

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date: 22 November 2021

Report of: Deputy Chief Executive Officer

Subject: ARRANGEMENTS FOR APPOINTMENT OF EXTERNAL AUDITORS

SUMMARY

This report sets out the proposals for appointing the external auditor to the Council for the second appointing period commencing 1 April 2023. This will span five years and covers the Core Audit work, which includes the audits of accounts for the financial years 2023/24 to 2027/28.

The current external auditors, Ernst & Young were appointed from 1 April 2018 following the Council's decision to opt-in to the joint tender process organised by Public Sector Audit Appointments (PSAA) as a recognised 'appointing person'. A similar option is available for the next appointment.

RECOMMENDATION

It is RECOMMENDED that the Audit and Governance Committee recommend to Full Council that the Council accepts Public Sector Audit Appointments (PSAA) invitation to 'opt in' to the sector led option for the appointment of external auditors for five financial years commencing 1 April 2023.

INTRODUCTION

1. The Local Audit and Accountability Act 2014 (the Act) brought to a close the Audit Commission and set out the arrangements for the appointment of auditors for subsequent years, with the opportunity for authorities to now make their own decisions about how and by whom their external auditors are appointed.
2. One option available under Regulations made under the Act allows authorities to 'opt in' to having their auditor appointed by an 'appointing person'.
3. In July 2016 Public Sector Audit Appointments (PSAA) were specified by the Secretary of State as an 'appointing person'. PSAA is an independent, not-for-profit company limited by guarantee and established by the Local Government Association (LGA). The appointing person is sometimes referred to as the "Sector Led Body" (SLB). PSAA was originally established to operate the transitional arrangements following the closure of the Audit Commission under powers delegated by the Secretary of State.
4. PSAA is now inviting the Council to opt-in to the next joint tender and appointment process for the external auditors for the 5-year period running from 1 April 2023. This will allow PSAA to invest resources into carrying out a national tender process and enter into a number of contracts with appropriately qualified audit firms, including appointing a suitable firm to be this Council's auditor.
5. This appointment will cover the Core Audit work but excludes the audit of the Benefit Subsidy claim which is subject to a separate appointment.
6. The decision to opt-in to the appointing process can only be taken by Full Council and has to be made by 11 March 2022. However, members of the Audit and Governance Committee are invited to forward their preferred recommendation to Full Council to consider.

CURRENT ARRANGEMENTS

7. **Tender Process:** The current external audit contract was the first time the new arrangements were used and covers the period from 1 April 2018 to 31 March 2023. The Council did opt-in to use PSAA to appoint their auditors for this contract, along with 480 (98%) of other bodies eligible to join the national scheme.
8. The SLB tender process started in April 2017 and was organised across 6 lots of decreasing size with different firms winning each lot. Fareham Borough Council was allocated to lot 2 (second largest) which was won by Ernst & Young LLP. They are consequently our current auditors.
9. **Audit Fees:** The table below shows the history of the external audit fees paid over the last 5 years. This highlights that although the tendered scale fee would have delivered a saving to the Council, in line with government expectations, some of the savings have been lost through variation fees charged.

Fees	2016/17	2017/18	New contract starts		
			2018/19	2019/20	2020/21
Original Core Audit cost - Scale Fee	£48,230	£48,230	£37,137	£37,137	£37,137
Variations Proposed	£1,500		£1,408	£32,578	£30,303
Variations Paid / To Pay	£1,500		£1,127	£19,944	To be confirmed
Total cost	£49,730	£48,230	£38,264	£57,081	

10. Variation fees are charged when the auditor considers they have had to carry out work over and above the level specified in the tender. In particular, this may arise as a result of the Government specifying additional changes to the Audit regime.
11. One of the roles of the PSAA is to consider and approve/reject requests for fee variations from the auditor, having also taken on the views of the local authority. The table shows that some of the fees proposed were reduced when reviewed by PSAA, but the majority were upheld.
12. **Audit Quality:** We have no concerns over the quality of the audit service being delivered under the current contract. However, members will be aware that the statutory deadline for the audit opinion on the 2020/21 Statement of Accounts has not been met. This was the first year that the deadline was missed for this Council.
13. Nationally there has been an increasing trend in Auditors from all firms not meeting the statutory deadline, with 87% of opinions given on time in 2018, 57% in 2019 and only 45% in 2020. The Fareham Borough Council opinion was delivered on time in all these years.

