



Report to: Audit and Governance Committee, 8th December 2021

Report of: Corporate Director – Finance and Resources

Subject: APPOINTMENT OF EXTERNAL AUDITOR

1. Recommendation

1.1 That the Committee recommends to Full Council agreement to opt into the PSAA auditor appointments process for the period 2022 - 27.

2. Background

- 2.1 Section 7 of the Local Audit and Accountability Act 2014 requires the Council to appoint a local auditor to audit its accounts for each financial year. The Act sets out the arrangements for the appointment of auditors, with the opportunity for authorities to make their own decisions about how and by whom their auditors are appointed. Section 8 governs the procedure for appointment including that the Council must establish an auditor panel and consult, and take account of the advice of, the panel on the selection and appointment of a local auditor.
- 2.2 Regulations made under the Act allow authorities to 'opt in' for their auditor to be appointed by an 'appointing person' rather than establish an auditor panel and make a local decision. In July 2016, Public Sector Audit Appointments (PSAA) were specified by the Secretary of State as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015. A decision to become an opted-in authority must be taken in accordance with the Regulation 19, that is by the members of an authority meeting as a whole.
- 2.3 PSSA undertook the appointment of a suitably qualified audit firm for each of the five financial years commencing 1 April 2018 for all those authorities, including Worcester City Council, that opted in. Ernst Young (EY) were appointed by PSAA for Worcester City and the other two south Worcester Districts, Wychavon and Malvern Hills for the period to 31 March 2023.
- 2.4 The contract with EY is therefore due to expire following the audit of the 2022/23 accounts and PSAA have launched a new 'opt-in' process. The Council has until 11 March 2022 to notify PSAA of its intentions.
- 2.5 If the Council decides not to accept the invitation to opt in by the closing date, it may subsequently make a request to opt in, but only after 1 April 2023. PSAA is required to consider such requests and agree to them unless there are reasonable grounds for their refusal. PSAA must consider a request as the appointing person in accordance with the Regulations which allow them to recover reasonable costs for making arrangements to appoint a local auditor in these circumstances, for example if they need to embark on a further procurement or enter into further discussions with our contracted firms.

- 2.6 On 23 September the Local Government Association (LGA) wrote to Chief Executives and Directors of Finance in all Councils in England and Wales, recommending that they opt in to the process. A copy of the LGA letter is attached at **Annex A**.

3. Preferred Option

- 3.1 To opt into the auditor appointments process for the appointment of auditors for the five-year period commencing financial year 2023/34.

4. Alternative Options Considered

- 4.1 To not opt in and seek to appoint a local auditor.
- 4.2 Arguments for and against this option are set out in the letter from the LGA annexed to the report. In summary, this would require the Council to establish an independent Auditor Panel. 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.
- 4.3 A full procurement exercise would be required. Following the decision of EY not to undertake the annual Housing Benefits Audit, the three south Worcestershire Council's invited the nine companies approved by The Department for Work and Pensions to apply for the work. Only one applied, which is the company already undertaking this work at the other billing authorities in Worcestershire. This suggests that there is no market for public sector audit work locally.

5. Implications

5.1 Financial and Budgetary Implications

There is a risk that current external fees levels could increase when the current contracts end in 2023.

Opting-in to a national scheme provides maximum opportunity to ensure fees are as low as possible, whilst ensuring the quality of audit is maintained by entering into a large scale collective procurement arrangement. It also provides for an independent assessment of the level of audit fees charged each year, thus preventing a conflict of interest over the level of charges to be applied between the auditor and the audited body.

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 resources may be required for audit fees for 2023/24 and how these would compare with a PSAA appointed auditor.

5.2 Legal and Governance Implications

Section 7 of the Local Audit and Accountability Act 2014 requires the Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year.

Section 8 governs the procedure for appointment including that the Council must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor.

Section 12 makes provision for the failure to appoint a local auditor: the Council must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council.

Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State. This power has been exercised in the Local Audit (Appointing Person) Regulations 2015 (SI 192) and this gives the Secretary of State the ability to enable a Sector Led Body to become the appointing person. In July 2016 the Secretary of State specified PSAA as the appointing person. There is no other appointing person for this purpose.

5.3 Risk Implications

The principal risks are that (1) the Council fails to appoint an auditor in accordance with the new frameworks or (2) does not achieve value for money in the appointment process. As set out in the report, these risks are considered best mitigated by opting into the sector-led approach through PSAA.

5.4 Corporate/Policy Implications

There are no corporate or policy implications arising from this report.

5.5 Equality Implications

There are no equality implications arising from this report.

