

Annual Audit Letter

North Lincolnshire Council

Year ending 31 March 2020





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1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for North Lincolnshire Council (the Council) for the year ended 31 March 2020. Although our letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide information on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 30 November 2020 included our opinion that the financial statements:</p> <ul style="list-style-type: none">• give a true and fair view of the Council's financial position as at 31 March 2020 and of its expenditure and income for the year then ended; and• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20
Other information published alongside the audited financial statements	<p>Our auditor's report included our opinion that:</p> <ul style="list-style-type: none">• the other information in the Statement of Accounts is consistent with the audited financial statements.
Value for money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020</p>
Reporting to the group auditor	<p>In line with group audit instructions, issued by the NAO on 4th November, we reported to the group auditor in line with the requirements applicable to the Council's WGA return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p>



2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the relevant financial reporting framework and whether they give a true and fair view of the Council's financial position and of its financial performance.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2020 and of its financial performance for the year then ended.

Emphasis of Matter – Effect of the Covid-19 pandemic on the valuation of land and buildings and investment properties

We drew attention to Notes 4, 14 and 16 of the financial statements, which describe the effects of the Covid-19 pandemic on the valuation of the Council's land and buildings and investment properties. As disclosed in those notes, the Council's valuers included a material valuation uncertainty declaration within their report as a result of the Covid-19 pandemic and the shortage of relevant market evidence upon which to base their judgements. Our opinion was not modified in respect of this matter.

Emphasis of Matter - Material uncertainty relating to valuations of unquoted investments

We drew attention to Notes 4 and 39 of the financial statements, which describe the effects of the Covid-19 pandemic on the valuation of the Council's share of Pension Fund investments. The outbreak of Covid-19 resulted in additional uncertainty with regard to level 3 investments particularly property funds. As such, a material valuation uncertainty clause has been included in a number of valuation reports as a result of the Covid-19 pandemic. Our opinion was not modified in respect of this matter.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider materiality in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. We set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) because of the nature of certain items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied for the year ended 31 March 2020.

Financial statement materiality	Our financial statement materiality is based on around 1.8% of Gross Operating Expenditure at the surplus/deficit on provision of services	£6.852m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£0.206m



2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p>Management override of controls In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Because of the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits</p>	<p>We addressed this risk by performing audit work in the following areas:</p> <ul style="list-style-type: none"> • accounting estimates impacting on amounts included in the financial statements; • consideration of identified significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements. 	<p>Our work obtained the required audit assurance.</p>



2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p>Property, plant and equipment (PPE) valuation</p> <p>The Council's accounts contain material balances and disclosures relating to its holding of property, plant and equipment, investment properties and assets held for sale, with the majority of land and building assets required to be carried at valuation. Because of the high degree of estimation uncertainty we have determined there is a significant risk in this area.</p>	<p>In carrying out our audit procedures we:</p> <ul style="list-style-type: none"> critically assessed the Council's valuer's scope of work, qualifications, objectivity and independence to carry out the required programme of revaluations; considered whether the overall revaluation methodologies used by the Council's valuer's are in line with industry practice, the CIPFA Code of Practice and the Council's accounting policies; assessed whether valuation movements are in line with market expectations by using information available from other sources; and critically assessed the treatment of the upward and downward revaluations in the Council's financial statements with regards to the requirements of the CIPFA Code of Practice. reviewed the approach that the Council adopts to ensure that assets not subject to revaluation in 2019/20 are materially correct, including considering the robustness of that approach in light of the valuation information reported by the Council's valuer. 	<p>As detailed on page 3, our Audit Report included an emphasis of matter associated with material uncertainty relating to valuations of land and buildings and investment properties.</p> <p>Our work obtained the required audit assurance.</p>



