

APPOINTING PERSON ARRANGEMENTS FOR THE APPOINTMENT OF THE EXTERNAL AUDITOR

**To:**

Civic Affairs Committee [02/02/2022]

Report by:

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Wards affected:

All

1. Introduction / Executive Summary

- 1.1. This report sets out the options available to the council regarding the adoption of an appointing person arrangement for the appointment of an external auditor to the council for the years 2023/24 to 2027/28.

2. Recommendations

- 2.1. To recommend to Council the adoption of Public Sector Audit Appointments Ltd (PSAA) as the appointing person for the council.
- 2.2. To delegate acceptance of the invitation to the Head of Finance, as the council's Section 151 Officer.

3. Background

- 3.1. The council opted into the 'appointing person' national auditor appointment arrangements established by Public Sector Audit Appointments (PSAA) for the period covering the accounts for 2018/19 to 2022/23. The current auditor appointment arrangements, therefore, cover the period up to and including the audit of the 2022/23 accounts. PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. It issued an invitation to all councils to opt into the national scheme for auditor appointments on 22 September 2021, with responses required by 11 March 2022. Councils have options to arrange their own procurement and make the appointment themselves or in conjunction with other bodies, or they can

join and take advantage of the national collective scheme administered by PSAA.

4. Option for the Appointing Person Arrangement

4.1 The Local Audit and Accountability Act 2014 sets out how local auditors should be appointed. There are three ways for a principal local government body to appoint its auditor for the five financial years from 2023/24, namely:

- To undertake an individual auditor procurement and appointment exercise;
- To undertake a joint audit procurement and appointing exercise with other bodies, those in the same locality for example; or
- To join PSAA's sector led national scheme. As a specified person under the Act, the PSAA's role is governed by the Local Audit (Appointing Person) Regulations 2015.

4.2. All of the above options require a local auditor to be appointed not later than 31 December in the financial year preceding the financial year of the accounts to be audited. So for the audit of the accounts of the 2023/24 financial year, there must be a local auditor appointed by 31 December 2022

5. The Appointed Auditor

5.1 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.

5.2. 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.

5.3. 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. As the report below sets out there is a currently a shortage of registered firms and Key Audit Partners.

- 5.4. 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.
- 5.5. Councils therefore have very limited influence over the nature of the audit services they are procuring, the nature and quality of which are determined or overseen by third parties

6. Appointment by the council or jointly

- 6.1. 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 council 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 council's external audit.
 - Manage the contract for its duration, overseen by the auditor panel.
- 6.2. Alternatively, 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.

7. The national auditor appointment scheme

- 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:

- 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 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.

8. Pressures in the current local audit market and delays in issuing opinions

8.1. 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.

- 8.2. 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 to be established, and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.
- 8.3. 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 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.
- 8.4. 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.
- 8.5. 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.

9. The invitation

9.1. PSAA is 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 auditor.

10. The next audit procurement

10.1. 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.

10.2. 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.

10.3. 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.

- 10.4. 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.

11. Assessment of options and officer recommendation

- 11.1 If the council did not opt in there would be a need to establish an independent auditor panel to make a stand-alone appointment, as outlined in 6.1 above. This means that elected members would not have a majority input to assessing bids and choosing to which audit firm to award a contract for the council's external audit.
- 11.2 Alternatively, the Act enables the council to join with other authorities to establish a joint auditor panel, see 6.2 above.
- 11.3 These 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. It would also be 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.
- 11.4 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.
- 11.5. 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.

11.6 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 PSAA.

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

12. The way forward

12.1 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.

13. Implications

a) Financial Implications

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There is a risk that current external audit fee levels could increase when the current contracts end. It is clear that the scope of audit has increased, requiring more audit work. There are also concerns about capacity and sustainability in the local audit market.

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.

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.

b) Staffing Implications

None

c) Equality and Poverty Implications

There are no equality and poverty implications.

- d) **Net Zero Carbon, Climate Change and Environmental Implications**
None
- e) **Procurement Implications**
Acceptance of the PSAA opt-in invitation will avoid the need to undertake a procurement exercise, while ensuring that the council's obligations are met
- f) **Community Safety Implications**
None.

14. Consultation and communication considerations

None.

15. Background papers

Invitation to opt into the national scheme for auditor appointments from April 2023.

16. Appendices

None.

17. Inspection of papers

To inspect the background papers or if you have a query on the report please contact Caroline Ryba, Head of Finance and Section 151 Officer, tel: 01223 - 458134, email: caroline.ryba@cambridge.gov.uk.