

STAFFORDSHIRE MOORLANDS DISTRICT COUNCIL

Report to Audit & Accounts Committee

3 December 2021

TITLE:	Process for Appointing the External Auditor
PORTFOLIO HOLDER	Cllr Sybil Ralphs – Council Leader SMDC
CONTACT OFFICERS:	John Betts – Interim Executive Director Keith Pointon - Head of Finance
WARDS INVOLVED:	Non-Specific

1. Reason for the Report

- 1.1 The report sets out proposals for appointing the external auditor to the Council for the five-year period from 2023/24.

2. Recommendations

- 2.1 That the Committee recommends that Council:
Accepts Public Sector Audit Appointments' invitation to opt into the sector-led option for the appointment of external auditors to principal local government bodies for five financial years from 1 April 2023.

3. Executive Summary

- 3.1 The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. 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.
- 3.2 PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. During Autumn 2021 all local government bodies need to make a decision about their external audit arrangements from 2023/24. They 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.
- 3.3 The report concludes that, on balance, the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than a procurement undertaken locally because:

- collective procurement reduces costs for the Council;

- if the Council does not use the national appointment arrangements, it 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 and this will be expensive and disproportionately burdensome;
- 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; 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.

3.4 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. To opt into the national scheme from 2023/24, the Council needs to return completed opt-in documents to PSAA by 11 March 2022.

4. How this Report Links to Corporate Priorities

4.1 An effective external audit service will help ensure the Council uses resources effectively and provides value for money.

5. Options and Analysis

5.1 The options available (including running a local procurement or joining in the national framework) are analysed in the report.

6. Implications

6.1 Community Safety - (Crime and Disorder Act 1998)

None.

6.2 Workforce

None.

6.3 Equality and Diversity/Equality Impact Assessment

None

6.4 Financial Considerations

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.

Opting into a national scheme provides maximum opportunity to ensure fees are as realistic as possible, while ensuring the quality of audit is maintained.

If the national scheme is not used some additional resource will 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.

6.5 Legal

Section 7 of the Local Audit and Accountability Act 2014 requires the 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 operates executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive.

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.

6.6 Sustainability None.

6.7 External Consultation None

6.8 Risk Assessment

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.

JOHN BETTS
Interim Executive Director Finance and Revenues & Benefits

**Web Links and
Background Papers**

Location

Moorlands House

Contact details

John.betts@highpeak.gov.uk
07581 010628

Decision to Opt Into the National Scheme for Auditor Appointments Managed by PSAA as the “Appointing Person”

7. Procurement of External Audit for the period 2023/24 to 2027/28

- 7.1. 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;
- 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 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 Public Sector Audit Appointments Limited (PSAA).
- 7.2. In order to opt into the national scheme, a council must make a decision at a meeting of the Full Council.

8. The Appointed Auditor

- 8.1. 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.
- 8.2. 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.
- 8.3. 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. There is a currently a shortage of registered firms and Key Audit Partners.
- 8.4. Auditors are currently 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.
- 8.5. Therefore, the Council has very limited influence over the nature of the audit services they are procuring. The nature and quality of the audits are largely determined or overseen by third parties.

9. Appointment Options

- 9.1. The Council may elect to appoint its own external auditor under the Act. This 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 the contract
 - Manage the contract for its duration, overseen by the Auditor Panel.
- 9.2. Alternatively, the Act enables the Council to join with other 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. Informal liaison with surrounding local authorities has elicited no appetite for such an arrangement.

10. The National Auditor Appointment Scheme

- 10.1. 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.
- 10.2. 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 (this is a key consideration for the Alliance);
 - managing the procurement process to ensure both quality and price criteria are satisfied;
 - 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 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.

11. Pressures in the Current Local Audit Market and Delays in Issuing Opinions

- 11.1. 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 this attracted competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.
- 11.2. During 2018 a series of financial crises and failures in the private sector led to a series of reviews regarding 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.
- 11.3. The recommendations are now under consideration by Government, with the clear implication that significant reforms will follow. A new audit regulator (ARGA) is being established and arrangements for “system leadership” in local audit are to be introduced. Further change will follow as other recommendations are implemented. The Audit committee has already considered the Government’s progress on responding to these recommendations.
- 11.4. The Kingman review led to an urgent drive for the FRC to deliver rapid improvements in audit quality. This created a major pressure for audit firms to ensure full compliance with regulatory requirements. To deliver 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.
- 11.5. This situation has been accentuated by growing auditor recruitment and retention challenges and the complexity of local government financial statements. Covid-19 creating further significant pressure for audit teams.
- 11.6. None of these problems is unique to local government audit. Similar challenges have played out in other sectors, where increased fees and poor responses to tender invitations have been experienced.

12. The Invitation & the Next Audit Procurement

- 12.1. 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.

- 12.2. 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. 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.
- 12.3. 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.
- 12.4. The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office)¹, the format of the financial statements (specified by CIPFA²) 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 material bearing on the actual fees required.
- 12.5. 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.

13. Assessment of Options

- 13.1. If the Council did not opt in there would be a need to establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need

¹ MHCLG's Spring statement proposes that overarching responsibility for Code will in due course transfer to the system leader, namely ARGAs, the new regulator being established to replace the FRC.

² CIPFA = Chartered Institute for Public Finance & Accounting

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 would not have any major input to assessing bids and choosing to which audit firm to award a contract for the Council's external audit.

- 13.2. Alternatively, the Act enables the Council to join with other 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. Neighbouring local authorities have expressed no appetite to consider such an arrangement.
- 13.3. 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.
- 13.4. The Council and its auditor panel would also need to maintain ongoing oversight of the contract. Local contract management cannot, however, influence the scope or delivery of an audit.
- 13.5. 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.

14. Recommendation & Way Forward

- 14.1. It is disappointing that PSAA appear not to acknowledge their role in the system that has precipitated the recent decline in the timeliness of audits, despite being instrumental in establishing a tender evaluation model that valued cost over quality and producing no discernible ongoing contract and performance management on behalf of local government. However, it is acknowledged that there are broader systemic issues in play and there is no alternative to PSAA available at a national level. The costs and risks of undertaking the tender process locally are too great, largely due to onerous national standards and requirements. Therefore, the recommended approach is to opt-in to the national auditor appointment scheme.
- 14.2. 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).
- 14.3. 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).

- 14.4. 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.