



Report of: **Executive Member for Finance & Performance**

Meeting of	Date	Ward(s)
Council	3 rd March 2022	All
Delete as appropriate		Non-exempt

SUBJECT: Update on the Local Authority External Audit Market & Appointment of External Auditors from 2023

1. Synopsis

- 1.1. On the 16th December 2021, the Government published information on a new package of measures to support the improved timeliness of local audit. This set out the background to the deterioration in performance in hitting audit deadlines by local bodies and a series of actions which are designed to abate the decline.
- 1.2. On 22 September 2021 PSAA invited all eligible bodies to become opted-in authorities (for the purposes of External Auditor arrangements) for the five consecutive financial years commencing 1 April 2023 (the compulsory appointing period).
- 1.3. A decision to become an opted-in authority must be taken in accordance with the Regulations by the members of an authority meeting as a whole (Full Council).
- 1.4. All local government and police bodies will need to make a decision on the procurement method of their external audit arrangements for the period commencing from the financial year 2023/24 by Friday the 11th March 2022.
- 1.5. On the 31st January 2022 the Audit Committee agreed a recommendation to Full Council that approval is given to the submission of the form of acceptance notice to the PSAA to opt in to the national auditor appointment arrangements for the audit years 2023/2024 to 2027/2028.

- 1.6. This report seeks the approval of Full Council to 'opt in' to the arrangements as set out in **section 4**.

2. Recommendations

- 2.1. To note the wider context in which the new appointment of External Auditors will be conducted within as set out in **section 3**.
- 2.2. To note that the considerations relevant to making a decision in relation to the appointment of its External Auditors from the financial year 2023/24 as set out in **section 4**.
- 2.3. To approve the submission of the form of acceptance notice to the PSAA to opt in to the national auditor appointment arrangements for the audit years 2023/2024 to 2027/2028 and delegate responsibility to the Section 151 officer to make the necessary arrangements.

3. Challenges in the local audit sector

- 3.1. On the 16th December 2021, the government published a set of measures to improve the timeliness of local audits. Within this document they set out that their priorities for local audit are a strong and coordinated quality framework, a buoyant local audit market, and improved transparency and governance.
- 3.2. Local government audit plays a vital role in providing local authorities with accurate and reliable financial information to plan and manage their services and finances effectively. The timely completion of local audit also ensures local authority financial arrangements, including whether value for money is being achieved, are transparent to the taxpayer, and facilitates assurance for the public sector more broadly through the audit of the Whole of Government Accounts.
- 3.3. However, challenges remain around the timeliness of local audit which was one of the key issues highlighted by Sir Tony Redmond's [independent review](#) of local authority financial reporting and external audit. In 2017/18 the deadline for issuing audit opinions was brought forward from 30 September to 31 July. Since this point there has been a reduction in the number of local government audit opinions delivered on time, with significant reductions from 2018/19 onwards. This downward trend accelerated during the COVID-19 pandemic, with only 45% of 2019/20 audits completed by the extended deadline of 30 November 2020 and, most recently, only 9% of 2020/21 audits completed by the extended deadline of 30 September 2021. Islington Council's accounts were submitted to auditors during July 2021 and were signed off by the Auditors on the 2nd February 2022.
- 3.4. As the National Audit Office (NAO) outlined in its 2020 report [Timeliness of local auditor reporting on local government in England](#), a variety of complex factors are contributing to audit delays. Audit firms are struggling with a net loss of qualified staff, with many qualified accountants choosing to leave the audit sector entirely. For

auditors that are choosing to stay within the profession, alternative audit opportunities are often perceived as more attractive than local audit, which is contributing a high turnover of staff within firms.

- 3.5. In addition, increasing workload and regulatory pressure on auditors has contributed to further delays. The NAO found that the additional requirements of new International Financial Reporting Standards (IFRS), along with increased expectations from the Financial Reporting Council (FRC) following high-profile corporate failures such as Carillion and Patisserie Valerie, had combined to produce a significant increase in audit work, particularly on asset and pensions valuations. In some cases, issues with the preparation of local authority accounts have led to delays in audits being signed off.
- 3.6. The Finance Department within Islington has sought to secure additional resources to support the production of the accounts. It is the view of the NAO however, that some local authorities have diverted staff resources away from completing working papers and preparing accounts. In others, the quality of processes within the finance functions of some local authorities has affected their preparedness for audit. These issues, have, understandably, been exacerbated by the impact of the COVID-19 pandemic. From an Islington perspective, the unforeseen, additional and never before required work particularly in relation to valuations has been a significant factor in putting finance colleagues under strain.
- 3.7. Considering the complexity of the drivers behind audit delays, it is clear that a whole system response is needed, with local bodies, audit firms, regulatory bodies and code-setters needing to work collectively to implement solutions across the sector.
- 3.8. The government laid new regulations on 21 October 2021 to provide greater flexibility to the appointing person through, for example, extending the deadline for setting fee scales so that they can reflect the most recent market conditions, and streamlining the fee variation process under certain circumstances.
- 3.9. The government also provided £15 million of additional funding to local bodies for 2021/22 to support with the implementation of recommendations following the Redmond Review and the additional costs resulting from new audit requirements, including the new value for money reporting arrangements. In addition, the statutory deadline for publishing audited local authority accounts was extended to 30 September from 31 July from 2020/21 for 2 years.
- 3.10. At the [Local Audit Liaison Committee](#) meeting on the 21 September, it was noted by members that, while in the past, ensuring the quality of the final audit had been the priority, timeliness had worsened to the extent it had become a quality issue.
- 3.11. In response, a set of additional measures were committed to by government and other key stakeholders which were set out in the December 16th update. The sections of this update, together with the key commitments are set out below.

