

Audit and Risk Committee

21 July 2020

Agenda item number 11

External Audit

Report by Chief Financial officer

Summary

This report appends the Local Government Audit Committee Briefing by Ernst & Young (EY).

Recommendation

That the briefing, including the key questions for Audit Committees as set out on page 8, be noted.

1. Briefing key issues

1.1. This briefing is presented to Members “for information”.

1.2. The items of relevance to the Authority are:

- Budget 2020 (page 2);
- Local Government Pension Scheme (LGPS) news (page 4);
- The local public audit environment (page 6); and
- PSAA Report on the Future Procurement and Market Supply Options Review (page 7).

Author: Emma Krelle

Date of report: 26 June 2020

Appendix 1 – Local Government Audit Committee Briefing, Quarter 1, March 2020

A woman with long dark hair and glasses is looking down at a tablet computer she is holding. She is wearing a light-colored blazer. The background is a dimly lit server room with blue lighting and computer monitors displaying data. A yellow banner is overlaid on the right side of the image.

Local Government Audit Committee Briefing

Quarter 1, March 2020

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. Above the 'Y' is a yellow chevron shape pointing to the right.

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This sector briefing is one of the ways that we support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation and the Local Government sector as a whole.

The briefings are produced by our national Government and Public Sector (GPS) team, using our public sector knowledge, and EY's wider expertise across UK and international business.

The briefings bring together not only technical issues relevant to the Local Government sector but also wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further please contact your local audit team.



Government and economic news

EY Club Item

The outlook for the UK economy has improved over the last three months, with the decisive nature of the General Election result and the resulting clarity on the first stage of Brexit expected to provide a short-term boost to economic activity. The strong performance of the labour market in terms of new jobs - although less so in pay growth - suggests there may be more momentum than previously thought, and it appears the global slowdown may be bottoming out. Reflecting these factors, The EY ITEM Club's Winter Forecast has increased its projection for GDP growth to 1.2% in 2020 and 1.7% in 2021, compared to the 1% and 1.5% predicted in its last quarterly previous forecast.

Significant uncertainty may still exist, but we can be certain that change is coming. The UK is leaving the EU, the new Government has talked of an ambitious programme, the global policy consensus is under real pressure, and demographics, technology and the climate emergency will all impact the economy in the coming years. These factors may come together in new ways: concerns over the climate may lead to further reductions in trade, and support for localism that boosts towns may be possible

through deploying technology in new ways. The economic outlook is challenging and now is the time for businesses to think creatively about their long-term strategy and plans to deliver it.

Budget 2020

Chancellor Rishi Sunak delivered his first Budget in the House of Commons on 11 March 2020, announcing the government's tax and spending plans for the year ahead. Key points have been summarised below.

Coronavirus – £30 billion stimulus package to counteract the COVID-19 outbreak, equivalent to 1.3% of GDP.

- ▶ This includes £5 billion for the NHS and other public services and £7 billion to businesses and families
- ▶ The government announced that statutory sick pay (SSP) will be paid to all those who choose to self-isolate, even if they aren't presenting any symptoms. Small- and medium-sized business will be refunded eligible SSP costs
- ▶ Local Authorities will be provided with £500mn hardship fund to support vulnerable people in the local area

- ▶ Small firms will be able to access up to £1.2mn of business interruption loans
- ▶ Business rates will be abolished for small business in the retail, leisure and hospitality sectors with a rateable value below £51,000

Personal taxation

- ▶ NIC threshold will be raised saving individuals £100 a year

Transport, Infrastructure and housing

- ▶ More than £600 billion to be spent on roads, rail, gigabit broadband and housing. This includes £12.2 billion for the Affordable Homes Programme and a commitment to create an average 300,000 homes a year
- ▶ Additional funding to help tackle potholes- £2.5 billion will be made available in 2020/21 then £500 million per year until 2024/25

Borrowings

- ▶ Public sector net borrowing is expected to increase by 0.3% to 2.1% of GDP in 2019/20 and rising to 2.4% and 2.8% in subsequent years

Environment

- ▶ The Plastic Packaging tax rate was confirmed at £200 per tonne of plastic packaging for manufactures and importers whose products are less than 30% recyclable. This tax will be effective from April 2022

Investment in flood defences will double to £5.2 billion over the next five years. £320 million has been made available for communities affected by this year's winter flooding.

