

Resources
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Report of: Corporate Director of Resources

Meeting of	Date	Agenda Item	Ward(s)
Audit Committee	15 November 2022		All

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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. The Audit Committee received a report on the 27th July 2021 which provided 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.
- 1.3. On 22 September 2021 PSAA invited all eligible bodies to become opted-in authorities for the five consecutive financial years commencing 1 April 2023 (the compulsory appointing period).
- 1.4. 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).
- 1.5. All local government and police bodies were required 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.
- 1.6. The London Borough of Islington agreed at Full Council on 3rd March 2022 to submit the form of acceptance notice to the Public Sector Audit Appointments (PSAA) to opt in to

the national auditor appointment arrangements for the audit years 2023/2024 to 2027/2028.

- 1.7. This report provides a market update on the significant price increases ahead and that the PSAA propose appointing KPMG as the auditor of the London Borough of Islington and Islington Pension Fund for five years from 2023/24.

2. Recommendations

- 2.1. To note that KPMG have been proposed as the new audit firm from 2023/24 for the Council and Pension Fund.
- 2.2. To note the scale fees are anticipated to rise by approximately 150%. For the Council that would mean an increase from approximately £180k to £450k. If this also applies to variations and variations remain the same, this would increase from £250k to £625k for 2021.

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.
- 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 have 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. 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.
- 3.7. 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.
- 3.8. 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.
- 3.9. At a recent [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.
- 3.10. 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. 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.
- 4.3. 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. This was subsequently revised up to £129k by the time the audit had concluded.
- 4.4. 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.
- 4.5. 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.
- 4.6. That arrangement has come 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. The Council opted in on 3rd March 2022 and this process has now concluded. Of the 10 firms currently registered to undertake local audits, seven tendered and the successful parties are now shown below:

	Share of PSAA's work
Grant Thornton	36.0%
Mazars	22.5%
Ernst & Young	20.0%
KPMG	14.0%
Bishop Fleming	3.75%
Azets Audit Services	3.25%

- 4.7. 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.

Audit Pricing

- 4.8. 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.
- 4.9. As previously mentioned in this report, the quality and resources of audits has been significantly constrained over the last few years, as such the PSAA announced in a bulletin that fees were likely to increase by up to 150% from the previous year's fees.
- 4.10. This should ensure additional resources are granted to the Council's external auditor to help ensure that the Council's audit process will be robust and provide significant assurance to the public, whilst being completed in a timely manner.
- 4.11. It worth noting that Audit fees have risen considerable across the audit sector, with FTSE 250 companies charged 33% more year on year for new auditors from 2020 to 2021.
- 4.12. Additional costs were always going to 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.

Update on the Appointment of the Council's Auditor

- 4.13. The PSAA wrote to the Council on 17 October 2022 to inform them that KPMG had been selected as the provisional auditor for the Council for the five years from 2023/24.
- 4.14. One of the 'Big Four' audit firms, KPMG operates in over 100 countries with over 230,000 employees providing audit, assurance, tax, consulting and advisory services to the public and private sectors. KPMG employees around 16,000 people in the UK. Within the public sector they have 14 active Key Audit Partners supported by a team of 100 staff and a

range of specialists. KPMG undertakes a range of other public sector audit work including Local Audits in the NHS, central and local government audit work on behalf of NAO and Audit Scotland and a range of external audits in the education and social housing sectors. Prior to 2018, KPMG were appointed auditors to a range of local government bodies through previous audit procurement exercises.

- 4.15. In developing appointment proposals, the PSAA considered information provided by both opted-in bodies and audit firms, and have had regard to and sought to balance a range of factors including:
 - 4.15.1. Auditor independence.
 - 4.15.2. Joint/shared working arrangements.
 - 4.15.3. Commitments to firms under the contracts.
 - 4.15.4. Bodies main offices and geographical preferences.
 - 4.15.5. Status of prior years audits.
 - 4.15.6. Continuity (where possible).

- 4.16. The PSAA will hold a consultation period that will close on 14th November 2022 for any body who wishes to make objections about the proposed auditors, but the scope for objections is very narrow and generally centres around the following:
 - 4.16.1. An independence issue in relation to the firm proposed as the auditor
 - 4.16.2. Joint-working arrangements relevant to the auditor's responsibilities

- 4.17. The Council was required to notify the PSAA of this when submitting its initial opt in. As such the Council does not have sufficient grounds to object to the appointment and has thus confirmed the appointment.

- 4.18. Officers note that they previously worked with KPMG after the original dissolution of the audit commission and the working relationship and performance of the firm was of a good standard.

- 4.19. The new contract does have limits on supplier liabilities as follows:
 - 4.19.1. Loss of damage to property of £2m per claim.
 - 4.19.2. Loss incurred from non-compliance with data protection legislation of £5m per claim.
 - 4.19.3. Loss in relation to a failure to perform the services in accordance with the Contract or any other loss caused directly by any act or omission of the supplier £10,000,000 per claim.

- 4.20. The PSAA will consult formally on scale fees for 2023/24 in Autumn 2023, and will publish confirmed scale fees for 2023/24 for opted-in bodies on their website by 30 November 2023.

5. Implications

Financial Implications:

- 5.1. The proposed fees cannot be fully known until the consultation process is completed; however, it is expected that they will be in the region of 150% higher from 22/23 fees. Given the widespread prevalence of fee variations, market uncertainty and the revision to an 80% quality weighting within the procurement, it was always certain that the fee payable by the Council will rise.
- 5.2. Given the 2021/22 scale fees of approximately £180k This would equate to a possible rise of £270k to £450k. If this also applies to variations and variations remain the same, this would increase fees from £285k to £712k based on 2020/21. A rise of £427k.
- 5.3. Additional costs arising will need to be found from departmental budgets as these costs are expected to be recurrent. There is no certainty on government funding for the anticipated fee increase at this time.

Legal Implications:

- 5.4. 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.
- 5.5. 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.
- 5.6. 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.
- 5.7. **Environmental Implications and contribution to net zero carbon by 2030.**
There are no environmental impacts arising from this report.

Resident Impact Assessment

- 5.8. 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.
- 5.9. 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. The report is for noting.

Appendices:

None

Background papers:

Committee	Paper	Hyperlink
Audit Committee 27 th July 2021	Appointment of External Auditors from 2023	https://democracy.islington.gov.uk/documents/s25473/External%20auditor%20appointment.pdf
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
Audit Committee 31 st January 2022	Update on the Local Authority External Audit Market & Appointment of External Auditors from 2023	https://democracy.islington.gov.uk/documents/s26918/External_auditor_appointment.pdf
Full Council 3 March 2022	Update on the Local Authority External Audit Market & Appointment of External Auditors from 2023	https://democracy.islington.gov.uk/documents/s27296/March%20Council%20-%20PSAA%20Decision.pdf

Final Report Clearance:

Signed by:

Corporate Director of Resources

Date

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