

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

A call for views issued by the Ministry of Housing, Communities & Local Government led by Sir Tony Redmond.

Comments from ACCA
21 January 2020
Ref: TECH-CDR-1854

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our **219,000** members and **527,000** students in **179** countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of **110** offices and centres and more than **7,571** Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

Further information about ACCA's comments on the matters discussed here can be requested from:

Mike Suffield
Director of Professional Insights
Mike.Suffield@accaglobal.com

Antonis Diolas
Head of Audit and Assurance
Antonis.Diolas@accaglobal.com



GENERAL COMMENTS

ACCA welcomes the opportunity to comment on the Call for Views to the Independent review into the arrangements in place to support the transparency and quality of local authority financial reporting and external audit in England led by Sir Tony Redmond.

ACCA conducted a global research study published in May 2019 entitled '*Closing the expectation gap in audit*¹'. The findings of our research show that the public see audit as part of the solution for preventing corporate failure. Furthermore, our research found that there is demand for a wider audit scope including assigning more responsibilities to the auditor in identifying and reporting fraud and a demand for auditors to do more in respect of liquidity, solvency and viability. Our research on the expectation gap surveyed 11,000 members of the general public across 11 countries (including 1,000 in the UK), weighted evenly by sample size, gender and spread across age, education level and household income. The Countries included in the initiative are; Greece, Czech Republic, New Zealand, South Africa, Australia, Netherlands, Singapore, Canada, UAE, Malaysia and the UK. Although the study focused mainly on company audits, we consider the findings of our report to be equally relevant to local authority (LA) external audits.

Under "Areas for Specific Comment" below, we provide responses to those questions in the Call for Views where we wish our views to be taken into account. We have, therefore, not provided a response to each and every question.

AREAS FOR SPECIFIC COMMENT

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

ACCA considers that the term primary in this context should refer to the most important, therefore anyone (individual or organisation) who:

- has been involved in funding the services, to align with investors in a private sector setting and/or
- receives or uses services whether they have funded them or not, the rationale being that for many local authority (LA) services the recipient/user does not have a choice and
- legislators and regulators

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

¹ https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf



We believe anyone (individual or organisation) who is directly or indirectly impacted by the LA activities, including how they have been generated and delivered, could potentially be an “other” user. In addition to the primary users identified in our answer to Q1 above, we would specifically identify the following as other users:

- Other surrounding LAs, whose
 - funding may be impacted
 - perception and valuation is impacted
- Business and charities
- Employees
- LA pensioners

Users could change based on presentation. More accessible reporting could create a broader group of users, increase transparency and public engagement.

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?

As noted in our answer to Q1, primary users include those receiving the services, therefore the general public. We would therefore expect diverse levels of financial literacy/familiarity. The implications for accounting and auditing are that a knowledge gap is created as identified in the paper. All information provided needs to include an education element, for example, a plain English summary, in order to set the right expectations of what is and is not delivered via the accounting and audit process.

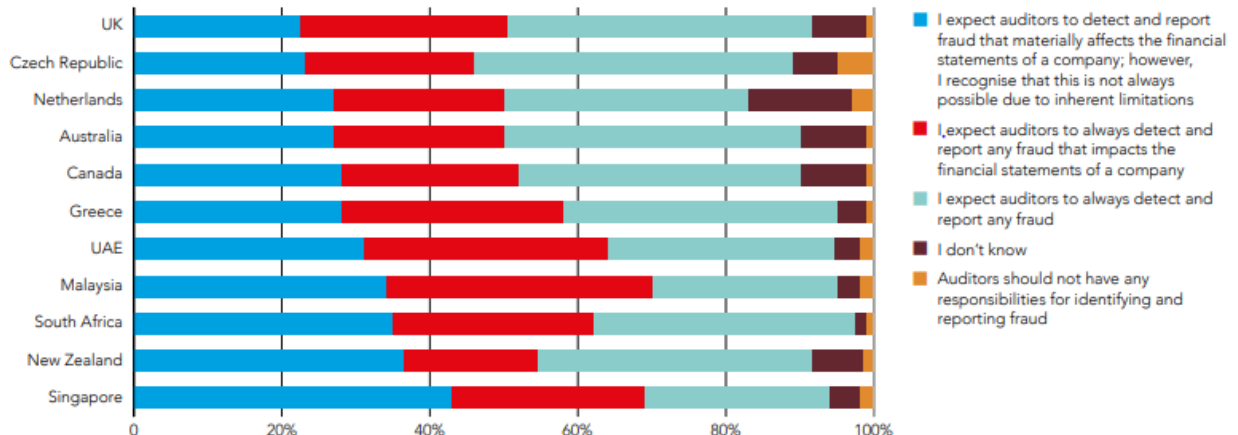
Q4. Does the external audit process cover the right things given the interests of the primary users of the accounts/is the scope of the opinions wide enough?

