local Audit in England (Jan 2019) and Local Authority Governance (Mar 2019). Finally, as part of its legal duties, the National Audit Office is required to review and replace the current Code of Audit Practice by April 2020.

E. Governance

The review will be led by Sir Tony Redmond and report to the Secretary of State for Communities and Local Government

The Independent Reviewer will be supported by an Advisory Group that will advise on the direction of the review and sources of evidence and will help to scrutinise and challenge emerging findings and recommendations.

F. The Review Secretariat

There will be a small dedicated Review Secretariat acting in support of the Independent Reviewer.

G. Stakeholder Engagement

The Review will undertake engagement with a wide range of stakeholder groups, including those representing the interests of local authorities, the accountancy profession, and local residents and taxpayers in order to fully understand the range of issues and to ensure constructive challenge.