



Report of: Corporate Director of Resources

Meeting of	Date	Agenda Item	Ward(s)
Audit Committee	27 th July 2021		All

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SUBJECT: Appointment of External Auditors from 2023

1. Synopsis

- 1.1. The purpose of this report is to provide the Audit Committee with an update on the local authority external audit market and to outline the timeline and options available to the Council in appointing an External Auditor when the current arrangements reach their end.
- 1.2. During Autumn 2021 all local government and police bodies will need to make important decisions about their external audit arrangements for the period commencing from the financial year 2023/24.
- 1.3. In relation to appointing auditors local bodies again 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.
- 1.4. This report provides an update on the process the PSAA is undertaking and provides information on the consequences of each of the options available to the Council in relation to the appointment of its external auditor.

2. Recommendations

- 2.1. To note that the Council will soon be required to make a decision in relation to the appointment of its External Auditors to commence from the financial year 2023/24.
- 2.2. To note the options available to the Council in relation to the appointment of its External Auditors from the financial year 2023/24.
- 2.3. To note the wider context in which the new appointment of External Auditors will be appointed within.

3. Background

Establishment of the PSAA

- 3.1. Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.
- 3.2. In July 2016, the Secretary of State specified PSAA as an appointing person for principal local government and police bodies for audits from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015.
- 3.3. Acting in accordance with this role PSAA is responsible for appointing auditors and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme, overseeing issues of auditor independence and monitoring compliance by the auditor with the contracts they enter into with the audit firms.
- 3.4. PSAA invited the Council to opt in, along with all other authorities, so that PSAA could enter into a number of contracts with appropriately qualified audit firms and appoint a suitable firm to be the Council's auditor.
- 3.5. The Council had three options, being 1) To undertake a complete procurement process itself and appoint its own auditor, or 2) Undertake a joint procurement with other bodies, or 3) To opt into a national collective scheme. The decision it made was to opt in to the national collective scheme.
- 3.6. This procurement on behalf of more than 480 bodies (98% of those eligible to join the national scheme) was very successful, attracting very competitive bids from firms. As a result the PSAA were able to enter into long term contracts with five suitable firms and to make auditor appointments to all bodies.

Changes in the Audit Market

- 3.7. 2018 proved to be a very significant turning point for the audit industry. A series of financial crises and failures in the private sector gave rise to questioning about the role of auditors and the focus and value of their work. In rapid succession we have then had the results of four independent reviews 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.

- 3.8. In total the four reviews set out more than 170 recommendations which are now in various stages of consideration by Government with the clear implication that a series of significant reforms will follow. Indeed, in some cases where new legislation is not required, significant change is already underway. A particular case in point concerns the FRC, where the Kingman Review has inspired an urgent drive to deliver rapid, measurable improvements in audit quality. This has already created a major pressure for firms and an imperative to ensure full compliance with regulatory requirements and expectations in every audit they undertake.
- 3.9. By the time firms were conducting 2018/19 local audits, the measures which they were putting in place to respond to a more focused regulator, determined to achieve change, were clearly visible. In order to deliver the necessary improvements in audit quality firms were requiring their audit teams to undertake additional work to gain deeper levels of assurance.
- 3.10. However, additional work requires more time, posing a threat to firms' ability to complete all of their audits by the target date for publication of audited accounts (then 31 July) – a threat accentuated by growing recruitment and retention challenges, the complexity of local government financial statements and increasing levels of technical challenges as bodies explored innovative ways of developing new or enhanced income streams to help fund services for local people.
- 3.11. This risk to the delivery of timely audit opinions first emerged in April 2019 when one of PSAA's contracted firms flagged the possible delayed completion of approximately 20 audits. Less than four months later, all firms were reporting similar difficulties, resulting in more than 200 delayed audit opinions.
- 3.12. 2019/20 audits have presented even greater challenges. With Covid-19 also impacting, unprecedented challenges faced the sector. Even with the benefit of an extended timetable targeting publication of audited accounts by 30 November, more than 260 opinions remained outstanding. It is vital that co-ordinated action is taken across the system by all involved in the accounts and audit process to address the current position and achieve sustainable improvement without compromising audit quality.
- 3.13. Delayed opinions are not the only consequence of the FRC's drive to improve audit quality. Additional audit work must be paid for. As a result, many more fee variation claims have been received than in prior years. Within Islington, additional fees of £50,900 relating to changing audit requirements were proposed in Grant Thornton's 2020/21 Audit Plan, considered by this Committee in March 2021.
- 3.14. None of these problems are unique to local government audit. Similar challenges have played out throughout other sectors where increased fees and disappointing responses to tender invitations have been experienced during the past two years.

