

Council Report

Report of Director of Resources

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Appointment of External Auditor

Executive Summary

Following the closure of the Audit Commission in 2015, the Council considered options for the appointment of its external auditors in December 2016 and agreed to opt-in to the appointing person arrangements made by Public Sector Audit Appointments (PSAA) for the appointment of external auditors from 2018-19 for a period of five years up to and including the audit of the 2022-23 accounts.

This arrangement will terminate on 31 March 2023. The Council is now invited to consider arrangements for the re-appointment of its external auditor for a 5-year period from 2023-24.

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 make important decisions about their external audit arrangements from 2023-24. They have options to arrange their own procurement and make the appointment themselves or in conjunction with other bodies, or they can join and take advantage of the national collective scheme administered by PSAA.

This report sets out the proposals for appointing the external auditor to Guildford Borough Council for the accounts for the five year period from 2023-24.

Officers consider that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than a procurement undertaken locally because:

- collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;
- if it does not use the national appointment arrangements, the Council will need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement and ongoing management of an audit contract;
- it is 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; and
- supporting the sector-led body offers the best way of ensuring there is a continuing and sustainable public audit market into the medium and long term.

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.

At its meeting on 18 November, the Corporate Governance and Standards Committee considered this report and endorsed the recommendation below.

Recommendation to Council:

That the Council accepts Public Sector Audit Appointments' invitation to opt in to 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.

Reason for Recommendation:

To enable the Council to comply with statutory obligations under Section 7 of the Local Audit and Accountability Act 2014.

Is the report (or part of it) exempt from publication? No

1. Purpose of Report

- 1.1 This report sets out the proposals for the appointment of an external auditor for the Council and the options open to the Council. The Council is asked once again to agree to opt in to the appointing person arrangements made by PSAA Ltd in respect of the appointment of our external auditor from 2023-24.

2. Strategic Priorities

- 2.1 The appointment of the external auditor contributes to the achievement of the priority of providing efficient, cost effective and relevant quality public services that give the community value for money.

3. Background

- 3.1 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.
- 3.2 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 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.
 - 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).
- 3.3 In order to opt in to the national scheme, a council must make a decision at a meeting of its Full Council.
- 3.4 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.
- 3.5 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.
- 3.6 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. There is currently a shortage of registered firms and Key Audit Partners.
- 3.7 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.
- 3.8 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

4. Options

Option1 – Stand Alone Appointment

- 4.1 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 which audit firm to award a contract for the Council's external audit.

- Manage the contract for its duration, overseen by the Auditor Panel.
- 4.2 Setting up an auditor panel allows the Council to take maximum advantage of the local appointment regime and have local input to the decision. However, recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract could increase the Council's costs because they would be more resource-intensive processes to implement for the Council, and without the bulk buying power of the sector-led procurement would be likely to result in a more costly service. It would also be more difficult to manage quality and independence requirements through a local appointment process. The Council is unable to influence the scope of the audit and the regulatory regime inhibits the Council's ability to affect quality.
- 4.3 The biggest risk is whether an authority managing its own procurement will be able to secure competitive bids. Auditors can only be appointed from a short (and currently shrinking) list maintained by the Institute of Chartered Accountants in England and Wales. As such an authority undertaking its own procurement may not get much more choice than the PSAA arrangement currently offers. However, there would be some scope to work with firms active in the local area to register new key audit partners (KAPs). PSAA is promising to work to increase the pool of KAPs and Government is considering how barriers to entry could be reduced. This may mean that the choice of auditor available may be greater in the future.
- 4.4 The great potential gain would be having some control over the Council's auditors. The PSAA route has been promoted as guaranteeing auditor independence. But the independence that matters in this context is that auditors should not be under undue influence to be forgiving in their audit work. It does not have to mean that authorities give up all influence over how auditors work, in particular in relation to the timing and staffing of audits and the determination of fees. With self-appointment, the Council may be able to secure better commitment from the auditors than has been seen in recent years but potentially at a cost. The more authorities that opt out of the PSAA arrangements, the less the capacity there will be for auditors to agree to such commitments.

Option 2 – Joint Auditor Panel

- 4.5 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. Legal advice will 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.
- 4.6 The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities offering a more cost-effective route than Option1 due to there being greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

- 4.7 However, the decision-making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor panel is used or possibly only one elected member representing each council, depending on the constitution agreed with the other bodies involved. The choice of auditor could be complicated where individual councils have independence issues. An independence issue occurs where the auditor has recently or is currently carrying out work such as consultancy or advisory work for a council. Where this occurs, some auditors may be prevented from being appointed by the terms of their professional standards. There is a risk that if the joint auditor panel chooses a firm that is conflicted for this Council then the Council may still need to make a separate appointment with all the attendant costs and loss of economies possible through joint procurement.

Option 3 – Sector Led Body (PSAA)

- 4.8 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.
- 4.9 PSAA is a not-for-profit organisation whose costs are around 4% of the scheme with any surplus distributed back to scheme members.
- 4.10 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.

5. Pressures in the current local audit market and delays in issuing opinions

- 5.1 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. Of those bodies eligible, 98% opted into the national scheme and attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.

- 5.2 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 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.
- 5.3 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.
- 5.4 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.
- 5.5 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.

6. The invitation

- 6.1 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 **Appendix 1** to this report.

- 6.2 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.
- 6.3 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.
- 6.4 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/LASAAC¹) 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.
- 6.5 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.
- 6.6 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.
- 6.7 The recommended approach is therefore to opt in to the national auditor appointment scheme.

¹ Chartered Institute of Public Finance and Accountancy/Local Authority (Scotland) Accounts Advisory Committee

- 6.8 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.

7. Equality and Diversity Implications

- 7.1 There are no equality and diversity implications associated with the decision in respect of this matter.

8 Financial Implications

- 8.1 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.
- 8.2 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.
- 8.3 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.

7. Legal Implications

- 7.1 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. 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). 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.
- 7.2 Section 7 of the Local Audit and Accountability Act 2014 requires a relevant authority 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 authority must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 also provides that where a relevant authority is a local authority operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the authority under those arrangements.
- 7.3 Section 12 makes provision for the failure to appoint a local auditor: the authority must immediately inform the Secretary of State, who may direct the authority to

appoint the auditor named in the direction or appoint a local auditor on behalf of the authority.

7.4 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 2015 No. 192) and this gives the Secretary of State the ability to enable a Sector Led Body to become the appointing person.

7.5 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.

7.6 The PSAA option is compliant with the Public Contract Regulations 2015 and ensure we meet our best value duties.

8. Human Resource Implications

8.1 There are no human resource implications associated with the decision in respect of this matter.

9. Summary of Options

9.1 Option 1: To make a stand-alone appointment;
Option 2: To set up a joint Auditor Panel / local joint procurement arrangements; and
Option 3: To opt-in to a sector led body (recommended)

9.2 Officers recommend Option 3 as the Council's preferred option.

10. Conclusion

10.1 Officers consider that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than a procurement undertaken locally because:

- collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;
- if it does not use the national appointment arrangements, the Council will need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement and ongoing management of an audit contract;
- it is 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; and

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

10.2 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.

11. Background Papers

None

12. Appendices

Appendix 1: PSAA Invitation letter