2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p>Defined benefit liability valuation</p> <p>The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of the East Riding Pension Fund, which had its last triennial valuation completed as at 31 March 2019.</p> <p>The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology.</p> <p>There are financial and demographic assumptions used in the calculation of, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of the Council's employees and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in valuing your pension obligation are not reasonable or appropriate to the Council's circumstances. This could have a material impact to the net pension liability in 2019/20.</p>	<p>As part of our work we reviewed the controls that the Council has in place over the information sent to the scheme actuary, including the Council's process and controls relevant to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of the scheme actuary, Hymans Robertsons.</p> <p>We reviewed the appropriateness of the methodology applied, and the key assumptions included within the valuation, and compared them to expected ranges, utilising the information provided by PwC, the consulting actuary engaged by the National Audit Office. We reviewed the methodology applied in the valuation of the liability by Hymans Robertsons.</p>	<p>The draft financial statements included figures provided by the actuary which were based on estimated asset values at 31 March 2020. During the course of the audit, the actuary provided an update which included pension figures based on actual asset values at 31 March 2020. The financial statements were amended to incorporate the revised figures. This reduced the value of the net pension liability.</p> <p>When agreeing the source data used by the actuary, we noted a difference on the pensionable pay figure. The Pension Fund confirmed an incorrect figure has been used and a revised actuary report was provided.</p> <p>As detailed on page 3, our Audit Report included an emphasis of matter associated with material uncertainty relating to unquoted investments.</p> <p>Our work obtained the required audit assurance.</p>



2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified the following deficiencies in internal control as part of our audit.

Description of deficiency	Pensions source data When reviewing the source data used by the actuary, we noted a difference in the pensionable pay amount. The Pension Fund has confirmed this amount was used in an error, and the actuary have provided a revised report based on the actual pensionable pay.
Potential effects	The financial statements are materially mis-stated in relation to the pensions liability.
Recommendation	The finance team should review the data used by the actuary to confirm the accuracy of it.
Management response	On receipt of the actuary report, a review of the data included will be carried out and verified back to any data we have provided for their use

Description of deficiency	Property, plant and equipment –valuations We noted four cases where there were arithmetic errors within the valuation certificates, resulting in incorrect asset valuations. The errors included overstatements and understatements which overall netted to an £80k variance which is below trivial. In addition, we identified a further case where an index had been incorrectly input into the valuation certificate. Again the value of the error was below our triviality threshold. It is, however, possible that these types of issues could result in a significant error.
Potential effects	PPE valuations are incorrect as a result of arithmetic or input errors within the valuation process.
Recommendation	Internal quality review processes are implemented to ensure valuation certificates once prepared are reviewed by a second officer prior to being provided to the finance team.
Management response	Existing valuation procedures and controls will be reviewed by the internal asset valuation working group, with a view to implementing additional quality control/checking systems.



2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations (continued)

Description of deficiency	<p>Property, plant and equipment controls</p> <p>When carrying out our walkthrough test of the property, plant and equipment system, we noted that the following control had not operated:</p> <p>The Capital Accountant compares new valuations to net book values plus this year's depreciation and investigates large differences over £100k.</p> <p>This check was completed upon request, with no issues identified.</p>
Potential effects	Property, plant and equipment may be held at inaccurate values in the ledger.
Recommendation	Year-end controls are carried out and implemented as designed.
Management response	A process will be written for the year-end capital procedures and when the new Capital Accountant is in post, emphasis will be drawn to the importance of completing all year-end controls.
Description of deficiency	<p>Creditor payments</p> <p>When carrying out our walkthrough test of the creditors system, we noted that random checks of signatories take place; however, there is no method in place for these checks and no evidence of the check is maintained.</p>
Potential effects	Unauthorised signatories are used to authorise expenditure.
Recommendation	A method is implemented for completing the checks, and evidence of the check is maintained.
Management response	A Business Objects Report will be scheduled to run at the beginning of each month. Using this report the Servicedesk will choose the top 10 randomly selected invoices and compare those signatories with those kept on file. The date checked will be recorded and results filed for reference



3. VALUE FOR MONEY CONCLUSION

Value for money conclusion

Unqualified

Our audit approach

We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, ‘in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’ To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

Our auditor’s report, stated that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2020.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<p>The Council operates an Executive with a Leader and Cabinet model, and this is governed by a Council Constitution including the normal features of an effective governance framework in local government.</p> <p>The Audit Committee monitors the Council’s system of internal control and it met regularly during the year. The Internal Audit plan has been delivered for the year and the Head of Internal Audit Opinion provided satisfactory assurance. Internal Audit reports directly to the Audit Committee. The Audit Committee receives regular reports tracking services progress in responding to Internal Audit recommendations. The Audit Committee challenges management to ensure recommendations are implemented and this is in a timely manner.</p> <p>An Annual Governance Statement has been prepared and approved by the Audit Committee.</p> <p>A medium term financial plan was in place for the year ended 31 March 2020. Performance against the plan was reported regularly to the Cabinet.</p>	Yes