- 3.15. All of this paints a picture of an audit industry under enormous pressure and of a local audit system which is experiencing its share of the strain and unavoidable instability as impacts cascade down to the frontline of individual audits.
- 3.16. The PSAA believes the audit market will continue to be relatively unstable and difficult to predict for a further period of time as the Government continues to develop and implement its policy response to the four independent reviews – Kingman, CMA, Brydon, and Redmond; as further regulatory pressure is applied; and as firms respond and adapt. It is their view that organisations attempting to procure audit services of an appropriate quality during this period are likely to experience markedly greater challenges than pre-2018. There is little evidence to suggest a contrary view.
- 3.17. Local government audit will not be immune from these difficulties. It is the view of the PSAA that bodies which opt into PSAA's national scheme will be in a better position than those which choose to make their own separate arrangements. This is on the presumption that firms are more likely to make positive decisions to bid for larger, long term contracts, offering secure income streams, than they are to invest in bidding for a multitude of individual opportunities.
- 3.18. The PSAA have led a sustained drive to improve the national scheme. During the past three years they have taken a number of initiatives to improve the operation of the scheme for the benefit of all parties including:
- proactively and constructively engaging with the numerous high-profile industry reviews, including the significant Redmond Review into Local Authority Financial Reporting and External Audit;
 - commissioning an independent review of the design and implementation of the appointing person role to help shape thinking about future arrangements;
 - commissioning an independent review of the sustainability of the local government audit market, which identified a number of distinctive challenges in the current local audit market;
 - working with MHCLG to identify ways to address concerns about fees by developing a new approach to fee variations which would seek wherever possible to determine additional fees at a national level where changes in audit work apply to all or most opted-in bodies;
 - the establishment of a Local Audit Quality Forum;
 - using an advisory panel and attending meetings of the various Treasurers' Societies and S151 officer meetings to share updates on their work, discuss audit-related developments, and listen to feedback;
 - maintaining contact with those registered audit firms that are not currently contracted with the PSAA, to build relationships and understand their thinking on working within the local audit market;
 - undertaking research to enable a better understanding of the outcomes of electors' objections and statements of reasons issued since April 2015; and
 - sharing their experiences with and learning from other organisations that commission local audit services such as Audit Scotland, the NAO, and Crown Commercial Services.

Auditor Procurement

3.19. The objectives of the procurement are to maximise value for local public bodies by:

- securing the delivery of independent audit services of the required quality (current thinking is to weigh the procurement 80:20 in favour of quality over price);
- awarding long term contracts to a sufficient number of firms (estimated between 7-10 – up from the current 5) to enable the deployment of an appropriately qualified auditing team to every participating body;
- encouraging existing suppliers to remain active participants in local audit and creating opportunities for new suppliers to enter the market;
- encouraging audit suppliers to submit prices which are realistic in the context of the current market;
- enabling auditor appointments which facilitate the efficient use of audit resources;
- supporting and contributing to the efforts of audited bodies and auditors to improve the timeliness of audit opinion delivery; and
- establishing arrangements that are able to evolve in response to changes to the local audit framework.

3.20. In the event that the procurement fails to attract sufficient capacity to enable auditor appointments to every opted-in body, there are fallback options to extend one or more existing contracts for the period spanning 2023/24 and 2024/25.