As identified in Chapter 2 para 2 of the paper, there are a number of audit expectations that are not matched or are not matched in full. As noted in our general comments, ACCA launched a thought leadership report *Closing the expectation gap in audit*². The report found that the general public expects more from auditors in respect of fraud with an aggregated 35% wanting auditors to ‘always detect and report any fraud’ as shown in the graph below. In the UK 41% of the respondents chose that option.

² https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf



FIGURE 3.5: Which of the following options best reflects your expectations of the auditor's responsibility for fraud?



Our report also found that the public sees audit as part of the solution for preventing corporate failure, with a demand for auditors to do more in respect of liquidity, solvency and viability. The findings suggest that there is demand for a wider audit scope, which we believe should be explored in the broader Government response to the Brydon review.

Q5. Is the going concern opinion meaningful when assessing local authority resilience? If not, what should replace it?

ACCA disagrees with the statement 'The financial audit opinion will always report that all local authorities are a going concern' mentioned in the paper. Auditors are providing an opinion on the financial statements as a whole and not specifically on the going concern of an entity. Furthermore, as specified in paragraph A2 *ISA (UK) 570 Revised, Going Concern*, 'Going concern risks may arise, but are not limited to, situations where public sector entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity.'³

Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit includes recommendations regarding a resilience statement. His recommendation 18.1.2 states 'I recommend the board should make a Resilience Statement that incorporates, enhances and builds on Going Concern and Viability Statements'⁴. ACCA is generally supportive of the recommendation. Clearly the statutory position of a local authority differs from that of a

³ <https://www.frc.org.uk/getattachment/13b19e6c-4d2c-425e-84f9-da8b6c1a19c9/ISA-UK-570-revised-September-2019-Full-Covers.pdf>

⁴ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf

company, at which the Brydon recommendation is directed. We therefore suggest that in the case of LA external audits, the focus should be different, and linked to the broader work that the external auditor carries out on financial resilience as part of the VFM arrangements work.

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

We consider that the external audit should cover the financial statements as prepared to meet relevant requirements by the local authority. Consideration should also be given, though, to the recommendations made by Sir Donald Brydon with regard to broadening the scope of audit and whether there are analogous requirements for local authority accounts. In general, however, we believe that the debate on the scope of local authority audit should focus on those unique elements of the “wider scope” (i.e. value for money audit and the challenge function) rather than the audit of the financial statements.

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

The scope of value for money work is set out in the Local Audit and Accountability Act. We do recognise the challenge of requiring auditors to draw a conclusion on “the arrangements in place” and the appetite for broader work which could include consideration of the actual achievement of value for money. This could be a challenging new regime to design and implement, and would potentially come with significant additional audit cost. We believe, nonetheless, that the Review should carefully weigh the response it receives from key stakeholders (in particular local authorities themselves and the users of local authority accounts and audit services) in reaching a conclusion.

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 Chapter 2 paragraph 2 the paper lists some of the audit expectations that are currently not matched or not matched in full. We would therefore suggest that this list is examined in more detail by exploring if such expectations can realistically be achieved. An example would be the expectation for auditors to have more responsibilities in respect of identifying and reporting fraud. The findings of our research support that the general public demands more from auditors in this area both in the private and public sector. Furthermore, we also note that Sir Donald Brydon’s Independent Review includes a recommendation stating that ARGA should amend ISA (UK) 240 to make clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways.

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?

Inspectorates may not have the capacity to engage directly with every LA external auditor. External auditors should be required to engage with the inspectorates to the extent that the inspectorate's activity is likely to have a significant bearing on the conclusion to be drawn by the auditor in meeting their responsibilities with regard to value for money arrangements.

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?