PWLB

Alongside the Budget, the Treasury launched a consultation on changes to the PWLB, which it said would attempt to "focus PWLB loans on service delivery, housing, and regeneration, and ensure that this money is not diverted into financial investments that serve no direct policy purpose. Once a workable system is designed and implemented, the government intends to cut the interest on all new loans from the PWLB."

The government said it would hold workshops with local authorities to develop rules that would prevent local authorities buying investment assets primarily for yield.

The consultation said: "Local authorities that wish to buy investment assets primarily for yield would remain free to do so but would not be able to take out new loans from the PWLB in the year in which they have bought the asset."

As a result of this budget, the Office of Budget Responsibility predicts a 1.1% GDP growth in 2020 and 1.8% in 2021 without taking into consideration the impact of COVID-19. This is in line with the EY Club Item predictions above.

Local Government Settlement 2020/21

Communities secretary, Robert Jenrick MP, submitted the proposed local government settlement for 2020/21 to the House of Parliament on 06 February 2020. This settlement is set to give local authorities a 4.4% real term increase in spending powers from £46.2 billion in 2019/20 to £49.2 billion in 2020/21. The government commented that the "settlement delivers the biggest real-terms increase in spending power for a decade."

The key elements of the settlement include:

- ▶ The core settlement resources, including Revenue Support Grant and business rates baseline funding, will rise in line with inflation. Local authorities will continue to be able to increase council tax by 2% without a local referendum. Those authorities with adult social care duties will be able to increase council tax by a further 2%
- ▶ Extra social care resources of £1.5bn for both children's and adult's social care
- ▶ New Homes Bonus payments will be maintained at 0.4% growth baseline

According to research conducted by the Local Government Information Unit 93% of councils plan to increase their council tax in 2020/21 by more than 1.5%. David Williams, chair of the County Councils Network, commented that the ability to increase council tax by up to 4% via a 2% adult social care precept will help address rising costs and growing demand, however in the long term this above inflation increase would still leave county authorities facing a £7.7bn funding shortfall.

It is not clear what the impact of Coronavirus and Brexit will have on local authority finances. CIPFA's chief executive has called upon the government to publish an economic assessment for the impact of Brexit in order for authorities to effectively plan ahead.

Another growing cost pressure faced by local authorities is the cost of providing for the homeless. Research conducted by the Local Government Association (LGA) found that 69% of local authorities in England overspent on homelessness budgets during 2018/19 by more than 27%. The LGA stated that the gap between affordable rents and housing benefits combined with an acute shortage of affordable housing has resulted in council having no choice but to increasingly provide temporary accommodation. The amount of money spent by local authorities in England housing families in bed and breakfasts increased by 23% in 2018/19 to £115mn compared to £93mn in 2017/18. Council Leaders and the LGA have urged the Government to use the upcoming budget to provide long term sustainable funding to help prevent homelessness.

Local Government Pension Scheme (LGPS) news: Exit Pensions Credit Payments and Pooling

The Ministry of Housing, Communities and Local Government (MHCLG) has announced amendments to regulations which require funds to pay exit credits where pension liabilities have been overfunded. This announcement is in response to concerns that outsourced contractors are claiming exit payments on top of existing arrangements designed to share pensions risk. MHCLG stated that "it became clear that service providers were becoming entitled to exit credits where this would not have been the intention." In response to this MHCLG have proposed changes to the 2013 Regulations which will required LGPS administering authorities to take into account the level of risk that an employer has borne in determining the amount of exit credits.

Critically, this change means that administering authorities will have discretion over the amount of exit credit paid. Responding to this announcement, actuary partner and pension advisor at Hymans Robertson, Richard Watson, said that "Amending regulations were needed to better reflect historic risk-sharing arrangements"; however, there is a fear that the new discretionary powers for funds may lead to more claims and disputes from outsourced contractors. The LGPS Advisory Board has been called upon to issue guidance on how to interpret the new regulations.

In other LGPS news the government has estimated that the shift to mandatory pooling of assets has saved more than £155mn between November 2015 and March 2019. It has also estimated that the total savings that will be achieved through asset pooling by 2033 is in the region of £2bn.

In a response to the growing climate emergency, that many local authorities have officially recognised, one LGPS asset pool, Brunel Pensions Partnership, has announced a five-point plan to increase the green credentials of its investments and to divest from

investments in companies with high carbon emissions. This plan will include stress-testing its portfolios under a range of climate scenarios such as alignment of emissions with the benchmark set in the Paris Climate Agreement. The Government minister for pensions has welcomed the move saying that they have their full support.