5.6 Human Resources Implications

External audit is undertaken by a wholly independent organisation appointed by a third party. There are, therefore, no human resources implications for the Council.

5.7 Health and Safety Implications

There are no health and safety implications arising from this report.

5.8 Social, Environmental and Economic Implications

There are no social, environmental or economic implications arising from this report. A locally-appointed independent auditor may have the implication of reducing environmental impacts due to reduced travel requirements. However, for the past two years the audit has been largely conducted remotely without the need for on-site presence. Travelling has therefore been reduced virtually to zero, except for attendance at audit committee.

Ward(s): All wards
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Background Papers: Letter from LGA, annexed

Letter from the Local Government Association regarding auditor appointments

From the Chairman of the Association
Cllr James Jamieson



To: Mayors/Leaders/Chief Executives/Chief Finance Officers of English Principal Councils

23 September 2021

Dear David Blake,

Retender of External Audit Contracts

I am writing because your council must shortly make a decision whether to opt into the national arrangement for the procurement of external audit or procure external audit for itself, and to set out the LGA's view on that decision.

In most councils this matter will be considered first in detail by the Audit Committee. You will therefore no doubt wish to pass on a copy of this letter and the more detailed attachment to the colleague who chairs the relevant committee.

Legislation requires a resolution of Full Council if a local authority wishes to opt into the national arrangement. The practical deadline for this decision is 11th March 2022. As this is a decision for the Full Council, I wanted to ensure that you had sight of the letter that has been sent to audit and finance colleagues and that you are aware of the crucial issues to be considered.

The way external audit has operated over the last couple of years has been extremely disappointing. This has led to many audits being delayed and dozens of audits remain uncompleted from 2019/20. Dealing with these issues is not a quick or easy fix.

Nevertheless, the LGA's view is that the national framework remains the best option for councils. There are many reasons for favouring the national arrangements and we think those reasons have become more compelling since 2016/17 when councils were last asked to make this choice.

We believe that in a suppliers' market it is imperative that councils act together to have the best chance of influencing the market and for nationally coordinated efforts to improve the supply side of the market to be effective.

The information attached goes into more detail about the background to this decision. My officers will be happy to answer any questions you may have. Please contact Alan Finch (alan.finch@local.gov.uk) if you have any issues you would like to raise.

Yours sincerely

Cllr James Jamieson
Chairman

cc: Chief Executive
Chief Finance Officer

RETENDER OF EXTERNAL AUDIT CONTRACTS

Information from the LGA for those charged with governance

The process for retendering for external audit in local authorities in England, for contracts due to start from 2023/24, is now underway and shortly the council will need to decide whether to procure its own external auditor or opt into the national procurement framework.

Legislation requires a resolution of Full Council if a local authority wishes to opt into the national arrangement. The deadline for this decision is the 11th March 2022. If the council doesn't make such a decision, the legislation assumes that the council will procure its own external audit, with all the extra work and administration that comes with it.

The national framework remains the best option councils can choose. There are many reasons for favouring the national arrangements and we think those reasons have become more compelling since 2016/17 when councils were last asked to make this choice.

The way external audit has operated over the last couple of years has been extremely disappointing. A lack of capacity in the audit market has been exacerbated by increased requirements placed on external auditors by the audit regulator. There is also a limited number of firms in the market and too few qualified auditors employed by those firms. This has led to a situation where many audits have been delayed and dozens of audit opinions remain outstanding from 2019/20 and 2020/21. Auditors have also been asking for additional fees to pay for extra work.

As the client in the contract, a council has little influence over what it is procuring. The nature and scope of the audit is determined by codes of practice and guidance and the regulation of the audit market is undertaken by a third party, currently the Financial Reporting Council. Essentially, councils find themselves operating in what amounts to a suppliers' market and the client's interest is at risk of being ignored unless we act together.

Everyone, even existing suppliers, agrees that the supply side of the market needs to be expanded, which includes encouraging bids from challenger firms. Public Sector Audit Appointments Ltd (PSAA), the body nominated by the Government to run the national arrangements, has suggested various ways this could be done, but these initiatives are much more likely to be successful if a large number of councils sign up to the national scheme.

It is therefore vital that councils coordinate their efforts to ensure that the client voice is heard loud and clear. The best way of doing this across the country is to sign up to the national arrangement.

