

Report of the Director of Finance to the meeting of the Governance and Audit Committee to be held on 27th January 2022

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Subject:

Appointment of External Auditors for Statutory Financial Statements

Summary statement:

Previously, Full Council took a decision to opt into the national Local Government Association led approach (via the Public Sector Audit Appointments Ltd) for the procurement of local authority external auditors for the 5-year period April 2018 through to March 2023.

The council now needs to consider the options available for the appointment of the external auditor for the 2023/24 statement of accounts, with a need to appoint an auditor by the end of December 2022.

In September 2021, the Public Sector Audit Appointments Ltd (PSAA) wrote to local authorities to issue a formal invitation to opt into the national sector-led approach for the 5-year period from April 2023. This report therefore sets out the options available to the council for the appointment external auditor.

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Corporate

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Overview & Scrutiny Area:

Corporate

1. MAIN ISSUES

- 1.1 The Local Audit and Accountability Act 2014 ended the Audit Commission and established transitional arrangements for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England. In July 2016, the Secretary of State specified PSAA as an appointing person for principal local government and police bodies for audits from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015.
- 1.2 The auditor appointed at the end of the procurement process will undertake the statutory audit of accounts and Best Value assessment of the council in each financial year, in accordance with all relevant codes of practice and guidance. The appointed auditor is also responsible for investigating questions raised by electors and has powers and responsibilities in relation to Public Interest Reports and statutory recommendations.
- 1.3 The auditor must act independently of the council and the main purpose of the procurement legislation is to ensure that the appointed auditor is sufficiently qualified and independent. The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC) and employ authorised Key Audit Partners to oversee the work. External auditors are regulated by the FRC, which will be replaced by a new body with wider powers, the Audit, Reporting and Governance Authority (ARGA) during the next audit contract. In addition, the scope of a local audit is fixed and is determined by the Code of Audit Practice (currently published by the National Audit Office), the format of the financial statements (specified by CIPFA/LASAAC) and the application of auditing standards regulated by the FRC. These factors apply to all local audits irrespective of whether an eligible body decides to opt into Public Section Audit Appointments (PSAA) national scheme or chooses to make its own separate arrangements.

The requirements are mandatory; they shape the work auditors undertake and have a bearing on the actual fees required. Local authorities therefore have quite limited influence over the nature of the external audit services being procured, with the nature and quality very much determined and overseen by third parties.
- 1.4 The Local Government Association (LGA) set up PSAA to provide a way for councils to meet the legislative requirements of audit procurement without unnecessary bureaucracy and to provide leverage for councils by collaborating in a difficult market. It is now more important than ever that councils work together to ensure we get what we need from the audit market.
- 1.5 The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. In 2017, Full Council took the decision to opt into the 'appointing person' national auditor appointment arrangements established by the PSAA for the period covering the accounts for 2018/19 to 2022/23.
- 1.6 Under the Local Government Audit & Accountability Act 2014, the council is required to appoint an auditor to audit its accounts for each financial year.

As a principal local government body, the council has three options;

