

**Agenda Item No:** 4

**Report To:** Audit Committee

**Date of Meeting:** 1 February 2022

**Report Title:** Invitation to become an opted-in authority

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**Portfolio Holder** Neil Shorter  
**Portfolio Holder for:** Finance and IT



**Summary:**

Public Sector Audit Appointments (PSAA) procure and tender contracts between Local Authorities and Audit firms whilst acting as a regulator to confirm that any fee variations raised by external auditors are fair and appropriate and in line with regulation.

The Council previously appointed the PSAA in 2016 and the Council now needs to decide if it wants to become an opted-in authority for the 5 year appointing period covering the 2023/24 to 2027/28 accounts.

This report considers the options available to the Council and proposes giving notice to PSAA of the authority's intention to become opted in authority.

**Key Decision:** No

**Significantly Affected Wards:** None

**Recommendations:** **The Committee is recommended to:-**

- I. Propose to Council that the Authority gives its intention to become an opted-in authority to the Public Sector Audit Appointments for the 5 year appointing period commencing 2023/24.**

**Financial Implications:**

The Audit fee and budget figure will need to be monitored and amended accordingly as per the outcome of any tender review, any amendment will be reported accordingly.

The Redmond Review has indicated that external fees are too low and therefore are likely to increase over the coming years, being part of a wider framework will enable economies of scale and help keep increases to a minimum.

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.

**Legal  
Implications:**

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.

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/Authority is a local Council/Authority operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council/Authority under those arrangements.

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.

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.

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## **Introduction and Background**

1. The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Council previously opted into the Public Sector Audit Appointments (PSAA) national auditor appointment scheme for the period covering the accounts for 2018/19 to 2022/23.
2. The Council now needs to make a decision about our external audit arrangements from 2023/24.
3. 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 available to the Council ;
  - To appoint its own auditor, which requires it to follow the procedure set out in the Act.
  - To act jointly with other authorities to procure an auditor following the procedures in the Act.
  - 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).
4. In order to opt in to the national scheme, a council must make a decision at a meeting of the Full Council.

### ***Pressures in the current local audit market and delays in issuing opinions***

5. 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 (Only one District Council remained outside the framework). The resulting audit contracts took effect from 1 April 2018.
6. 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.
7. 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. In reality this means that the auditor has to review high value items on our balance sheet regardless of any amendments to accounting practice that apply to Local Authorities, a good example of this would be understanding the value of a school or a heritage asset, if its recorded at £1 or £1m it makes very little difference to the assets use or the taxpayer. 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.

8. 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.
9. 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.
10. 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.

## **Options**

### **Appointment by the Authority itself or jointly**

11. The Council may 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 Authority itself, 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 Authority's external audit.
  - Manage the contract for its duration, overseen by the Auditor Panel.

### **The national auditor appointment scheme**

12. This is in effect a re-run of the current arrangement with PSAA as specified as the 'appointing person' for principal local government.
13. The PSAA 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.

14. In summary the national opt-in scheme provides the following:

- the PSAA manage the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1 April 2023;
- 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;
- 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;
- ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period;
- minimising the scheme management costs and returning any surpluses to scheme members;
- consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed;
- consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk; and
- ongoing contract and performance management of the contracts once these have been let.

#### **Assessment of options and officer recommendation**

15. If the Council does not opt in to the national auditor appointment scheme there would be a need to establish an independent auditor panel to make a stand-alone appointment, although this could be done jointly with other Council.
16. 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.
17. 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/Authority's external audit.
18. This would be a 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. It would also be more difficult to manage quality and independence requirements through a local appointment process.
19. The Council and the auditor panel would need to maintain ongoing oversight of the contract.
20. In weighing up the options we must be mindful of the issues that there have been with the current arrangements, and the PSAA must take some responsibility for the issues caused, accepting bids that are unviable resulting in fee increases, concentrating work in too few firms, and not penalising auditors within the contract framework for poor performance. However it is considered that working within the system to improve standards will be more effective than opting out.

21. The national auditor appointment scheme provides appointment of an independent auditor with limited administrative cost to the council. By joining the scheme, better outcomes would be expected and be less burdensome for the Council than a procurement undertaken locally because:

- collective procurement will reduce costs for the sector and for the Council compared to a multiplicity of smaller local procurements;
- it does not require the Council 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;
- 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
- supporting the sector-led body offers the best way of ensuring there is a continuing and sustainable public audit market into the medium and long term.

### **Recommendation**

22. This report concludes that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than a procurement undertaken locally.

23. This route also minimises risks to the authority if we failed to appoint an auditor in accordance with the requirements and timing specified in local audit legislation, and not achieving best value for money.

24. It is therefore **recommended that the Audit Committee propose to Council that the Authority gives its intention to become an opted-in authority to the Public Sector Audit Appointments for the 5 year appointing period commencing 2023/24.**

25. 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.

26. 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 which is the 11 March 2022.

### **The next audit procurement**

27. The 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.

28. 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:

- 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;
- 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);

- 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.

29. 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.

30. The scope of a local audit is fixed. It 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 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.

31. 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.

### **Portfolio Holder's Views**

32. This report brings forward a number of options and I support the recommendation to procure future external audit services through the PSAA framework. However, the learning points identified in Paragraph 20 need to be taken forward in the procurement process and this should be advocated to the PSAA procurement team. Council's will also need to be more robust in holding the PSAA to account if improved performance is not delivered.

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