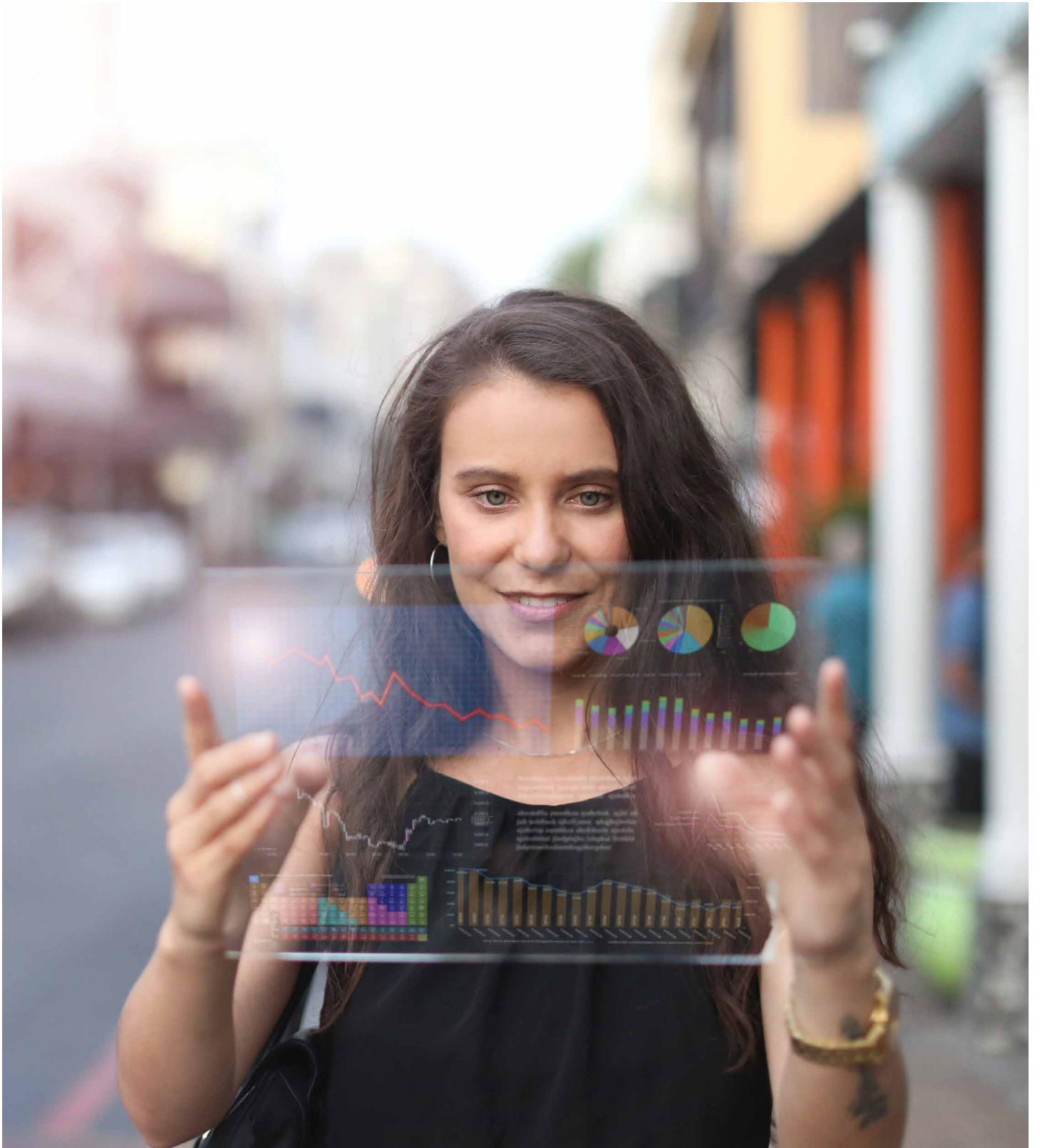
Local Authority Investment in Commercial Properties

