

ASSEMBLY

2 March 2022

Title: External Auditor Appointment for 2023/24 to 2027/28	
Report of the Chief Financial Officer	
Open Report	For Decision
Wards Affected: None	Key Decision: No
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Accountable Director: Philip Gregory, Finance Director	
Summary This report sets out the arrangements for the appointment of external auditors to Local Authorities, and the options available to the Council following on from the current contract period which runs until the completion of the 2022/23 financial year audit. In compliance with the Local Audit and Accountability Act 2014 an external auditor must be appointed for a financial year not later than 31 December in the preceding financial year. For an external auditor to be appointed for the 2023/24 financial year an appointment must be made by 31 December 2022.	
Recommendation(s) The Assembly is recommended to: (i) Note the options appraisal set out in the report for appointing an external auditor for the financial years 2023/24 onwards; and (ii) Endorse the recommendation of the Audit and Standards Committee that the Council accepts the Public Sector Audit Appointments Limited (PSAA) invitation to 'opt in' to the sector-led body procurement option, conducted by PSAA, for the appointment of external auditors for the five-year period commencing 1 April 2023.	
Reason(s) The external audit is a statutory requirement that provides reassurance that the Council is a Well Run Organisation and is achieving Value for Money from its use of resources.	

1. Introduction and Background

- 1.1 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.

- 1.2 PSAA is a subsidiary of the Improvement and Development Agency (IDeA) which is wholly owned by the Local Government Association. It was set up in 2014 and, under the provisions of the Local Audit (Appointing Person) Regulations 2015, specified as an appointing person for local government organisations for audits from 2018/19 onwards.
- 1.3 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 determine their external audit arrangements from 2023/24. There a number of options available including arranging their own procurement and making the appointment themselves or in conjunction with other bodies, joining and taking advantage of the national collective scheme administered by PSAA.
- 1.4 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. The opt-in period started on 22 September 2021 and closes on 11 March 2022. To opt into the national scheme from 2023/24, the Council needs to return completed opt-in documents to PSAA by 11 March 2022.
- 1.5 In accordance with Regulation 19 of the Local Audit (Appointing Person) Regulations 2015, the authority will need to make the decision to opt in at full Council but this report is being brought to the Audit and Standards Committee for their prior review and consideration.

2. Proposal and Issues

- 2.1 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 appointment of a new auditor may last more than one year but a new appointment must be made once every five years.
- 2.2 The appointed auditor 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.
- 2.3 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.
- 2.4 The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC), employ authorised Key Audit Partners to oversee the work. As the report below sets out there is a currently a shortage of registered firms and Key Audit Partners. Below is a summary table of all firms, with the numbers of licensed audit partners and current major local audits undertaken at each firm.

Licensed Local Audit firms	Licensed Audit Partners	Number of Audits
Azets Audit Services Limited	2	-
BDO LLP	7	16
Cardens Accountants LLP	1	-
Deloitte LLP	9	16
Ernst & Young LLP	14	73
Grant Thornton UK LLP	27	122
KPMG LLP	25	25
Mazars LLP	10	46
PricewaterhouseCoopers LLP	4	1
Grand Total	99	299

2.5 Auditors are regulated by the FRC, which will be replaced by a new body with wider powers, the Audit, Reporting and Governance Authority (ARGA) during the course of the next audit contract.

2.6 Councils therefore have very limited influence over the nature of the audit services they are procuring, the nature and quality of which are determined or overseen by third parties.

The External Audit market

2.7 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 attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.

2.8 During 2018 a series of financial crises and failures in the private sector led to questioning about the role of auditors and the focus and value of their work. Four independent reviews were commissioned by Government: 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. The recommendations are now under consideration by Government, with the clear implication that significant reforms will follow. A new audit regulator (ARGA) is to be established, and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.

2.9 The Kingman review has led to an urgent drive for the FRC to deliver rapid, measurable improvements in audit quality. This has created a major pressure for audit firms to ensure full compliance with regulatory requirements and expectations in every audit they undertake. By the time firms were conducting 2018/19 local audits during 2019, the measures they were putting in place to respond to a more focused regulator were clearly visible. To deliver the necessary improvements in audit quality, firms were requiring their audit teams to undertake additional work to gain deeper levels of assurance. However, additional work requires more time, posing a threat to the firms' ability to complete all their audits by the target date for publication of audited accounts. Delayed opinions are not the only consequence of the FRC's drive to improve audit quality. Additional audit work must also be paid for. As a result, many more fee variation claims have been needed than in prior years.

- 2.10 This situation has been accentuated by growing auditor recruitment and retention challenges, the complexity of local government financial statements and increasing levels of technical challenges as bodies explore innovative ways of developing new or enhanced income streams to help fund services for local people. These challenges have increased in subsequent audit years, with COVID-19 creating further significant pressure for finance and audit teams.
- 2.11 None of these problems is unique to local government audit. Similar challenges have played out in other sectors, where increased fees and disappointing responses to tender invitations have been experienced during the past two years.
- 2.12 The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office), the format of the financial statements (specified by CIPFA/LASAAC) and the application of auditing standards regulated by the FRC. These factors apply to all local audits irrespective of whether an eligible body decides to opt into PSAA's national scheme or chooses to make its own separate arrangements. The requirements are mandatory; they shape the work auditors undertake and have a bearing on the actual fees required.
- 2.13 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.
- 2.14 The PSAA, in its response to the market challenges, has changed its national contract weighting from a price:quality split of 80:20 in the 2017 procurement to a 50:50 split in the upcoming procurement exercise.
- 2.15 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. Details relating to PSAA's invitation are provided in an Appendix to this report.