3. VALUE FOR MONEY CONCLUSION

Value for money conclusion

Unqualified

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	<p>The updated financial plan was approved by full Council in February 2020 and sets out the pressures faced by the Council in the coming year including demand and funding issues. The plan included the need for cost reduction initiatives over the medium term including to ensure a balanced financial position. The Council is now revisiting the financial plan in light of Covid-19 and the anticipated economic consequences in the short and medium term. This includes consideration of the key expenditure and income assumptions included in the plan. This is understandably difficult given the significant levels of ongoing uncertainty. Our VFM conclusion considers the arrangements in place for the 2019/20 financial year and recognises that the consequences of the pandemic affect arrangements in 2020/21.</p> <p>The 2019/20 outturn shows that this was a challenging financial year for some areas of Council. Demand pressures meant there were overspends in some service areas, especially within need led budgets, but these were partially offset by one off savings. The Council ended the year with a slight overspend of approx. 1.1%. The above pressures will continue alongside the financial pressures and challenges created by the response and recovery from Covid-19.</p> <p>In the year earmarked reserves increased by £6.6m mainly due to Covid-19 grant received at the yearend. The General Fund reserve increased by £300k. Overall total useable reserves as at 31 March 2020 are £60.5m.</p> <p>Capital expenditure was lower than planned in the year by £7.3m against a total budget of £39.5m. The underspend has been carried into the 2020/21 budget.</p>	Yes
Working with partners and other third parties	<p>The Council works with a range of third parties including NHS Providers, LEP's and Housing Associations. There is a Partnership Protocol and a Joint Working Framework to govern the arrangements.</p> <p>The Council has issued procurement guidance, has contract procedures in place and maintains a contracts register. The Council seeks to achieve best value from the procurement process, driving savings where possible, but also aiming to deliver sustainable services.</p>	Yes



3. VALUE FOR MONEY CONCLUSION

Significant audit risks

The NAO’s guidance requires us to carry out work to identify whether or not a risk to our conclusion exists. Risk, in the context of our work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. In our Audit Strategy Memorandum, we reported that we had identified one significant audit risk. The work we carried out in relation to this significant risk is outlined below.

Risk	Work undertaken	Conclusion
<p>Financial Sustainability</p> <p>The Council’s medium term financial plan (MTFP) for the period 2020/21 to 2022/23 sets out the financial challenges the Council faces in the medium term. To achieve financial balance in the coming years, the MTFP includes planned use of reserves of £1.9m in 20/21 and £1.6m in 21/22.</p> <p>The continuing challenges the Council faces are not new and are not unique to North Lincolnshire Council. The challenges do, however, present a significant audit risk in respect of the arrangements that the Council has in place to deliver financial sustainability over the medium term.</p>	<p>We reviewed the arrangements the Council has in place for ensuring financial resilience and ensuring that the medium term financial plan has taken into consideration factors such as funding reductions, salary and general inflation, demand pressures and restructuring costs.</p> <p>We also reviewed the arrangements in place to monitor income and expenditure to deliver the budget and the Council priorities.</p>	<p>Our work provided sufficient assurance. We have no matters to report.</p> <p>The impact of the Covid-19 pandemic means the Council will need to revisit the financial plan, including assumptions and future budget gaps. Our conclusion considers arrangements in the 2019/20 financial year and recognises that the impact of Covid-19 was in March 2020. When setting the updated financial plan, arrangements were in place to set a financial plan which reflected the circumstances at that time.</p>



4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of group audit reporting requirements	Below review threshold
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data, and to carry out certain tests on the data. We submitted this information to the NAO on 1 December 2020.

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.



5. OUR FEES

Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to Audit Committee in July 2020.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	£80,186	£95,136*
Certification of Housing Benefit Subsidy Claim	£7,800	£7,800**
Reporting Accountant's Report on the Teachers' Pensions return	£3,000	£3,000
Reporting Accountant's Report on the School Centred Initial Teacher Training (SCITT) return	£2,500	£2,500

*Additional fee to meet additional work requirements for property valuations and pensions.

** Subject to satisfactory completion of the work



6. FORWARD LOOK

Financial outlook

The Covid-19 pandemic and the consequences of local and regional lockdowns and restrictions will have a significant impact on the UK economy for years to come. The pandemic has created significant uncertainties and pressures in the Council's medium term financial planning arrangements. Clarity over the impact will only be obtained when the virus has been brought under control and the impact on the economy becomes clearer. The Council is monitoring and updating plans but is anticipating future pressures in the income it receives. In particular, Collection Fund income is likely to be affected by any negative impact to the local and national economy. Public spending is also likely to be tightly controlled as the Government begins to manage the levels of borrowing incurred.