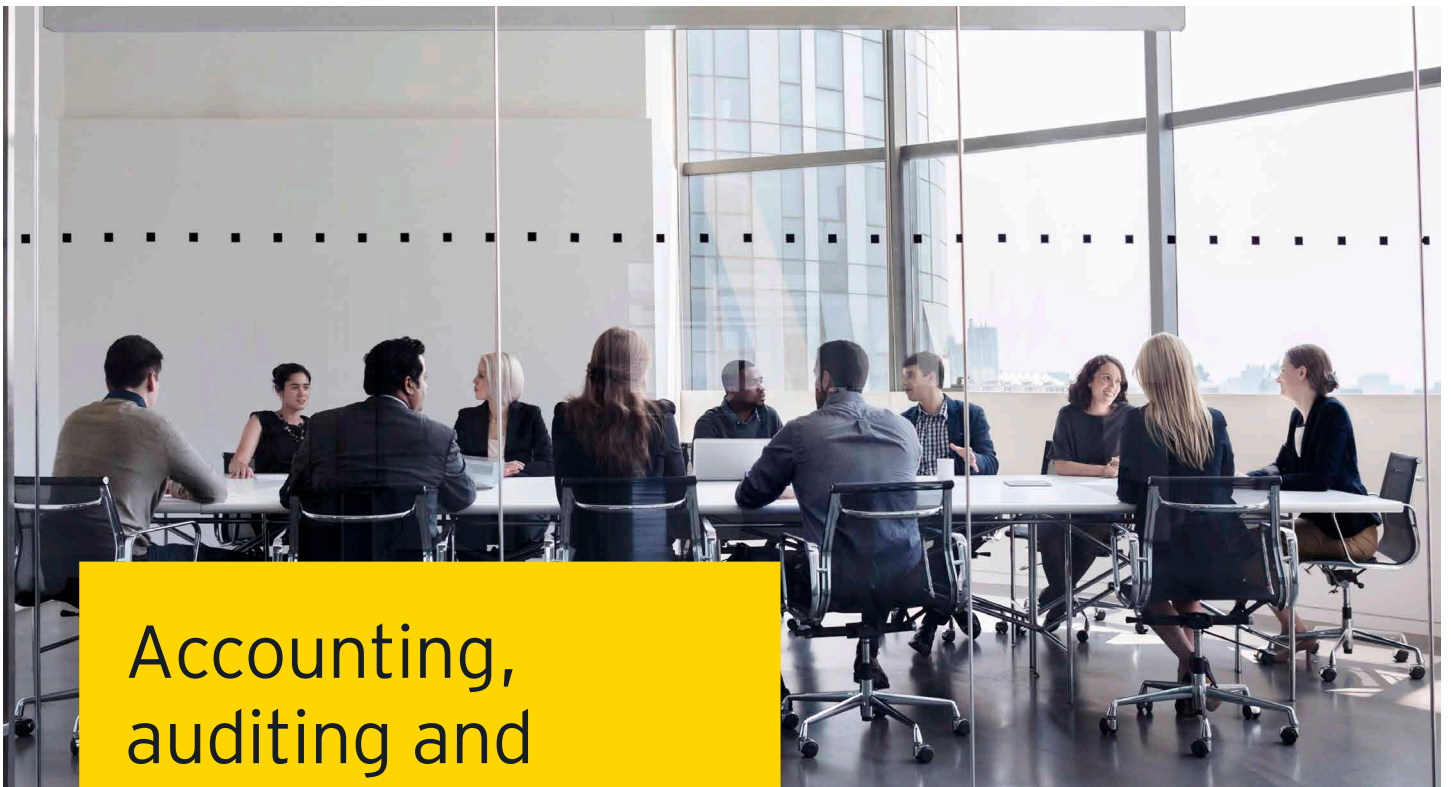
The National Audit Office (NAO) has published a report on the increasing activity of some local authorities making investments in commercial properties. The report comments that between 2016/17 and 2018/19 £6.6bn was spent by local authorities on commercial properties; this is 14.4 times more than the preceding 3 years. However, 80% of this cumulative spend was only incurred by 49 councils (14%). Interestingly district councils are disproportionately active compared to their size and there is a significant geographical skew as authorities in the South East contributed to 53% of the total cumulative spend on commercial properties during this period. The report also highlighted an increasing trend that 38% of commercial property purchases within this period being made out of the geographical area of the councils.