The Call for Views notes that the FRC has indicated that the quality of local authority audits tends to be lower than in the private sector. Furthermore, the review notes that "there is also a widely expressed concern that the reduction in fees has led to a change in the mix of staff undertaking local authority audits – i.e. teams are less experienced and have less sector specific knowledge, which has a detrimental impact on quality". We agree that there are legitimate concerns with regard to audit quality, in a context where the approach over recent procurements has been to secure cost reduction over the contracts as a whole. We do not consider that a pattern of steadily reducing costs in audit is likely to support high audit quality. Experience in the private sector would support this view.

We also note that Sir John Kingman's review highlighted serious concerns since the abolition of the Audit Commission in 2015 and with the new Framework enabling local bodies to appoint their own auditors form an open and competitive market of qualified providers. Such concerns include the reduction of costs at the expense of audit quality. ACCA's view is that the primary focus should be on audit quality and therefore prioritising a reduction in cost at the expense of audit quality is not acceptable.

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 consider that there should be a single separate sector specific regulatory entity for LA audit. There would need to be a connection to the overall audit regulator (i.e, the successor body to the FRC) to ensure appropriate evolution in the private sector is fairly reflected within the LA audit world and vice versa. This connection should be in the development of standard implementation and monitoring activities.

As noted in our response to the Independent Review of the Financial Reporting Council – Call for Evidence, ACCA proposes that responsibility for local public sector audit should be transferred to another body as this responsibility distracts from the key responsibilities of the FRC which we consider should be focussed on the FRC's role as competent authority for audit and in particular, the audit of Public Interest Entities.



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?

Yes, we believe that external audit firms have enough understanding of the LA regulatory framework, but we do note that this can be a challenging and evolving environment. The activities of LAs are diverse, complex and subject to governmental and political influence.

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

Yes, we believe that auditing standards have a positive impact on the quality of LA financial audits.

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, financial resilience is a key factor in considering the programme of VFM work. The areas to be covered in carrying out this work are by now reasonably well-established, covering, for example, short, medium and long term financial planning, the robustness of budgeting, delivery of efficiency and cost reduction programmes, effectiveness of income generation, risks arising from joint ventures, risks arising from commercial activities, and the quality of people. We believe that the guidance issued by the National Audit Office to local authority auditors in this area has been successful in supporting a consistent and commonly understood approach to the review of financial resilience matters at local authorities.

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?

The Code of Audit Practice provides high level guidance emphasising the responsibilities for both the audited body and the auditor in respect of value for money arrangements. The extent of work needed is in the auditor's judgement which is appropriate. We believe that because of the diverse and complex nature of LAs, auditors benefit from more support via guidance and practical examples. The current Code came into force in April 2015 with 5 years maximum life-span. The NAO has consulted on the draft Code of Audit Practice with a closing date 22 November 2019 and the Code should be ready to be laid in Parliament early in 2020. The new Code will apply from audits of local bodies' 2020-21 financial statements onwards.

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?



There is no specific guidance provided by auditing standards on vfm audits. Currently, the guidance provided is supplementary to the Code of Audit Practice. We believe that guidance should continue to be supplementary to the Code of Audit Practice and not included within it.

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?

The role of internal audit is crucial in all business but especially ones where the impact is wide, and stakeholders include the general public financing and receiving services. The work of the Internal Audit function is of value to external auditors and should be used with the appropriate mitigations, thus drawing on the guidance within ISA (UK) 610 (Revised June 2013), Using the Work of Internal Auditors.

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?

LA Auditors have a responsibility to perform audits effectively, just as they do within the private sector. Therefore, if a regulator finds that a local authority audit has not met the quality standards then the appropriate sanctions should follow depending on the particular circumstances.

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

The audit of vfm arrangements, i.e. the processes and systems that support and enable the delivery of vfm, does not lend itself to a simple binary conclusion. The achievement of vfm is a graded delivery and thus the arrangements are too, there will always be always room for improvement. The option of a more discursive and informative conclusion on VFM arrangements, and on the management of key risks that threaten the achievement of VFM, would be helpful.

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 relevance and materiality of an inadequate opinion issued by another inspectorate or regulator is a matter of judgement for the external auditor. There should be no “automatic” qualification. Information on performance and systems obtained from other regulators should form part of the broader evidence base gathered by the auditor on which they will base their conclusion.

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?