There is also uncertainty stemming from the UK's new trading arrangements with the European Union. While this may not directly affect the Council's supply chains, the impact on the overall economy may create indirect pressures.

It is critical that the Council continues to monitor and refresh its medium term plan so that potential funding shortfalls can be identified as early as possible and mitigations identified to minimise the impact on services.

Operational challenges

The Covid-19 pandemic has had a significant impact on the services provided by the Council. Services have either been suspended or redesigned in order for them to be delivered in a safe manner for officers and users. The Council's offices have been largely closed since March 2020 so officers have had to adapt to working from home. It is likely that these measures will continue until the roll out of a vaccine and coronavirus is brought under control.

Aside from Covid-19, other key challenges faced by the Council include:

- successfully generating the savings necessary to deliver the medium term financial plan;
- responding to the demand and funding pressures faced in adult and children's services.

How we will work with the Council

In terms of the technical challenges around the production of the statement of accounts, we will continue to offer accounting workshops to finance officers, and the audit team will continue to share our knowledge of new accounting developments. We will also be on hand to discuss any issues as and when they arise.

Given the impact of Covid-19 on the 2019/20 reporting timetable, there is some uncertainty in respect of the 2020/21 completion dates. We will continue to work with the finance team to ensure timely completion of our audit work.

We will also share relevant insights that we have as a national and international accounting and advisory firm with experience of working with other public sector and commercial service providers.



6. FORWARD LOOK

Changes to the Code of Audit Practice

The Code of Audit Practice (the Audit Code), issued by the Comptroller and Auditor General, prescribes the way we carry out our responsibilities as your auditors. On 1st April 2020 a new Code came in to force and will apply to our work from 2020/21 onwards.

The new Audit Code continues to apply the requirements of International Standards on Auditing (ISAs) to our audit of the financial statements. While there are changes to the ISAs that are effective from 2020/21 the Audit Code has not introduced any changes to the scope of our audit of the financial statements. We will continue to give our opinion on the financial statements in our independent auditor's report.

There are, however, significant changes to the work on value for money arrangements, and the way we report the outcomes of our work to you.

The auditor's work on value for money arrangements

From 2020/21 we are still required to satisfy ourselves that you have made proper arrangements for securing the economy, efficiency and effectiveness in your use of resources. Unlike under the 2015 Audit Code, however, we will no longer report in the form of a conclusion on arrangements. Instead, where our work identifies significant weaknesses in arrangements, we are required to report those weaknesses to you, along with the actions that need to be taken to address those weaknesses.

Our work on value for money arrangements will focus on three criteria, specified in the revised Audit Code:

- financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;
- governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under the new Audit Code we will be expected to report and make recommendations as soon as we identify a significant weakness in arrangements, as opposed to reporting our conclusion on arrangements at the end of the audit cycle as has previously been the case.

Reporting the results of the auditor's work

We currently issue you with an Annual Audit Letter which provides a summary of our work across all aspects of our audit. From 2020/21 the Annual Audit Letter will be replaced by the Auditor's Annual Report. This will continue to provide a summary of our work over the year of audit but will also include a detailed commentary on your arrangements in place to achieve economy, efficiency and effectiveness. This commentary replaces the conclusion on arrangements that was previously provided and will include details of any significant weakness identified and reported to you, follow up of any previous recommendations made, and the our view as to whether recommendations have been implemented satisfactorily.

The guidance supporting the new Audit Code is being developed by the National Audit Office and we will provide you with any further updates to our approach arising from this guidance when it is release. In particular we will communicate any increases in work which will impact on the audit fees charged.



6. FORWARD LOOK

Redmond Review

In September 2020, Sir Tony Redmond published the findings of his independent review into the oversight of local audit and the transparency of local authority financial reporting. The report makes several recommendations that, if implemented, could affect both the financial statements that local authorities are required to prepare and the work that we as auditors are required to do.

The report and recommendations are wide-ranging, and includes:

- the creation of the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit;
- reviewing reporting deadlines;
- reviewing governance arrangements in local authorities, including the membership of the Audit Committee; and
- increasing transparency and reducing the complexity of local authority financial statements.

The recommendations and findings will now be considered by the Ministry of Housing, Communities and Local Government and we look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.

The full report is available here: <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>



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*where permitted under applicable country laws

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