Section 1: Measures relating to audit firms and timely completion of audit

- Financial Reporting Council to publish updated Key Audit Partner guidance by spring 2022, including new routes for an experienced Registered Individual to become a Key Audit Partner
- Government to work with CIPFA to further develop the proposal for a new local audit training diploma in local government financial reporting and management aimed at different levels of auditor, and a new technical advisory service that could provide support to firms, and in particular new entrants

Section 2: Measures relating to local bodies and quality of accounts preparation

- DLUHC to provide further funding of £45 million over the course of next Spending Review period to support local bodies with the costs of strengthening their financial reporting, new burdens related to appointment of independent members and other Redmond recommendations and increased auditing requirements.
- CIPFA to publish strengthened guidance on audit committees by April 2022. The guidance will emphasise the role that audit committees should have in ensuring accounts are prepared to a high standard, alongside broader changes including appointment of independent members. Following consultation, consider making the guidance, committees and the independent member statutory
- DLUHC to provide via the Local Government Association a sector grant for a number of targeted training events for audit committee chairs

Section 3: Proposed measures relating to accounting and audit requirements

- National Audit Office (NAO) rolling over of amendments to allow for altering the timing of elements on the Value for Money arrangements work and enable more focus on fully delivering opinions on the financial statements
- CIPFA/LASAAC is undertaking a project to improve the presentation of local authority accounts to inform the development of the 22/23 Accounting Code and comply with International Financial Reporting Standards and statutory accounting principles
- HMT to undertake thematic review of financial reporting valuations for non-investment properties to inform development of the Accounting Code from 22/23 onwards
- The government has asked CIPFA/LASAAC to consider the merits of a time-limited change to the Accounting Code for 21/22
- Delaying implementation of standardised statements and associated audit requirements

Section 4: Longer-term measures to help stabilise the market and address long-term supply issues

- PSAA to progress their proposed procurement strategy for the next round of local audit contracts from 2023/24

- Extending the deadline for publishing audited local authority accounts to 30 November 2022 for 21/22 accounts and the 30 September date for 5 years from 2023/24 – 2027/28.
- NAO to prepare for a re-laying of the Code of Audit Practice 2020 in parliament, so that it will apply for the whole of the next appointing period
- Developing an industry-led workforce strategy, working with the system leader and audit firms, to consider the future pipeline of local audits, and associated questions related to training and qualifications

4. Appointment of an External Auditor

- 4.1. 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.
- 4.2. 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.
- 4.3. The previous 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.
- 4.4. That arrangement is coming to an end and once again the 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.
- 4.5. The Council has 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.
- 4.6. Section 3 of this report 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.
- 4.7. 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 Audit Committee in March 2021.

- 4.8. 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.
- 4.9. 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.
- 4.10. 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.
- 4.11. 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 DHULC 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.

PSAA Auditor Procurement Process

- 4.12. The objectives of the PSAA procurement are to maximise value for local public bodies by:
- securing the delivery of independent audit services of the required quality (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.
- 4.13. 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.
- 4.14. As set out previously in this report, 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 supporting the following 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.

4.15. 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.

Audit Pricing

- 4.16. 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.
- 4.17. 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.
- 4.18. If the changes that relate to audit fees, proposed in DLUHC's 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.
- 4.19. 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.
- 4.20. 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

- 4.21. 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.

- 4.22. 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.
- 4.23. 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.
- 4.24. 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.
- 4.25. 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.

5. Implications

Financial Implications:

- 5.1. 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.
- 5.2. 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.
- 5.3. If the national scheme is not used some additional financial 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 how much additional resource may be required for audit fees for 2023/24 however it is anticipated to be significant given the lack of purchasing power.
- 5.4. 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:

- 5.5. 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;
- 5.6. 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.
- 5.7. 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.

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

Resident Impact Assessment

- 5.9. 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.
- 5.10. 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.

6. Conclusion and reasons for recommendations:

- 6.1. Given the Council does not possess sufficient capacity and capability internally to run its own Auditor procurement exercise, the option to procure independently is discounted. Owing to the compelling financial and non-financial benefits of the collective purchasing arrangement together with the contract management benefits of utilising the PSAA, option 3 - To opt into a national collective scheme that PSAA is developing is the recommended method.

Appendices: None

Background papers: None

Final Report Clearance:

Signed by:



17 February 2022

Executive Member for Finance & Performance

Date

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