The report focused on MHCLG's role in relation to local government finance and concluded that improvements should be made to the quality of data and analysis of that data by MHCLG to better understand the commercial risks that local authorities are entering into. This will help provide MHCLG with better assurance as to whether local authorities are complying with the CIPFA's Prudential Code, that sets out the framework for responsible financial management. Furthermore, MHCLG should also give consideration as to whether the Prudential Code in its current form is achieving its intended objectives.

CIPFA has welcomed the NAO's report stating it provides vital insight into the activity and extent of commercial investments within the sector. CIPFA commented that councils have the flexibility to make their own investment decisions, however these decisions should be taken in line with service objectives and should be prudent and sustainable in order to provide value for money to tax payers. Avoidance of all risk is not possible; however councils should have full regard to CIPFA's prudential code to ensure that they do not take on an inappropriate amount of risk.

MHCLG has responded to the NAO report stating that councils are responsible for managing their finances and must properly consider the risks as well as the opportunities when commercial decisions are made. As the steward of the local government finance system MHCLG will carefully consider the findings of this report.





Accounting, auditing and governance

CIPFA Financial Resilience Index

CIPFA launched its latest iteration of the Financial Resilience Index on 16th December 2019. The index uses a range of indicators to analyse council finances based on data collected over the past four years. The index includes indicators which assess the level of stress in a council's finances including the level of reserves, rate of depletion of reserves and external debt. The overall outlook based on the results of the Financial Resilience Index is that approximately 1 in 10 councils are showing signs of risk to their financial stability and security. CIPFA has commented that most failures in financial resilience are due to whether effective governance arrangements are in place, rather than down to poor financial management itself.

CIPFA's Financial Resilience Index is publicly available on its website.

The local public audit environment

In our last briefing we highlighted the outcome of the Brydon review which was focused on the quality and effectiveness of audit in the UK and Ireland. We note that the recommendations seek to enhance transparency, including more focus on resilience, internal control and the public interest, for the benefit of investors and stakeholders (including the public). It has also increased the responsibility of boards, audit committees and auditors. A number of the recommendations go to the heart of what we do as auditors and will require pragmatic implementation.

Running side by side with the Brydon review has been the MHCLG review of local government financial reporting and audit, led by Sir Tony Redmond. We now expect the Redmond review to report its findings and recommendations this summer. These reviews, as well as the Competition and Markets Authority and Kingman reviews, have been carried out during a period of significant challenge for local public auditors and local government audited bodies.

On 10 February 2020, Janet Dawson, EY's UK Government and Public-Sector Assurance Leader, wrote to the audit committee chairs and chief finance officers (CFOs) of the local government bodies EY audits under its contract with Public Sector Auditor Appointments (PSAA) Ltd. The letter focused on the concerns we all share regarding the timetable for financial reporting and auditing, audit fees and the regulatory, contractual and legal context of delivering local government external audit. The key messages Janet highlighted were:

- ▶ We believe the current timetable and expectations for financial reporting and external audit are unsustainable and need to change
- ▶ Because of our views on the factors driving an unsustainable timetable, to ensure we deliver the best quality audit, we have informed PSAA, the NAO and the Local Public Audit Stakeholder forum that we will be scheduling a number of 2019/20 external audits for completion after the 31st July 2020

- ▶ We do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity, and the audit profession context for cost and fee increases, including the attractiveness of audit, investment in technology, innovation and the regulatory environment
- ▶ In the face of all these unprecedented factors, we still remain committed to deliver high quality sustainable local public audit that serves the public interest and stakeholder needs. It is clear therefore that audit fees for local public audit will have to rise

At the end of February, PSAA emailed CFOs with an update on audit matters. PSAA referenced several of the issues highlighted in Janet's letter and stated that it is encouraging audited bodies and local auditors to have early dialogue about when the audit will take place and the likelihood of additional audit work being required which may lead to a fee variation proposal.

Your Audit Partner has been discussing the proposed timing of your 2019/20 external audit with your CFO and a current estimate of your audit fee and will communicate with the audit committee in due course.

PSAA Report on the Future Procurement and Market Supply Options Review

On 4 March PSAA released a report it commissioned from independent consultants to inform its future procurement and market supply options review project. The consultants were asked to capture the views of current and potential local public audit providers on how to structure a future procurement approach and audit contracts in order to maximise a sustainable audit supply in the next procurement exercise. The report's summary findings were that the sustainability of audit supply will be difficult to achieve and will depend to a great extent of factors that are outside PSAA's control.