To summarise, the same arguments apply as at the time of the last procurement:

- A council procuring its own auditor or procuring through a joint arrangement means setting up an Audit Panel with an independent chair to oversee the procurement and running of the contract.
- The procurement process is an administrative burden on council staff already struggling for capacity. Contract management is an ongoing burden.
- Procuring through the appointing person (PSAA) makes it easier for councils to demonstrate independence of process.
- Procuring for yourself provides no obvious benefits:
 - The service being procured is defined by statute and by accounting and auditing codes
 - Possible suppliers are limited to the small pool of registered firms with accredited Key Audit Partners (KAP).
 - Since the last procurement it is now more obvious than ever that we are in a 'suppliers' market' in which the audit firms hold most of the levers.

- PSAA has now built up considerable expertise and has been working hard to address the issue that have arisen with the contracts over the last couple of years:
 - PSAA has the experience of the first national contract. The Government’s selection of PSAA as the appointing person for a second cycle reflects MHCLG’s confidence in them as an organisation.
 - PSAA has commissioned high quality research to understand the nature of the audit market.
 - It has worked very closely with MHCLG to enable the government to consult on changes to the fees setting arrangements to deal better with variations at national and local level, hopefully resulting in more flexible and appropriate Regulations later this year

Councils need to consider their options. we have therefore attached a list of Frequently Asked Questions relating to this issue which we hope will be useful to you in reaching this important decision.

When the LGA set up PSAA in 2015, we did so with the interests of the local government sector in mind. We continue to believe that the national arrangement is the best way for councils to influence a particularly difficult market.

If you have any questions on these issues please contact Alan Finch, Principal Adviser (Finance) (alan.finch@local.gov.uk).

PROCUREMENT OF EXTERNAL AUDIT from financial year 2023/24

FREQUENTLY ASKED QUESTIONS

“Were prices set too low in the current contract?”

It is clear that firms did submit bids that reflected what seemed at the time to be very stable market conditions. Unfortunately, a series of financial collapses in the private sector have since created a very different climate and resulted in a whole series of new regulatory pressures. It is very likely that firms thought they could make savings as a result of the new timetable, essentially finishing the accounts audits by the end of July each year. Of course, that is not what has happened.

The Government opened up the market principally on the argument that costs would reduce, and views were mixed in the sector when the first contract was being let. Some councils wanted more savings and some were worried about reduced standards.

“Has the current contract helped cause these issues?”

Since the current contract is based around the Code of Audit Practice and the local government accounting code, this is unlikely. The first year of the new contract coincided with the introduction of new standards and with the emergence of some difficult audit issues such as the [McCloud judgement](#) (a legal case which affected the valuation of pension liabilities). The second year was affected by COVID-19. This laid bare the lack of capacity in the supplier side of the market and led to considerable delays. It is hard to see how the contract could have pre-empted this, but now we are clearer about the level of uncertainty in the system, the next contract can adjust for it.

“If we let our own contract, could we have more influence over auditors?”

No. The auditors are required to be independent and are bound by the Codes and need to deliver to them in line with the regulator’s expectations or face action under the regulatory framework.

As far as delays in audits is concerned, auditors are required to allocate resources according to risk and councils that procure for themselves will find themselves in the same queue as those within the national arrangement.

“If we let our own contract, can we get the auditors to prioritise our audit over others?”

Very unlikely. Auditors are running at full capacity and have to deploy resources according to their assessment of audit risks in accordance with professional standards. It is very unlikely that auditors could give preference to some clients rather than others even if they wanted to.

“Didn’t we used to get more from our auditors?”

Yes we did. For example, auditors were often prepared to provide training to audit committees on a pro-bono basis. The fact that they used to be with us for most of the year meant officers could develop professional working relationships with auditors and they understood us better, within the boundaries required of their independent status. Auditors no longer have the capacity to do extra work and the light shone on audit independence in other sectors of the economy has reinforced the rules on the way auditors and councils work together.

“Under the national framework we have had to negotiate our own fee variations. Will that continue to be the case?”

Unfortunately, virtually all councils have had to engage in discussions with auditors about fee variations linked to new regulatory requirements and, of course, the challenges of COVID-19. SAA has worked hard with MHCLG to enable the recent consultation on changes to the fee setting regime, and the resulting regulatory change will bring scope for more issues to be settled at a national level in future.

“Can we band together in joint procurements to get most of the benefits of not going it alone?”

We understand that this is lawful. However, joint procurement partners would not be part of PSAA’s efforts on behalf of the sector to increase the number of firms competing in the market, which will therefore be less likely to succeed.

At best, joint procurement spreads the pain of procuring over a larger number of councils and at worst it introduces a new layer of bureaucracy, because someone is going to have to take the lead and bring all the members of the consortium along. It’s not altogether clear to us why a joint procurement would be better than the national contract, especially as the consortium would then have to manage the contract throughout its life (for example, the implications of changes of audit scope).



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