3.21. Rather than simply extending the contracts at this stage, the PSAA believe that it is preferable, if possible, to enter into new long term contracts with suppliers at realistic market prices to coincide with the commencement of the next appointing period.

3.22. Prior to initiating the procurement the PSAA plan to set out the detailed basis on which, if necessary, the fallback decision to extend one or more current contracts will be taken. One of the objectives of the approach will be to encourage firms to participate in the procurement and in doing so to ensure that their tenders reflect realistic market bid prices.

3.23. One of the most concerning features of the local audit system since 2018 has been the large number of audit opinions which have been delayed beyond the target timetable set out in the Accounts & Audit Regulations, and the disruption and reputational damage that results for all parties as a result of those delays. The [NAO published a report](#) on this matter in March, 2021. The report concludes “The increase in late audit opinions, concerns about audit quality and doubts over audit firms’ willingness to continue to audit local authorities all highlight that the situation needs urgent attention. This will require cooperation and collaboration by all bodies involved in the local audit system, together with clear leadership from government.” To support the drive for market sustainability, PSAA are considering the following possible options:

1. accepting consortia bids including those that involve firms which are seeking to enter the market by gaining experience working in partnership with an existing registered supplier;

2. accepting bids from firms that are currently proceeding through the local audit registration process; and
 3. inclusion of one or two lots specifically aimed at seeking to encourage additional capacity into the market, mostly likely through some form of joint working arrangement between more experienced suppliers and new entrants or less experienced suppliers.
- 3.24. Additional costs may arise as an inevitable consequence of striving to bring new suppliers into the market. If additional costs were to occur, they would be borne by the scheme as a whole rather than by an individual audited body or a sub-set of bodies.
- 3.25. The MHCLG has recently undertaken a consultation proposing amendments to the Appointing Person Regulations. Subject to its outcome and the approval of relevant changes to the regulations, it is likely that the PSAA will set the length of the next compulsory appointing period as the five consecutive financial years commencing 1 April 2023.
- 3.26. In late September the PSAA is expected to invite all eligible bodies to opt into the scheme for the second appointing period. The intention at this stage is that bodies will be able to commit to join the scheme until the end of January 2022.

Audit Pricing

- 3.27. Audit fees must ultimately be met by individual audited bodies. The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies. Regardless of the additional costs incurred by local authorities as fee variations, the PSAA national scheme has reduced the costs of local audits significantly. The core audit fee for the Council was £270,440 in 2014/15 whereas the scale fee quoted in the 2020/21 Audit Plan is £156,179 - £114,000 less.
- 3.28. Additional fees (fee variations) are part of the legal framework. They only occur if auditors are required to do substantially more work than anticipated, for example, if local circumstances or the Code of Audit Practice change or if the Regulator (the FRC) increases its requirement on auditors.
- 3.29. If the changes that relate to audit fees, proposed in MHCLG's recent consultation on the Appointing Person Regulations, are ultimately approved and implemented, PSAA will be able to manage the scale of fees and fee variations more flexibly. This will enable scale fees to be determined taking into account the outcome of more recently completed audits, and fee variations to be managed differently depending on whether they are driven by national or local factors.
- 3.30. Within the national scheme the PSAA review and assess each fee variation proposal. This uses the knowledge and experience of their team in order to assess each submission, comparing with similar submissions in respect of other bodies/auditors before reaching a decision. Should the Council procure directly, this would fall upon our internal resources and expertise to undertake.

3.31. Audit developments since 2018 have focused considerable attention on audit fees. The drive to improve audit quality has created significant fee pressures as auditors have needed to extend their work to ensure compliance with increased regulatory requirements. Changes in audit scope and technical standards, such as the requirement in the new Code of Audit Practice 2020 for the auditor to provide a VFM arrangements commentary, have also had an impact.

