

<b>Classification:</b> Open	<b>Decision Type:</b> Non-Key
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<b>Report to:</b>	Audit committee	<b>Date:</b> 12 January 2022
<b>Subject:</b>	External Audit procurement	
<b>Report of</b>	Leader and Cabinet Member for Finance and Growth	

## 1. Summary

- 1.1 The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Council, as with the vast majority of other Council's, opted into the 'appointing person' national auditor appointment arrangements which were established by Public Sector Audit Appointments (PSAA) for the period covering the accounts for 2018/19 to 2022/23.
- 1.2 PSAA is now undertaking a procurement exercise for the next appointing period, covering audits for the 2023/24 to 2027/28 financial years. During Autumn 2021 all Local Government bodies need to make important decisions about their external audit arrangements from 2023/24. The other options for the procurement are to arrange their own procurement and make the appointment themselves or, in conjunction with other bodies, they can join and take advantage of the national collective scheme administered by PSAA.
- 1.3 This report concludes that the sector-wide procurement conducted by PSAA is the best option for the Council because:
- collective procurement reduces costs for those submitting bids and for individual authorities compared to a multiplicity of smaller local procurements;
  - if the Council does not use the national appointment arrangements, the Council will need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement exercise and ongoing management of the audit contract;
  - it is the best opportunity to secure the appointment of a qualified, registered auditor - there are only nine accredited local audit firms, and should the Council undertake our own procurement exercise, the Council would be drawing from the same limited supply of auditor resources as PSAA's national procurement, and;
  - supporting the sector-led body helps to ensure there is a continuing and sustainable public audit market into the medium and long term.
- 1.4 If the Council wishes to take advantage of the national auditor appointment arrangements, it is required, under the Local Audit Regulations, to make the decision at full Council. The opt-in period started on 22 September 2021 and closes on 11 March 2022. To opt into the national scheme from 2023/24, the Council must return completed opt-in documents to PSAA by 11 March 2022.

## 2. Recommendation(s)

- 2.1 That the Council accepts the PSAA invitation to opt into the sector-led option for the appointment of external auditors to principal Local Government and Police Bodies for five financial years from 1 April 2023.

### **3. Reasons for recommendation(s)**

- 3.1 The preferred option is therefore to opt-in to the national auditor appointment scheme.
- 3.2 Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt-in must be made by a meeting of the Council (meeting as a whole), except where the authority is a corporation sole.
- 3.3 The Council then needs to respond formally to PSAA's invitation in the form specified by PSAA by the close of the opt-in period (11 March 2022).
- 3.3 PSAA will commence the formal procurement process in early February 2022. It expects to award contracts in August 2022 and will then consult with authorities on the appointment of auditors so that it can make appointments by the statutory deadline of 31 December 2022.

### **4. Alternative options considered and rejected**

- 4.1 **Option 1** is to opt into the PSAA external audit appointment arrangements as outlined in the report.
- 4.2 **Option 2** - If the Council chose not to opt-in to the PSAA appointment arrangements, there would be a need to establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council itself, and the members of the panel must be wholly or a majority of independent members as defined by the Act. Independent members (who are in scarce supply) 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.
- 4.3 **Option 3** - The Act enables the Council to join with other authorities to establish a joint auditor panel. Again, this will 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 the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.
- 4.4 **Options 2 and 3** would be more resource-intensive processes to implement for the Council, and without the bulk buying power of the sector-led procurement would be likely to result in a more costly service. The Council and its auditor panel would need to maintain ongoing oversight of the contract. Under the PSAA contract this is provided at a high level by this organisation.
- 4.5 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.

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## **5 Background**

- 5.1 Under the Local Government Audit & Accountability Act 2014 (“the Act”), the Council is required to appoint an auditor to audit its accounts for each financial year. The Council has three options:
- a. To appoint its own auditor, which requires it to follow the procedure set out in the Act
  - b. To act jointly with other authorities to procure an auditor following the procedures in the Act
  - c. To opt-in to the national auditor appointment scheme administered by a body designated by the Secretary of State as the ‘appointing person’. The body currently designated for this role is Public Sector Audit Appointments Limited (PSAA).
- 5.2 To opt-in to the national scheme, the Council must make a decision at a meeting of the Full Council.
- 5.3 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.
- 5.4 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.
- 5.5 The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC). They must also employ authorised Key Audit Partners to oversee the work. As this report sets out, there is a currently a shortage of registered firms and Key Audit Partners available to undertake this work.
- 5.6 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 course of the next audit contract period.
- 5.7 As a result of these oversight arrangements, Councils therefore have limited influence over the scope of the audit services they are procuring, with the availability of firms available limited to nine.

## **6 Current Position**

- 6.1 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. 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 1 April 2018.