NATIONAL EXTERNAL AUDIT LANDSCAPE

14. Nationally there has been significant debate in recent years about the external audit industry in both the public and private sectors which have led to four independent reviews being commissioned by Government.
15. The last of these, the Redmond review, looked specifically at local authority financial reporting and external audit. The conclusions from the report issued in September 2020 was that the local audit market was fragile and the fee structure was not enabling auditors to fulfil the role in an entirely satisfactory way. The ambition to attract new audit firms to the local authority market had not been realised and there was a significant risk that firms will withdraw from the local government market.
16. The Ministry of Housing Community and Local Government have responded to the review and a number of reforms have been proposed. However, PSAA recognise that the procurement process for the next round of appointments will need to be carried out in the context of the following “big issues” still affecting local government audit:

- The audit industry is under heavy scrutiny.
 - There is great regulatory pressure to improve audit quality.
 - Audit resources are stretched, and other factors cause delay.
 - Delayed local audit opinions are a huge unresolved concern.
 - Local government audit's focus is being questioned.
 - Additional work means additional fees are needed.
 - Regulations need updating.
17. Public Sector Audit Appointments have developed a scheme prospectus for the next round of appointments highlighting some of the actions they have taken / will take to mitigate the risks above. In particular, they have a number of proposals to support market sustainability and encourage additional capacity into the market, given that the current legal requirement is that local audit work has to be undertaken by firms registered by the Institute of Chartered Accountants of England and Wales (ICAEW).
18. Councils were invited to comment on the scheme prospectus and this Council submitted their response in July 2021.

OPTIONS FOR THE NEXT APPOINTMENT

19. The Council has 3 options when appointing the next external auditors.

Option A - Make a standalone appointment

This will involve the Council carrying out its own procurement process to evaluate and award the contract to an appropriate firm.

In order to do this the Council will need to set up an Auditor Panel to select the winning firm.

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 firm of accountants to award a contract for the Council's external audit.

Option B - Carry out a joint local procurement

This will involve the Council joining up with other authorities to carry out the procurement approach and to establish a joint Auditor Panel. This will need to be constituted of wholly, or a majority of independent appointees (members). Legal advice will be required on the exact constitution of the Panel having regard to the obligations of each Council under the Act.

It should be noted that the Council has not been approached by any Councils to join in with a joint local procurement. A joint local procurement approach, led by Portsmouth City Council, was used to appoint the current external auditors for the Subsidy Claim Audit in 2018.

Option C - Opt-in to the national scheme managed by PSAA

This will involve the Council being part of the national procurement process undertaken by PSAA who will decide which lot the Council is in and which firm is appointed to that lot.

There is no fee to join the Sector Led arrangements. The audit fees that opted-in bodies are charged by PSAA will cover the costs of appointing auditors.

PSAA Ltd commit to ensure that fee levels are kept to a reasonable level by securing competitive prices from firms and by minimising their own costs. Any surplus funds arising from the scheme are returned to Councils.

The proposed contract duration is five years, with an option to extend for a further one or two years with supplier agreement using a single tender, restricted procedure. There will be between seven and ten contract lots; sizes to be determined but the largest being 20-25% of the market to reflect a balance of geography and blend of authority types.

Provisional contracts with audit firms are likely to be awarded at the end of June 2022 followed by consultation on the proposed scale of fees towards the end of 2022.

20. The table below summarises the main advantages and disadvantages of each approach. The preferred option is therefore to again opt-into the PSAA national scheme.

Options	Advantages / Benefit	Disadvantages / Risk
<p>A-Stand-alone appointment</p>	<p>This would be a direct one to one arrangement with the firm, including management of fee variations against the contract specification.</p> <p>The Council can choose any firm who applies rather than the winner of the lot into which they are placed.</p> <p>The winning firm will be an independent decision taken just for FBC interests.</p>	<p>The limited marketplace for audit firms with public sector expertise, could result in no new bidders for a stand-alone contract, except those who have limited involvement in this field, which may result in a lower quality audit.</p> <p>The Council will not benefit from any jointly negotiated fee reductions.</p> <p>There are significant resource requirements in creating the specification and running the procurement process.</p> <p>There are significant resource requirements in recruiting and managing the Auditor Panel. (Estimated cost in 2016 of £15,000 plus ongoing expenses)</p>
<p>B-Local Joint Procurement</p>	<p>This gives greater attractiveness to firms for a contract for more than one Council so may encourage more tender submissions.</p> <p>This gives greater opportunity for negotiating economies of scale offered by the larger contract value.</p> <p>This will allow the costs and resources involving in running the procurement exercise and establishing and managing the Joint Audit Panel to be shared.</p>	<p>There may be no other Councils wishing to be part of a joint local procurement.</p> <p>The limited marketplace for audit firms with public sector expertise, is likely to result in no new bidders for a local joint contract, except those who have limited involvement in this field, which may result in a lower quality audit.</p> <p>The choice of winning firm will not just be under the decision of the local FBC panel members. Depending on the other bodies involved the FBC representation on the Panel may be small.</p> <p>The choice of auditor could be complicated where individual Councils have independence issues. An independence issue occurs where the auditor has, carried out work such as consultancy work for the 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 choose a firm that is conflicted with this Council then the Council may still need to make a separate appointment. Likewise, the Joint Panel may not want to choose the best option for FBC as they have other conflicts to consider.</p> <p>There will still be resource requirements and costs in supporting the joint procurement and recruiting and managing Fareham's representatives on the Joint Auditor Panel.</p>

**C-Opt-In to
PSAA national
scheme**

This approach is the most likely to secure quality bids from competent firms so that an appointment can be made.

This approach is expected to achieve the best value for money in terms of the appointment and scale fees paid based on the economies of scale that will be achieved by the size of the contracts being offered.

There are few costs and resource implications as the procurement process will be designed and implemented by PSAA.