The vfm and financial audit process are likely to have practical connected audit activities, so ideally these should happen at the same time to ensure the effectiveness of the audit process. However, there may be instances when VFM is not connected to the annual audit cycle and these could be separated out if deemed to enhance audit quality.

The vfm opinion should be released as close to the financial audit as possible, delay can result in the continuation of sub-standard arrangements. That said, there are ample opportunities in place for auditors to raise serious concerns.

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?

We believe that there a number of reasons that could lead to audit certificates and reports to be delayed. Some examples include, information requested by the auditor might not be provided on time, the significant issues identified might require substantial additional audit work making it impossible to report on time. The reasons behind delays would vary between audits and therefore is not easy to make changes to the framework that would apply to each individual audit. Disclosing the reasons for delay could be one approach to consider.

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?

Deciding upon when it might be appropriate to issue a PIR or Statutory Recommendation can be complex, and for the former in particular, it can represent a significant move on the part of the auditor which, given the legal status of such a report, requires significant consideration. It is perhaps more surprising that we have not seen more Statutory Recommendations in recent years, given the challenges that local authorities have faced in delivering statutory services and balanced budgets. Cost (i.e. the ability of the auditor to recover the costs arising from these activities) may be a practical barrier, and this should be considered in looking at potential incentivisation.

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 perform this function effectively?

The publication does add some value because it aids comparison, however more in relation to the nature of failings or improvements would benefit all.

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?

The report should be presented to the individuals with responsibility over the LA or bodies with responsibility to ensure they are operating effectively and in the public interest, so will include the audit committee. In situations where findings are not presented to full council or equivalent, they should at least be informed about the key audit issues.

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?

Monitoring the implementation of recommendations should be embedded in the local authorities' culture and be an integral part of continued improvement. Formal procedures should be in place ensuring that recommendations made by any auditor or inspectorate are followed up.

External auditors should take into consideration the recommendations not implemented and any implication for the following year's audit.

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?

Yes, we believe that an external body should be tracking the action taken in response to modified audit opinions and/or statutory recommendations and public interest reports. We would expect that Government, i.e. MHCLG, would wish to have visibility of responses as part of its broader oversight arrangements for the local government sector, though in practice it may be that the proposed sector specific oversight body could gather this information.

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?

Whilst, on the whole LA accounts probably do provide a good base level of information, their accounts are lengthy, complex, and very difficult to understand even to the expert. This has long been the case, and efforts have been made in the past to develop a more simplified approach, without any real success. We believe that this review provides a new opportunity to reconsider the form and content of local authority accounts and to render them more understandable to all.



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?

We believe that following recommendations should be considered:

- The cashflow statement should be based on the direct method only, employing similar headings relating to the corresponding items within the income and expenditure statement and balance sheets
- Inclusion of the balanced budget statement
- Outturn statement of actual expenditure against budget and the budget proposed for the following year

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?

We believe that the summary financial information could certainly be included in any strategic report. The audit opinion should include an obligation to review the whole reporting package and consider the consistency of the numbers reported outside with the financial statements themselves, which would provide sufficient assurance.

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?

Any summary financial information on performance should be based on the following:

- Budget and outturn statement
- CEIS key items including the result on the provision of services and the total comprehensive income

Additionally, it would be most helpful if the reporting can be as integrated as possible. Financial performance should be presented along with other key performance indicators that the Council will have set for example in terms of service provision, carbon footprint etc. The connections and trade-offs between them should be explained.

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?

Yes, however the log of the number and type of issues should be maintained. These can be compared across LAs, and/or overtime to assess persistent issues or support KPIs relating to management of issues.



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?

Yes, our view is that guidance is needed to help auditors assess the impact of significant changes to common business models for both financial audit and vfm audit.

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?

The financial reporting framework for category 2 authorities seems reasonable. We note that the simplified Annual Governance and Accountability Return should present fairly the position of the entity and that financial information is included which is consistent with the public interest in such bodies and is broadly comparable to that provided by charities. On the assurance framework for reporting entities with incomes or expenditure below £6.5 million, the assurance framework might be reconsidered and upgraded from the current limited assurance. We note that for charities, where there might be said to be a comparable level of public interest, audits are generally required for any with incomes over £500,000.

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?

Yes, we believe that the inspection and objection regime does allow local residents to hold their council to account in an effective manner. Care needs to be exercised in the application of this regime to ensure that resultant costs are proportionate.

