

Audit Committee

29 November 2021



Decision to Opt-in to the National Scheme for Auditor Appointments managed by Public Sector Audit Appointments (PSAA)

Ordinary Decision

Report of Paul Darby, Corporate Director of Resources

Electoral division(s) affected:

Countywide

Purpose of the Report

- 1 To seek Members' approval to accept the invitation from Public Sector Audit Appointments (PSAA) to opt into the national sector-led arrangement for the appointment of external auditors with effect from 1 April 2023.

Executive Summary

- 2 The current auditor appointment arrangement covers the period up to and including the audit of the 2022/23 accounts, after which they expire.
- 3 In February 2017, the Council agreed to opt into the 'appointing person' national auditor appointment arrangements, established by PSAA for the period covering the accounts for 2018/19 to 2022/23.
- 4 PSAA is currently undertaking a procurement for the next appointing period, covering audits for five financial years from 2023/24 to 2027/28.
- 5 The council must now make a decision about its external audit arrangements from 2023/24 onwards.
- 6 Options for the council include arranging to carry out its own procurement process to appoint its external auditor, or do so in conjunction with other bodies, or join, and take advantage of, the national collective scheme administered by PSAA.

- 7 This report recommends 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 for the following reasons:
- a) collective procurement should reduce costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;
 - b) if it 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 and ongoing management of an audit contract;
 - c) 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
 - d) 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.
- 8 Should the council wish to take advantage of the national auditor appointment arrangements, under the local audit regulations, a decision is required to be agreed by 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 needs to return completed opt-in documents to PSAA by 11 March 2022, backed by a Council resolution to support these arrangements.

Recommendation

- 9 It is recommended that Members agree to accept the PSAA invitation to opt into the sector-led option for the appointment of external auditors for five financial years commencing 1 April 2023 and propose that full Council formally approves the decision at their meeting to be held on 26 January 2022.

Background

- 10 Under the Local Government Audit and 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; or
 - c) to opt into 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 PSAA.
- 10 To opt into the national scheme, the council must make a decision at a meeting of the Full Council.

The Appointed Auditor

- 11 The auditor appointed at the end of the procurement process will undertake the statutory audit of the councils Statement of Accounts (including any associated specific grant returns) 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.
- 12 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.
- 13 The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC) who employ authorised Key Audit Partners to oversee the work. There is a currently a shortage of registered firms and Key Audit Partners.
- 14 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.
- 15 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.

Options for the council to appoint itself or via a joint arrangement

- 16 Should the council wish to appoint its own external auditor under the Act, it would need to:
- a) 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 would have to 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 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.
 - b) manage the contract for its duration, overseen by the auditor panel.
- 17 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 authority under the Act and the council would need to liaise with other local authorities to assess the appetite for such an arrangement.
- 18 These two options would be more resource-intensive and without the bulk buying power of the sector-led procurement service, would likely result in a more costly process for the council to implement. It would also be more difficult to manage quality and independence requirements through a local appointment process. The council would not be able to influence the scope of the audit and the regulatory regime would inhibit the council's ability to affect quality.
- 19 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.

The national auditor appointment scheme

- 20 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.

- 21 PSAA is a not-for-profit organisation whose costs are around 4% of the scheme. Any surplus generated is distributed back to scheme members.
- 22 The benefits of opting into the national scheme are as follows:
 - a) the appointment of a suitably qualified audit firm to conduct audits for 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 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.
- 23 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.

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

- 24 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 bodies who were eligible, opted into the national scheme and attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.

- 25 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:
- a. Sir John Kingman's review of the Financial Reporting Council (FRC), the audit regulator;
 - b. the Competition and Markets Authority review of the audit market;
 - c. Sir Donald Brydon's review of the quality and effectiveness of audit; and
 - d. Sir Tony Redmond's review of local authority financial reporting and external audit.
- 26 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.
- 27 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.
- 28 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.

- 29 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.
- 30 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 last two years.

The invitation

- 31 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. A copy of the PSAA invitation to the council is provided in Appendix 2 to this report.

The next audit procurement

- 32 The prices submitted by bidders through the procurement exercise 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 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 £3.5 million to relevant bodies and returned a further £5.6 million in 2021).

- 33 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 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.
- 34 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.
- 35 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.

Next Steps

- 36 Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of full Council (meeting as a whole), except where the authority is a corporation sole (e.g. Police and Crime Commissioner) in which case this decision can be taken by the holder of that office.
- 37 Therefore, if Audit Committee Members are in agreement, it is intended that this report will be presented to full Council at its meeting on 26 January 2022, where it will be recommended that Members agree to become an opted-in authority.
- 38 The closing date to provide formal acceptance of the invitation to PSAA is 11 March 2022.
- 39 PSAA will commence the formal procurement process in early February 2022. It expects to award contracts in August 2022, then

consult with authorities on the appointment of auditors in order to make appointments by the statutory deadline of 31 December 2022.

Contact: Beverley White Tel: 03000 261900

Appendix 1: Implications

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.

Section 8 governs the procedure for appointment including 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 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.

Section 12 makes provision for the failure to appoint a local auditor. The council 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.

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.

Finance

There is a risk that current external audit fee levels could increase when the current contract ends. 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.

Consultation

None.

Equality and Diversity / Public Sector Equality Duty

None.

Climate Change

None.

Human Rights

None.

Crime and Disorder

None.

Staffing

None.

Accommodation

None.

Risk

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.

Procurement

The scope of the audit will be specified nationally, the National Audit Office (NAO) is currently responsible for writing the Code of Audit Practice which all firms appointed to carry out the council's audit must follow. Not all audit firms will be eligible to compete for the work, they will need to demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council. Currently, there are only nine providers that are eligible to audit local authorities and other relevant bodies; all of these being firms with a national presence. This means that a local procurement exercise would seek tenders from these same firms, subject to the need to manage any local independence issues. Local firms could not be invited to bid.

Appendix 2: Opt-in invitation issued by PSAA

Appointing Period 2023/24 to 2027/28

Form of notice of acceptance of the invitation to opt in

(Please use the details and text below to submit to PSAA your body's formal notice of acceptance of the invitation to opt into the appointing person arrangements from 2023)

Email to: ap2@psaa.co.uk

Subject: Durham County Council

Notice of acceptance of the invitation to become an opted-in authority

This email is notice of the acceptance of your invitation dated 22 September 2021 to become an opted-in authority for the audit years 2023/2024 to 2027/2028 for the purposes of the appointment of our auditor under the provisions of the Local Audit and Accountability Act 2014 and the requirements of the Local Audit (Appointing Person) Regulations 2015.

I confirm that **Durham County Council** has made the decision to accept your invitation to become an opted-in authority in accordance with the decision-making requirements of the Regulations, and that I am authorised to sign this notice of acceptance on behalf of the authority.

Name: **[insert name of signatory]**

Title: **[insert role of signatory]** (authorised officer)

For and on behalf of: **Durham County Council**

Date: **[insert date completed]**