

## Audit Committee – 26<sup>th</sup> November 2021

<b>Title of paper:</b>	Retender of External Audit for 2023/24 to 2027/28	
<b>Director(s)/ Corporate Director(s):</b>	Clive Heaphy – Interim Corporate Director of Finance & Resources	<b>Wards affected:</b> All
<b>Report author(s) and contact details:</b>	Shail Shah Head of Audit & Risk	
<b>Other colleagues who have provided input:</b>	None	
<b>Does this report contain any information that is exempt from publication? No</b>		
<b>Recommendation(s):</b>		
1.	To endorse the proposed course of action, which is that Council accepts Public Sector Audit Appointments' (PSAA) invitation to opt into the sector-led option for the appointment of external auditors to principal local government and police bodies for five financial years from 1 April 2023.	

### 1. Reasons for recommendations

- 1.1 This report sets out proposals for appointing the external auditor to the Council for the accounts for the five-year period from 2023/24. This report is due to be taken to Full Council on 10th January 2022.

### 2. Background

- 2.1 During Autumn 2021 all local government bodies need to make important decisions about their external audit arrangements from 2023/24. At Nottingham City Council the decision must be made by Full Council by 10<sup>th</sup> January in order to be able to respond to PSAA by the deadline of 11<sup>th</sup> March 2022.

#### **The Role of the Appointed Auditor**

- 2.2 The auditor appointed at the end of the procurement process 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) and 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.

- 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.

### **Risk Management**

- 2.7 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.
- 2.8 These risks are considered best mitigated by opting into the sector-led approach through PSAA as set out in the assessment of options section below.

### **Current Arrangements**

- 2.9 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. Following a national procurement exercise PSAA appointed Grant Thornton to audit the accounts for these periods. Should the Council choose to opt in to national arrangements PSAA would select the Council's auditor following a procurement exercise. PSAA's current policy on rotation of key staff would preclude the selection of the current Key Audit Partner from 2023 and in practice PSAA prefers shorter terms for audit firm appointments too.
- 2.10 For administrative convenience, PSAA requires audit firms to bill opted-in bodies on its behalf and to act as its agents to collect fees. PSAA invoices firms at the scale fee adjusted for the firm's agreed remuneration. Firms are required to update quarterly work in progress returns with the amount of work they have completed in the quarter to establish the percentage complete. The revenue received by PSAA is to cover directly the costs of the auditors and the operating expenses of PSAA. If at the end of the period there is a remaining surplus or a shortfall, as a result of expenses being over or under-estimated, revenue is adjusted to the actual amount receivable from the opted-in bodies and payable by PSAA in total. Surpluses have been paid out to opted in bodies in recent years.

### **Options**

- 2.11 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 council has three options;
- To opt in to the national auditor appointment scheme administered by a body designated by the Secretary of State as the 'appointing person'. The body currently designated for this role is Public Sector Audit Appointments Limited (PSAA).
  - To appoint its own auditor, which requires it to follow the procedure set out in the Act.
  - To act jointly with other authorities to procure an auditor following the procedures in the Act.

2.12 In order to opt in to the national scheme, a council must make a decision at a meeting of the Full Council.

### **The national auditor appointment scheme**

2.13 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. PSAA is now preparing to undertake a procurement for the next appointing period, covering audits for 2023/24 to 2027/28, and it has invited eligible bodies to opt in. 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. PSAA is a not-for-profit organisation whose costs are around 4% of the scheme with any surplus distributed back to scheme members.

2.14 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.
- supporting the sector-led body offers the best way of to ensuring there is a continuing and sustainable public audit market into the medium and long term.

2.15 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 starts 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.

### **The next audit procurement**

2.16 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.

2.17 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.

2.18 The scope of a local audit is determined by the Code of Audit Practice (currently published by the National Audit Office - MHCLG's Spring statement proposes that overarching responsibility for Code will in due course transfer to the system leader, ARGA, the new regulator being established to replace the FRC.), 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 in to 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.