- i) to undertake an individual auditor procurement and appointment exercise,
 - ii) to undertake a joint audit procurement and appointing exercise with other bodies, for example neighbouring local authorities,
 - iii) to join the PSAA's sector-led national scheme.
- 1.7 In terms of option 3, to opt into the national scheme, the decision would need to be made by Full Council.
- 1.8 The PSAA is a not-for-profit organisation, under the umbrella of the Local Government Association, whose costs are around 4% of the scheme with any surplus distributed back to scheme members. In 2019, the PSAA returned a total £3.5m to relevant bodies and in 2021 a further £5.6m was returned.
- 1.9 Much has changed in the local audit market since audit contracts were last awarded in 2017. At that time the audit market was relatively stable, there had been few changes in audit requirements, and local audit fees had been reducing over a long period. Around 98% of those bodies eligible opted into the national scheme and attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1st April 2018.
- 1.10 During 2018 a series of financial crises and failures in the private sector year led to questioning about the role of auditors and the focus and value of their work. Four independent reviews were commissioned by Government: Sir John Kingman's review of the Financial Reporting Council (FRC), the audit regulator; the Competition and Markets Authority review of the audit market; Sir Donald Brydon's review of the quality and effectiveness of audit; and Sir Tony Redmond's review of local authority financial reporting and external audit. The recommendations are now under consideration by Government, with the clear implication that significant reforms will follow. A new audit regulator (ARGA) is to be established, and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.
- 1.11 The Kingman review has led to an urgent drive for the FRC to deliver rapid, measurable improvements in audit quality. This has created a major pressure for audit firms to ensure full compliance with regulatory requirements and expectations in every audit they undertake. By the time firms were conducting 2018/19 local audits during 2019, the measures they were putting in place to respond to a more focused regulator were clearly visible. To deliver the necessary improvements in audit quality, firms were requiring their audit teams to undertake additional work to gain deeper levels of assurance. However, additional work requires more time, posing a threat to the firms' ability to complete all their audits by the target date for publication of audited accounts. Delayed opinions are not the only consequence of the FRC's drive to improve audit quality. Additional audit work must also be paid for. As a result, many more fee variation claims have been needed than in prior years.

- 1.12 This situation has been accentuated by growing auditor recruitment and retention challenges, the complexity of local government financial statements and increasing levels of technical challenges as bodies explore innovative ways of developing new or enhanced income streams to help fund services for local people. These challenges have increased in subsequent audit years, with Covid-19 creating further significant pressure for finance and audit teams.
- 1.13 None of these problems are unique to local government audit. Similar challenges have played out in other sectors, where increased fees and disappointing responses to tender invitations have been experienced during the past two years.
- 1.14 The PSAA is now undertaking a procurement for the next appointing period, covering audits for the financial years 2023/24 through to 2027/28. The opt-in period starts on 22nd September 2021 and closes on 11th March 2022. To opt into the national scheme from 2023/24, the council needs to return completed opt-in documents to the PSAA by the 11th March 2022. Based on the level of opt-ins it will enter contracts with appropriately qualified audit firms and appoint a suitable firm to be the council's auditor - details relating to PSAA's invitation are provided at appendix A to this report.
- 1.15 In summary the national opt-in scheme provides the following;
- i) the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1st April 2023,
 - ii) appointing the same auditor to other opted-in bodies that are involved in formal collaboration or joint working initiatives to the extent this is possible with other constraints,
 - iii) managing the procurement process to ensure both quality and price criteria are satisfied. The PSAA has previously sought views from the local government sector to help inform the procurement strategy,
 - iv) ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period,
 - v) minimising the scheme management costs and returning any surpluses to scheme members,
 - vi) consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed,
 - vii) consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk, and
 - viii) ongoing contract and performance management of the contracts once these have been let.
- 1.16 The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies. Through the

national sector-led procurement, the PSAA will;

- i) seek to encourage realistic fee levels and to benefit from the economies of scale associated with procuring on behalf of a significant number of bodies,
 - ii) continue to pool scheme costs and charge fees to opted-in bodies in accordance with the published fee scale as amended following consultations with scheme members and other interested parties (pooling means that everyone within the scheme will benefit from the prices secured via a competitive procurement process – a key tenet of the national collective scheme),
 - iii) continue to minimise its own costs, around 4% of scheme costs, and as a not-for-profit company will return any surplus funds to scheme members. The PSAA will seek to encourage market sustainability in its procurement. Firms will be able to bid for a variety of differently sized contracts so that they can match their available resources and risk appetite to the contract for which they bid. They will be required to meet appropriate quality standards and to reflect realistic market prices in their tenders, informed by the scale fees and the supporting information provided about each audit. Where regulatory changes are in train which affect the amount of audit work suppliers must undertake, firms will be informed as to which developments should be priced into their bids.
- 1.17 There are currently nine audit providers eligible to audit local authorities and other relevant bodies under local audit legislation. This means that a local procurement exercise would seek tenders from the same firms as the national procurement exercise, subject to the need to manage any local independence issues. Any local procurements must deliver the same audit scope and requirements as a national procurement, reflecting the auditor's statutory responsibilities.
- 1.18 Should the council decide to implement option 3, and again opt into the national sector-led procurement, then the council would need to formally respond to the PSAA invitation by the close of the opt-in period which is the 11th March 2022. The PSAA will commence the formal procurement process in early February 2022, and it expects to award contracts in August 2022. There will then be a period of consultation with authorities on the appointment of auditors so that it can make the necessary appointments by the statutory deadline of the 31st December 2022.

