

Report No.
FSD22054

London Borough of Bromley

PART ONE - PUBLIC

Decision Maker: **AUDIT AND RISK MANAGEMENT COMMITTEE**

Date: **Thursday 30th June 2022**

Decision Type: Non-Urgent Non-Executive Non-Key

Title: **EXTERNAL AUDIT AND FINANCIAL REPORTING UPDATE**

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Ward: Borough Wide

1. Reason for report

- 1.1 This report sets out for the newly formed Audit and Risk Management Committee, details of the current external audit and financial reporting landscape, including a progress update on the Council's Statement of Accounts and related matters.

2. **RECOMMENDATION(S)**

- 2.1 **The Committee is requested to consider and note the contents of this report.**

Impact on Vulnerable Adults and Children

1. Summary of Impact: None arising directly from this report
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Corporate Policy

1. Policy Status: Existing Policy
 2. BBB Priority: Excellent Council
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Financial

1. Cost of proposal: Not Applicable
 2. Ongoing costs: Not Applicable
 3. Budget head/performance centre: External Audit
 4. Total current budget for this head: £244,506 for the authority and £22,600 for the Pension Fund.
 5. Source of funding: Not Applicable
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Personnel

1. Number of staff (current and additional): Not Applicable
 2. If from existing staff resources, number of staff hours: Not applicable
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Legal

1. Legal Requirement: Statutory Requirement – The report concerns the statutory requirements required by the Local Audit and Accountability Act 2014
 2. Call-in: Not Applicable
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Procurement

1. Summary of Procurement Implications: The report contains recommendations that may, at some point in the future, alter the mechanism by which the Council procures its external auditor.
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): Not applicable
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? Not Applicable
2. Summary of Ward Councillors comments: Council Wide

3. COMMENTARY

Background

- 3.1 The current statutory basis for external audit in local authorities is set out in the Local Audit and Accountability Act 2014. This Act introduced a new audit regime for local government to replace the previous arrangements which were led by the Audit Commission. Currently, the various roles and responsibilities relating to external audit are discharged by separate bodies, namely:
- Public Sector Audit Appointments (PSAA)
 - Institute of Chartered Accountants in England and Wales (ICAEW)
 - Financial Reporting Council (FRC)¹
 - The National Audit Office / Comptroller and Auditor General
- 3.2 The appointment of the Council's external auditor, currently EY, is managed at arm's length by PSAA. PSAA is currently undertaking a procurement exercise to determine audit appointments for local government bodies for the five-year period starting 2023/24. PSAA will appoint an external auditor based on the firms that are currently registered, authorised and accredited to undertake the external audit of local government bodies; there are currently nine such firms.
- 3.3 Accounting requirements for local government are set out in guidance maintained and updated annually by the Chartered Institute of Public Finance and Accountancy (CIPFA), the local government standard setter. CIPFA produces the Code of Practice on Local Authority Accounting. The Code specifies the principles and practices of accounting required to prepare financial statements which give a true and fair view of the financial position and transactions of a local authority. Additionally, the Code is prepared under International Financial Reporting Standards (IFRS), which have been adopted as the basis for public sector accounting in the UK.

Current audit and financial reporting landscape

- 3.4 There are a number of related challenges affecting the external audit and financial reporting landscape. Some of these impact only local government, but many are also widespread across the entire UK external audit market. These, inter alia, include
- A perceived decline in the standard of work generally undertaken by external auditors, particularly in light of recent corporate failings, such as Patisserie Valerie and Carillion.
 - An expectations gap between what an audit certificate signifies and the demands and needs of various stakeholder groups concerning external audit.
 - A lack of capacity to undertake the external audit work in the local government sector; this relates to the number of firms willing to participate in the market and a declining number of individuals wishing to pursue a career in audit.
 - A recognition that audit fees in the local government sector may be too low to make the market attractive enough to sustain current participating firms and encourage new entrants; conversely a recognition that increased fees are ultimately a cost to local council taxpayers.
 - Whether local authority accounts report financial performance including use of resources against budget in a manner that is transparent and comprehensible to Council Taxpayers and the general public?

¹ The FRC is in transition to a new body, the Audit, Reporting and Governance Authority (ARGA)

- Does the financial information provided in local authority accounts facilitate scrutiny by local taxpayers and by the local press?
 - A combination of factors has meant that only 9% of 2020/21 local authority audits were completed by the statutory deadline
 - Are audit recommendations effective in helping local authorities to improve their financial management?
- 3.5 In response to these issues, the Government commissioned the Redmond Review. This is one of four key reviews that have recently examined different aspects of the scope and quality of external audit in the UK, as set out below:
- Kingman Review into the Financial reporting Council (*published December 2018*)
 - Competition and Market's Authority Review into the UK statutory audit market (*April 2019*)
 - Brydon Review into the Quality and Effectiveness of Audit (*December 2019*)
 - Redmond Review of the Quality of Local Authority Financial Reporting and External Audit (*September 2020*).
- 3.6 The Redmond Review focused on 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 review considered the quality of local authority audits and whether they are highlighting when an organisation is in financial trouble early enough. Additionally, it also looked at whether the public has lost faith in auditors and whether the current audit arrangements for Councils are still 'fit for purpose'. The review raised a number of recommendations which MHCLG (now DLUHC) has started to respond to.