3. Options Appraisal

- 3.1 There are essentially three options available to Barking and Dagenham in procuring and appointing the next auditor for the 2023/24 financial year audit:
- i. undertake an individual auditor procurement and appointment exercise;
 - ii. undertake a joint audit procurement and appointing exercise with other authorities, for example those in the same locality; or
 - iii. join PSAA's sector led national auditor appointment scheme.

Appointment by the Council itself or jointly

- 3.2 The Council may elect to appoint its own external auditor under the Act, which would require the Council to:

- a) Establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council itself, and the members of the panel 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 a contract for the Council's external audit.
 - b) Manage the contract for its duration, overseen by the Auditor Panel.
- 3.3 Alternatively, the Act enables the Council to join with other authorities to establish a joint auditor panel. Again, this will need to be constituted of wholly or a majority of independent appointees. Further legal advice would be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.
- 3.4 While a local auditor panel would ensure full ownership of the tender process and contract parameters, there are administrative challenges and costs associated with setting up a panel; including attracting and appointing suitably qualified panel members, and the costs associated with its running.
- 3.5 There are currently nine audit providers eligible to audit local authorities and other relevant bodies under local audit legislation, as presented in section 2.4. This means that a local procurement exercise would seek tenders from the same firms as the national procurement exercise, however audit firms may be disinterested in a local procurement exercise due to the high overhead of submitting bespoke papers to individual exercises. There is a risk that contracts will not provide value for money, and further, given the national scheme will provide the vast majority of local audit work to firms, an independent tender may not generate any interest at all from the market.

The national auditor appointment scheme

- 3.6 The national PSAA scheme offers authorities the simplest and most economical route to auditor appointment. It avoids the need to undertake an auditor procurement and ongoing contract management activities (such as fee variation management), saving local time, effort and cost; and negotiating contracts with the audit firms nationally maximises the opportunities for maximising value for money for the whole sector.
- 3.7 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.
- 3.8 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;
- managing the procurement process to ensure both quality and price criteria are satisfied. PSAA has sought views from the sector to help inform its detailed procurement strategy;
- 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 auditor appointments, giving the Council the opportunity to influence which auditor is appointed;
- 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.

3.9 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 in accordance with the published fee scale as amended following consultations with scheme members and other interested parties (pooling means that everyone within the scheme will benefit from the prices secured via a competitive procurement process – a key tenet of the national collective scheme);
- 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.

3.10 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.

3.11 As PSAA is set up as an independent appointing person it negates the need to establish a local auditor panel, which could be difficult, costly and time-consuming. PSAA also provides the most independent option to auditor appointment and contract management.

3.12 The PSAA itself has considerable expertise and experience in the role of appointing auditors, with a dedicated team that is familiar with the relevant regulations to

appoint auditors, manage contracts with audit firms, and set and determine audit fees.

Assessment of options and officer recommendation

- 3.13 All of the above options require a local auditor to be appointed no later than 31 December 2022. Legislation requires an independent auditor panel to make the appointment.
- 3.14 The benefits of pursuing local control over the auditor procurement and appointment process are limited by the pre-defined scope of the audit, and the limited contract levers available for contract management.
- 3.15 In addition, the relatively small market means that consideration needs to be given to the likelihood of obtaining sufficient interest in an independent procurement strategy. There is a real risk that an independent procurement would not achieve value for money. Audit fees are anticipated to increase from their current levels to address existing market failings and increased audit requirements, and through economies of scale the PSAA scheme will provide the best mitigation against this.
- 3.16 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.
- 3.17 The recommended approach is therefore to opt in to the national auditor appointment scheme.
- 3.18 Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in to the PSAA national scheme or to appoint auditors directly must be made by a meeting of the Council.
- 3.19 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).
- 3.20 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.

4. Consultation

- 4.1 The proposals in this report were considered and endorsed by the Corporate Strategy Group at its meeting on 16 December 2021.

5. Financial Implications

Implications completed by: Philip Gregory, Finance Director

- 5.1 There is a risk that current external audit fee levels could increase when the current contracts end. It is clear that the scope of audit has increased, requiring more audit

work. There are also concerns about capacity and sustainability in the local audit market.

- 5.2 Opting into a national scheme provides maximum opportunity to ensure fees are as realistic as possible, while ensuring the quality of audit is maintained, by entering into a large scale collective procurement arrangement.
- 5.3 If the national scheme is not used additional resources 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. Legal Implications

Implications completed by: Dr Paul Feild Senior Governance & Standards Lawyer

- 6.1 Section 7(1) of the Local Audit and Accountability Act 2014 (the 2014 Act), 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.
- 6.2 Section 8 of the 2014 Act 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. Schedule 3(1) of the 2014 Act provides that where a relevant Council operates executive arrangements, ie Leader and Cabinet then function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements. By definition this function would be for the Councils Assembly.
- 6.3 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.
- 6.4 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 No192 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.

7. Other Implications

- 7.1 **Risk Management** – 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.

Public Background Papers Used in the Preparation of the Report:

- **PUBLIC ACCOUNTS AND AUDIT SELECT COMMITTEE, 5 Dec 2016:** Options for the Appointment of an External Auditor.
<https://modgov.lbbd.gov.uk/internet/documents/s107932/Report.pdf>
- **ASSEMBLY, 25 Jan 2017:** Options for the Appointment of an External Auditor.
<https://modgov.lbbd.gov.uk/internet/documents/s109240/Report%20-%20External%20Auditors%20Appointment.pdf>

List of appendices:

- Appendix 1: Invitation to opt into PSAA national scheme for auditor appointments
- Appendix 2: Extract from CIPFA Guide to Auditor Panels