2. (A) FINANCIAL & RESOURCE APPRAISAL

- 2.1 The total external audit fee for 2019/20 was £182,235 which comprised £142,694 for the financial statement audit, including the Whole of Government Accounts and procedures in respect of Value for Money assessment, together with a further £39,541 in respect of additional procedures to address regulatory focus areas and additional risks identified due to Covid-19. It should be noted that under the current contractual arrangement any additional fees are subject to agreement with the PSAA.
- 2.2 The cost of establishing a local or joint auditor panel outlined in options 1 and 2

above will need to be estimated and included in the Council's budget. This will include the cost of recruiting independent appointees (members), servicing the Panel, running a bidding and tender evaluation process, letting a contract and paying members fees and allowances. Opting in to the PSAA provides maximum opportunity to limit the extent of any increases by entering into a large-scale collective procurement arrangement and would remove the costs of establishing an auditor panel.

- 2.3 There is a risk that current external audit fee levels could increase when the current contracts end. The scope of audit has increased, requiring more audit work. There are also concerns about capacity and sustainability in the local audit market.
- 2.4 Opting into a national scheme provides maximum opportunity to ensure fees are as realistic as possible, while ensuring the quality of audit is maintained, by entering into a large-scale collective procurement arrangement.

3. RISK MANAGEMENT AND GOVERNANCE ISSUES

- 3.1 The council has a statutory obligation to appoint an external auditor by the end of December 2022 for the audit of the 2023/24 statement of accounts. In practical terms this means that one of the options outlined in this report will need to be implemented in spring 2022 to enable to an appointment to be in place. The deadline to opt into the national sector-led approach is 11th March 2022.
- 3.2 The principal risks are that the council fails to appoint an auditor in accordance with the requirements and timing specified in local audit legislation or does not achieve value for money in the appointment process. These risks are considered best mitigated by opting into the sector-led approach through the PSAA.

4. LEGAL APPRAISAL

- 4.1 Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council/Authority to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year.
- 4.2 Section 8 governs the procedure for appointment including that the Council/Authority must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 provides that where a relevant council is a local council operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the council under those arrangements.
- 4.3 Section 12 makes provision for the failure to appoint a local auditor. The Council/Authority must immediately inform the Secretary of State, who may direct the Council/Authority to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council/Authority.
- 4.4 Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State. This power has been

exercised in the Local Audit (Appointing Person) Regulations 2015 (SI 192) and this gives the Secretary of State the ability to enable a sector-led body to become the appointing person. In July 2016 the Secretary of State specified PSAA as the appointing person.

5. OTHER IMPLICATIONS

5.1 EQUALITY & DIVERSITY

There are no specific equality and diversity issues arising from this report.

5.2 SUSTAINABILITY IMPLICATIONS

There are no specific sustainability implications arising from this report.

5.3 GREENHOUSE GAS EMISSIONS IMPACTS

There are no specific greenhouse gas emissions impacts arising from this report.

5.4 COMMUNITY SAFETY IMPLICATIONS

There are no specific community safety implications arising from this report.

5.5 HUMAN RIGHTS ACT

There are no specific issues arising from this report.

5.6 TRADE UNION

The Director of Human Resources may advise on this aspect.

5.7 WARD IMPLICATIONS

There are no specific issues arising from this report.