- 6.2 During 2018, a series of financial crises and failures in the private sector 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 proposed to be established, and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.
- 6.3 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 assurance work requires more time, posing a threat to the firms' ability to complete all their audits for the price tendered 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 submitted than in prior years.
- 6.4 This situation has been exacerbated 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.
- 6.5 None of these problems is 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.

## **7 The Invitation from the PSAA**

- 7.1 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. PSAA let five-year audit services contracts in 2017 for the first appointing period, covering audits of the accounts from 2018/19 to 2022/23. It is now undertaking the work needed to invite eligible bodies to opt in for the next appointing period, from the 2023/24 audit onwards, and to complete a procurement for audit services. PSAA is a not-for-profit organisation whose costs are around 4% of the scheme with any surplus distributed back to scheme members.
- 7.2 In summary the national opt-in scheme provides the following:
- a) the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1 April 2023;
  - b) 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;

- c) managing the procurement process to ensure both quality and price criteria are satisfied. PSAA has sought views from the sector to help inform its detailed procurement strategy;
  - d) ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period;
  - e) minimising the scheme management costs and returning any surpluses to scheme members;
  - f) consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed;
  - g) consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk; and
  - h) ongoing contract and performance management of the contracts once these have been let.
- 7.3 PSAA are now inviting the Council to opt in for the second appointing period, for 2023/24 to 2027/28, along with all other eligible authorities. Based on the level of opt-ins, it will enter into contracts with appropriately qualified audit firms and appoint a suitable firm to be the Council's/Authority's auditor.
- 7.4 The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies. PSAA will:
- a) 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;
  - b) 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);
  - c) 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. In 2019 it returned a total £3.5million to relevant bodies and in 2021 a further £5.6million was returned.
- 7.5 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
- 7.6 The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office)<sup>1</sup>, the format of the financial statements (specified by the Chartered Institute of Public Finance and Accountancy (CIPFA)/ The Local Authority (Scotland) Accounts Advisory Committee (LASAAC)), and the application of auditing standards regulated by the FRC. These factors apply to

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<sup>1</sup> The Governments Spring statement proposes that overarching responsibility for Code will in due course transfer to the system leader, namely ARGA, the new regulator being established to replace the FRC.

all local audits irrespective of whether an eligible body decides to opt into PSAA's 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.

- 7.7 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. Local firms cannot be invited to bid. Local procurements must deliver the same audit scope and requirements as a national procurement, reflecting the auditor's statutory responsibilities.

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### **Links with the Corporate Priorities:**

*Please summarise how this links to the Let's Do It Strategy.*

A strong financially sustainable Council is essential to the delivery of the Let's do it Strategy.

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### **Equality Impact and Considerations:**

*Please provide an explanation of the outcome(s) of an initial or full EIA.*

This proposal does not adversely affect equality.

Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows: A public authority must, in the exercise of its functions, have due regard to the need to –

- a. Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
- b. Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
- c. Foster good relations between persons who share a relevant protected characteristic and persons who do not share it. 16.

The public sector equality duty (specific duty) requires us to consider how we can positively contribute to the advancement of equality and good relations and demonstrate that we are paying 'due regard' in our decision making in the design of policies and in the delivery of services.

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### **Environmental Impact and Considerations:**

*Please provide an explanation of the carbon impact of this decision.*

The decision by cabinet from this report would have no carbon impact

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**Assessment and Mitigation of Risk:**

<b>Risk / opportunity</b>	<b>Mitigation</b>
fails to appoint an auditor in accordance with the requirements and timing specified in local audit legislation	These risks are considered best mitigated by opting into the sector-led approach through PSAA.
does not achieve value for money in the appointment process.	These risks are considered best mitigated by opting into the sector-led approach through PSAA.

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**Legal Implications:**

Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year.

The Act sets out that the procedure for appointment. The procedure states that the Council must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 of the Act provides that we need to publicise the appointment of our auditors.

If the council do not appoint auditors we must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council.

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**Financial Implications:**

*To be completed by the Council's Section 151 Officer.*

There is a risk that current external audit fee levels could increase when the current contracts end (however the external auditor is appointed). The depth of the external audit work to be undertaken has increased, requiring more resources.

Opting into a national scheme provides maximum opportunity to ensure fees are as realistic as possible, while ensuring the quality of contract documentation to oversee the undertaking of the audit is maintained, by entering into a large-scale collective procurement arrangement.

If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement. Until a procurement exercise is completed it is not possible to state what, if any, additional resource may be required for audit fees from 2023/24.

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**Background papers:**

*Please list any background documents to this report and include a hyperlink where possible.*

**Please include a glossary of terms, abbreviations and acronyms used in this report.**

<b>Term</b>	<b>Meaning</b>