Summary of the options available

3.32. As a result of the position described in this report, the Council has three options:

1. To undertake a complete procurement process itself and appoint its own auditor, or
2. Undertake a joint procurement with other bodies, or
3. To opt into a national collective scheme that PSAA is developing.

3.33. The option to undertake an individual procurement provides the Council with the independence to select a supplier itself. However this will require the time, effort and skill of having to undertake a procurement and appointment process. It will also involve specifying the service required, inviting tenders, evaluating tenders. In addition a single procurement will lack the buying power to significantly influence quality and price. There would also be a need to establish an independent auditor panel. In order to make a stand-alone appointment the auditor panel would need to be set up by the Council itself. 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, this excludes 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 which audit firm to award a contract for the Council's external audit.

3.34. The option of a joint procurement with a small number of Councils exists. Whilst previously this option was superseded by the national collective arrangement attracting better economies of scale, it would give the authorities a more direct relationship with the audit firm and allow some pooling of costs and expertise. At this stage it is unclear whether many of our local neighbouring boroughs are likely or not to opt in to the PSAA collective arrangement and would thus be inclined to join a smaller local joint procurement.

3.35. The option to take advantage of the national collective scheme is beneficial to the Council for a number of reasons. Although the Council loses some influence on the final outcome and will gain from:

- PSAA will ensure the appointment of a suitably qualified and registered auditor and expects to be able to manage the appointments to allow for appropriate groupings and clusters of audits where bodies work together;
- PSAA will monitor contract delivery and ensure compliance with contractual requirements, audit quality and independence requirements;
- Any auditor conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon;

- It is expected that the large scale contracts procured through PSAA will bring economies of scale and attract keener prices from the market than a smaller scale competition;
- The overall procurement costs would be expected to be lower than an individual smaller scale local procurement;
- The overhead costs for managing the contracts will be minimised through a smaller number of large contracts across the sector;
- There will be no need for the Council to establish alternative appointment processes locally, including the need to set up and manage an 'auditor panel'; and
- A sustainable market for audit provision in the sector will be easier to ensure for the future.

4. Implications

Financial Implications:

- 4.1. The proposed fees cannot be fully known until the procurement process has been completed, as the costs will depend on proposals from the audit firms. Given the widespread prevalence of fee variations, market uncertainty and the revision to an 80% quality weighting within the procurement, it is almost certain that the fee payable by the Council will rise.
- 4.2. Opting-in to a national scheme provides a strong opportunity to ensure fees are as low as possible, whilst ensuring the quality of audit is maintained by entering in to a large scale collective procurement arrangement.
- 4.3. 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 for 2023/24.
- 4.4. The scope of the audit will still be specified nationally, the National Audit Office (NAO) is 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 or bid under the proposed arrangements whereby those going through registration or being 'supervised' by an appropriate approved body would be eligible.

Legal Implications:

- 4.5. 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;

- 4.6. 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.
- 4.7. 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.
- 4.8. **Environmental Implications and contribution to net zero carbon by 2030.**
There are no environmental impacts arising from this report.

Resident Impact Assessment

- 4.9. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.
- 4.10. A resident impact assessment has not been carried out since the contents of this report relate to a purely administrative function and there are no direct impacts on residents.

5. Conclusion and reasons for recommendations:

- 5.1. This report is to provide a briefing on the next steps in the appointment of the authority and pension fund's external auditor. As the Council is yet to be invited to 'opt in' to a national scheme, the recommendations within this report are to note its contents.

Appendices:

None

Background papers:

Committee	Paper	Hyperlink
Audit Committee 24 th January 2017	Opt in to the national scheme for auditor Appointments with PSAA as the 'Appointing Person'	https://democracy.islington.gov.uk/documents/s10520/Audit%20cttee%20PSAA%20Audit%20appointment%2024Jan17%202.pdf

Final Report Clearance:

Signed by:



Corporate Director of Resources

Date: 16 July 2021

Received by:

Head of Democratic Services

Date

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