External audit and financial reporting at the Council

- 3.7 At Bromley, Statement of Accounts for the years up to and including 2018/19 have been audited, finalised and published on the Council's website. Latterly, completion of the audit has impacted by two issues, objections to the accounts and issues with the valuation of fixed assets.
- 3.8 Objections are when a local government elector asks the external auditor to apply to the High Court for a declaration that an item of account [in relation to a specific financial year].is unlawful, or to issue a report on matters which are in the public interest ('a public interest report'). When these occur, the external auditor will make enquiries and determine what action to take by way of response. In such cases, if the matter cannot be resolved promptly, then the final sign-off of the audit will be delayed whilst the auditor completes their enquiries.
- 3.9 Bromley recently had outstanding objections delaying the completion of the external audit for the 2016/17, 2017/18 and 2018/19 accounts. The objections affecting the 2016/17 and 2017/18 were recently completed by the predecessor auditor, KPMG, allowing the audits for those years to be concluded. An objection remains outstanding for 2018/19 and this is currently under review by EY.
- 3.10 Progress on the external audit has also been impacted by issues affecting the accounts that relate to the valuation of fixed assets. The 2018/19 audit was significantly delayed owing to widespread material errors in the valuation work carried out by the Council's valuers at that time, Cushman & Wakefield. These errors were remediated over a long period of time and the 2018/19 accounts audit opinion [subject to the outstanding objection] was signed on 13 August 2020, compared to the deadline of 31 July 2019.
- 3.11 The 2019/20 accounts audit, which started during August 2020 has also been delayed, largely owing to issues in the valuation work undertaken by Montagu Evans (who replaced Cushman & Wakefield as the Council's outsourced valuers) concerning the Council's investment properties

(assets held for their capital value and the income that they generate). As a result of errors found in the initial sample reviewed by the external auditor (and similar errors in the 2018/19 accounts) this area received significant additional audit scrutiny over a period of some months.

- 3.12 On 30th November 2021, EY provided a report to the General Purposes & Licensing Committee, detailing the significant delays that had affected the 2019/20 audit. The report included five recommendations designed to improve the Council’s financial reporting processes. EY’s report also highlighted the possibility of making a Schedule 7 Public Interest Report should the Council not be able to demonstrate improvement in its financial reporting arrangements. The report stated that *‘If we were to report under schedule 7, our recommendations would highlight the investment required by the Council to support its financial reporting function to close out the 19/20 audit, prepare the 20/21 accounts and support that audit, and prepare the 21/22 accounts and support that audit, in order to address the reporting timetable backlog by the end of 2022. We would highlight the need for a clear timetable, accountability and consequences to complete the work. We would also include the need to ensure that actions taken were sufficient to put the financial reporting function on a sustainable footing for the future, rather than just tackling the immediate issues.’* In response to this, the Council took a number of actions, including increasing resources in the Finance Department and scheduling weekly meetings with the valuers and external auditor to understand, escalate and respond to outstanding audit issues.
- 3.13 EY has recently confirmed that it has substantially completed its audit work on the 2019/20 accounts and anticipates finalising the audit in the coming months. Once the 2019/20 audit has been completed, the 2020/21 and 2021/22 accounts and audit will need to be progressed.

4. FINANCIAL IMPLICATIONS

- 4.1 Fees are discussed agreed annually with the external auditor to cover the cost of their annual audit activity. The base audit fee is set by PSAA and then varied locally depending on various risk factors.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications. This report focuses on the arrangements for local authority financial reporting and auditing put in place by the Local Audit and Accountability Act 2014.

Non-Applicable Sections:	Impact on Vulnerable Adults and Children Policy, Procurement Implications and Personnel Implications.
Background Documents: (Access via Contact Officer)	Reports to General Purposes and Licensing Committee: <ul style="list-style-type: none"> • ‘Appointment of the External Auditor’ – 8th February 2022 • ‘Draft Audit Results Report 2019/20 Update’ – 8th February 2022 • ‘EY Briefing Paper’ - 30th November 2021 • ‘Audit of the 2019/20 Financial Statements’ – 6th July 2021 • ‘Audit of the Financial Statements 2019/20’ – 25th November 2020 • ‘Redmond Review of Local Authority Financial Reporting and External Audit’- 25th November 2020

	<p>Local Audit and Accountability Act 2014.</p> <p>Redmond Review of Local Authority Financial Reporting and External Audit – <i>published by MHCLG on 8th September 2020.</i></p> <p>Local authority financial reporting and external audit: government response to the Redmond review – <i>published by MHCLG on 17th December 2020.</i></p> <p>Local authority accounts: A guide to your rights – <i>published by the National Audit Office during August 2021</i></p>
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