#### **Appointment by the council itself or jointly**

2.19 The Council may elect to appoint its own external auditor under the Act, which would require the council to;

- 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.
- Manage the contract for its duration, overseen by the Auditor Panel.

2.20 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 body under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.

2.21 Initial discussions with Heads of Audit at Core Cities indicates that only local partnering is being considered within this option, with these Councils retaining existing arrangements where the course is known. Leicestershire County Council, which partners with the Council for transactional HR and Finance, proposes to opt in. For other councils in Nottinghamshire, the proposed course of action, where known, is to opt in.

### **Pressures in the current local audit market and delays in issuing opinions**

- 2.22 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.
- 2.23 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.
- 2.24 During 2018 a series of financial crises and failures in the private sector year 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.
- 2.25 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, across the sector, many more fee variation claims have been needed than in prior years.
- 2.26 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.
- 2.27 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.

### **Assessment of options and officer recommendation**

- 2.28 Whilst every option carries some risk, it can be seen that opting in to the national auditor appointment scheme minimises risks for the following reasons:

- 2.29 If the Council did not opt in there would be a need to 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. Neither elected members nor officers would have a majority input to assessing bids and choosing which audit firm to award a contract for the Council's external audit.
- 2.30 Alternatively, if the Council were to join with other authorities to establish a joint auditor panel, this would 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.
- 2.31 There is little enthusiasm at other councils contacted for establishing joint procurement of external audit.
- 2.32 Both these options would be
- at risk of not being able to procure an auditor in good time and not meeting deadlines set out in legislation
  - at risk of not being able to source these independent panel members. Opting in to the national scheme removes this risk;
  - subject to early costs in respect of Auditor Panel and procurement process, which are incorporated into the auditor fee when opting in to the national scheme;
  - subject to the cost of ongoing oversight of the contract, which is incorporated into the auditor fee when opting in to the national scheme;
  - more resource-intensive processes to implement for the council, including an additional body (the auditor panel) to service, and ongoing oversight of the contract;
  - likely to result in a more costly service, without the bulk buying power of the sector-led procurement;
  - more difficult to manage quality and independence requirements.
- 2.33 Nor would they enable the Council to influence the scope or quality of the audit, as it is fixed by the regulatory regime.
- 2.34 The national offer provides the appointment of an independent auditor with
- guaranteed compliance with legislative framework
  - the best opportunity to secure the appointment of a qualified, registered auditor - there are only nine accredited local audit firms, and a local procurement would be drawing from the same limited supply of auditor resources as PSAA's national procurement;
  - no early costs
  - significantly less administrative cost to the council;
  - the opportunity to influence the market that a national procurement provides by acting with other councils;
  - reduced procurement costs compared to local procurement due to economies of scale such as shared costs;
  - management of quality and independence requirements through PSAA's existing policy and administrative arrangements

2.35 In addition organisations opted in to the PSAA scheme are given free access to the Local Audit Quality Forum and webinar events on key topics. These resources have been useful to Internal Audit.

#### **Next steps**

2.36 Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of the Council (meeting as a whole), except where the authority is a corporation sole.

2.37 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).

2.38 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.

2.39 The Council must publish details of the appointment within the period of 28 days beginning with the day on which the appointment is made (in January 2023).

#### **Financial Implications:**

2.40 The PSAA fees are incorporated in external audit charges.

2.41 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.

2.42 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.

2.43 If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement. Until a procurement exercise is completed it is not possible to state what, if any, additional resource may be required for audit fees from 2023/24.

### **3 Legal and Procurement comments (if applicable) including risk management considerations:**

3.1 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.

3.2 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. A notice detailing the appointment and length of the appointment must be published on the Council's website within 28 days of the appointment being made.

- 3.3 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.
- 3.4 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 (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.

Beth Brown, Head of Legal and Governance  
22 October 2021

**4 Background papers other than published works or those disclosing exempt or confidential information**

4.1 None

**5 Published documents referred to in compiling this report**

5.1 None