Specific findings to note:

- ▶ A lack of experienced local public auditors is the main threat to the future sustainability of the market
- ▶ It will be difficult to bring in new providers to the market due to a lack of enthusiasm for entering the market in its current state, barriers to entry and a lack of belief from these providers that they would not be successful against the existing providers in a tender exercise

- ▶ All existing providers highlight that their risks have increased significantly since they bid for the current contracts and fees have not increased to compensate for the increased risk and the timing of local audits

The report suggests some options for PSAA including changing the balance of price and quality in its tender evaluation arrangements and considering the number and size of contracts. However, the report recognises that some of the issues that impact the future sustainability of local audit are outside of PSAA's control, including the:

- ▶ Fragmentation of the market for procurement of public sector audits (including distinctive arrangements in local government, health and central government)
- ▶ Accreditation regime for local audits
- ▶ Timing of local authority audits
- ▶ Regulatory regime for quality checking of audits

PSAA have shared the report publicly to inform the debate and support the work ongoing to strengthen the system of local public audit.

In the next quarter, we will be publishing thought leadership papers and thereafter a series of articles setting out our point of view on several areas that we believe are critical to secure the future sustainability of local public audit.

Key Questions for the Audit Committee

Budget 2020

How does the Budget 2020 impact your local authority?

Has your authority assessed the impact of the coronavirus on day-to-day operations?

Local Government Settlement 2020-21

How will the local government settlement for 2020/21 impact your local authority? Does this change any of the budgeting assumptions included on your authority's medium term financial plan?

How much financial pressure is homelessness creating for your authority? What are your authority's plans to address homelessness over the long term?

Local Government Pension Scheme (LGPS): Exit Pensions Credit Payments

Is your authority impacted by the change in regulation regarding LGPS payment of pensions exit credits?

How is your authority's LGPS scheme achieving value for money through asset pooling?

Local Authority Investment in Commercial Properties

How does your authority assess its risk appetite for making commercial decisions? How does your authority ensure that it will achieve long term value for money for tax payers?

How does your authority comply with CIPFA's Prudential Code?

CIPFA Financial Resilience Index

How does your authority compare to other local authorities in CIPFA Financial Resilience Index?

What steps does your authority take to achieve long term financial resilience?

The local public audit environment

Are you clear on the timing of your 2019/20 audit and an indication of the fees being proposed by your auditor?

PSAA Report on the Future Procurement and Market Supply Options Review

Have you read PSAA's report and considered what your perspectives are on the steps that should be taken to support the future sustainability of local public audit?

Find out more

EY Club Item

https://www.ey.com/en_uk/growth/ey-item-club/ey-item-club-winter-forecast-2020

Budget 2020

<https://www.gov.uk/government/publications/budget-2020-documents/budget-2020#executive-summary>

<https://www.bbc.co.uk/news/uk-politics-51832634>

Local Government Settlement 2020-21

<https://www.gov.uk/government/speeches/final-local-government-finance-settlement-2020-to-2021-written-statement>

<https://www.publicfinance.co.uk/news/2019/12/local-government-settlement-provides-ps29bn-cash-boost>

<https://www.publicfinance.co.uk/news/2020/01/majority-councils-overspend-homelessness-pressure-mounts>

Local Government Pension Scheme (LGPS): Exit Pensions Credit Payments

<https://www.publicfinance.co.uk/news/2020/02/lgps-funds-given-discretion-over-employer-exit-payments>

<https://www.publicfinance.co.uk/news/2020/02/pooling-lgps-schemes-has-saved-ps155m-four-years>

<https://www.publicfinance.co.uk/news/2020/01/lgps-pension-pool-demands-action-climate-change>

Local Authority Investment in Commercial Properties

<https://www.nao.org.uk/press-release/local-authority-investment-in-commercial-property/>

<https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-response-nao-report-on-council-investment-in-commercial-property>

CIPFA Financial Resilience Index

<https://www.publicfinance.co.uk/news/2019/12/cipfa-financial-resilience-index-finances-10-councils-risk>

<https://www.cipfa.org/services/financial-resilience-index/financial-resilience>

The local public audit environment

<https://www.gov.uk/government/consultations/review-of-local-authority-financial-reporting-and-external-audit-call-for-views>

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

PSAA Report on the Future Procurement and Market Supply Options Review

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

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