5.8 AREA COMMITTEE ACTION PLAN IMPLICATIONS (for reports to Area Committees only)

Nil

5.9 IMPLICATIONS FOR CHILDREN AND YOUNG PEOPLE

There are no specific children and young people implications arising from this report.

5.10 ISSUES ARISING FROM PRIVACY IMPACT ASSESMENT

There are no specific issues arising from this report.

7. NOT FOR PUBLICATION DOCUMENTS

None

9. OPTIONS

9.1 As mentioned above, the council essentially has 3 options for the procurement of its external auditor;

- i) **Option 1 (not recommended)** – the council could elect to appoint its own external auditor under the Act, which would require the council to establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the council, and the members of the panel must be wholly, or a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees, excluding current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input to assessing bids and choosing to which audit firm to award a contract for the council's external audit and the council would need to establish processes and procedures to manage the contract for its duration, overseen by the auditor panel. Whilst it could be argued that setting up an auditor panel allows the council to take maximum advantage and have local input into the decision, the recruitment and servicing of the independent auditor panel, managing the procurement process and negotiating the contract is estimated to cost in the region of £15k plus ongoing expenses. In addition, the council would not be able to take advantage of the economies of scale through the national sector-led approach and the assessment of bids and the decision on awarding the contract would be taken by independent appointees and not solely by elected members.
- ii) **Option 2 (not recommended)** - alternatively, the Act does enable the council to join with other local authorities to establish a joint auditor panel. Again, this would need to be constituted of wholly or a majority of independent appointees. Further legal advice would be required on the exact constitution of such a panel having regard to the obligations of each council under the Act and there is no appetite locally in other local authorities for such an arrangement. The advantages of this option compared to option 1 are that the costs of setting up the panel, running the bidding exercise and negotiating the contract would be shared across several authorities and there is greater opportunity for negotiating some economies of scale. However, the decision-making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor panel is used or possible only one elected member representing each Council, depending on the constitution agreed with the other bodies involved. In addition, the choice of auditor could be complicated where individual councils have independence issues. There could be a risk that if the joint auditor panel choose a firm that is conflicted for this council then the council may still need to make a separate appointment with all the attendant costs and loss of economies possible through joint procurement.
- iii) **Option 3 (recommended option)** – to maintain and the current arrangement and again opt into the national sector-led procurement. Under the national auditor appointment scheme the PSAA is specified as the 'appointing person'

for principal local government under the provisions of the Act and the Local Audit (Appointing Person) Regulations 2015.

9.2 Option 1 and option 2 would require more resource-intensive processes to implement for the council, and without the economies of scale of the sector-led procurement (option 3) would likely result in a more costly service. It would also be potentially more difficult to manage quality and independence requirements through a local appointment process. The council is unable to influence the scope of the audit and the regulatory regime inhibits the council's ability to affect quality. In addition;

- i) The council and its auditor panel would need to maintain ongoing oversight of the contract. Local contract management cannot, however, influence the scope or delivery of an audit.
- ii) The national offer provides the appointment of an independent auditor with limited administrative cost to the council. By joining the scheme, the council would be acting with other councils to optimise the opportunity to influence the market that a national procurement provides.

9.3 The recommended approach is therefore to opt into the national auditor appointment scheme.

10. RECOMMENDATIONS

10.1 That the Committee recommends option 3 (opt into the national auditor appointment scheme) to Council as the preferred option and that the recommendation be included within reports to Budget Council in February 2022.

Reasons for recommendation

- 10.2 The report concludes that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council/Authority than a procurement undertaken locally because;
- i) collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements,
 - ii) the alternative options would mean that the council would need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement and ongoing management of an audit contract,
 - iii) it is the best opportunity to secure the appointment of a qualified, registered auditor - there are only nine accredited local audit firms, and a local procurement would be drawing from the same limited supply of auditor resources as PSAA's national procurement, and,

- iv) supporting the sector-led body offers the best way of to ensuring there is a continuing and sustainable public audit market into the medium and long term.

11. APPENDICES

None

12. BACKGROUND DOCUMENTS

None