Other benefits, according to PSAA in their invitation to opt in, are attached as [Appendix A](#).

There will be no local input into the firm chosen for the Council and the scale fee to be paid. (However, the Council does not have to accept the firm chosen for them).

The scale fee paid for the Auditor work will include an element for the cost of the procurement and oversight processes.

The Council will not have a direct relationship with the supplier and any contract or fee variation negotiations will ultimately be decided by PSAA.

RISK ASSESSMENT

21. The principal risks are that the Council fails to appoint an auditor in accordance with the new framework or does not achieve value for money in the appointment process. These risks are considered best mitigated by opting-in to the sector let approach through PSAA.

If the Council fails to appoint a local auditor, under Section 12 of the Local Audit and Accountability Act, 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.

22. The residual risks are that the external auditor fails to deliver the statutory opinions in the required timescales, or to the required standard, and/or the cost of the external audits continue to escalate. These are likely to be national risks rather than local risks and none of the options offer full mitigation for these risks.
23. There is an expectation that the drive for greater audit coverage in the statutory framework will mean that fees will increase in the second appointing period.

Appendices

Appendix A – Extract from the Public Sector Audit Appointments Limited (PSAA) Invitation - Benefits of the Opt-in Option

Background Papers:

Fareham Borough Council's response to the PSAA Consultation in July 2021 – Help us shape the national scheme for local auditor appointments from April 2023

Public Sector Audit Appointments Scheme Prospectus 2023 and beyond, published 22 September 2021

Public Sector Audit Appointments Invitation to opt into the national scheme for auditor appointments, September 2021

Reference Papers:

Local Audit and Accountability Act 2014

Local Audit (Appointing Person) Regulations 2015.

National Audit Office Report 2020 – Timeliness of local auditor reporting on local government in England

Local authority financial reporting and external audit. Independent review by Sir Tony Redmond into the effectiveness of external audit and transparency of financial reporting in local authorities

Report to Audit and Governance Committee on 28 November 2016 – New arrangements for the appointment of external auditors from April 2018.

Report to Council on 15 December 2016 – New arrangements for the appointment of external auditors from April 2018.

Report to Audit and Governance Committee on 15 March 2017 – Update on the new arrangements for the appointment of external auditors.

Report to Audit and Governance Committee on 27 September 2017 – Update on the new arrangements for the appointment of external auditors.

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext 4344)

Extract from the Public Sector Audit Appointments Limited (PSAA) Invitation - Benefits of the Opt-in Option

Why accepting the national scheme opt-in invitation is the best solution

Public Sector Audit Appointments Limited (PSAA)

We are a not-for-profit, independent company limited by guarantee incorporated by the Local Government Association in August 2014.

We have the support of the LGA, which in 2014 worked to secure the option for principal local government and police bodies to appoint auditors through a dedicated sector-led national body.

We have the support of Government; MHCLG's Spring statement confirmed our appointment because of our "strong technical expertise and the proactive work they have done to help to identify improvements that can be made to the process".

We are an active member of the new Local Audit Liaison Committee, chaired by MHCLG and attended by key local audit stakeholders, enabling us to feed in body and audit perspectives to decisions about changes to the local audit framework, and the need to address timeliness through actions across the system.

We conduct research to raise awareness of local audit issues, and work with MHCLG and other stakeholders to enable changes arising from Sir Tony Redmond's review, such as more flexible fee setting and a timelier basis to set scale fees.

We have established an advisory panel, which meets three times per year. Its membership is drawn from relevant representative groups of local government and police bodies, to act as a sounding board for our scheme and to enable us to hear your views on the design and operation of the scheme.

The national scheme for appointing local auditors

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. Acting in accordance with this role PSAA is responsible for appointing an auditor and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme. 98% of eligible bodies made the choice to opt-in for the five-year period commencing in April 2018.

We will appoint an auditor for all opted-in bodies for each of the five financial years beginning from 1 April 2023.

We aim for all opted-in bodies to receive an audit service of the required quality at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local audit. The focus of our quality assessment will include resourcing capacity and capability including sector knowledge, and client relationship management and communication.

What the appointing person scheme from 2023 will offer

We believe that a sector-led, collaborative, national scheme stands out as the best option for all eligible bodies, offering the best value for money and assuring the independence of the auditor appointment.

The national scheme from 2023 will build on the range of benefits already available for members:

- transparent and independent auditor appointment via a third party;
- the best opportunity to secure the appointment of a qualified, registered auditor;
- appointment, if possible, of the same auditors to bodies involved in significant collaboration/joint working initiatives, if the parties believe that it will enhance efficiency;
- on-going management of any independence issues which may arise;
- access to a specialist PSAA team with significant experience of working within the context of the relevant regulations to appoint auditors, managing contracts with audit firms, and setting and determining audit fees;
- a value for money offer based on minimising PSAA costs and distribution of any surpluses to scheme members - in 2019 we returned a total £3.5million to relevant bodies and more recently we announced a further distribution of £5.6m in August 2021;
- collective efficiency savings for the sector through undertaking one major procurement as opposed to a multiplicity of smaller procurements;
- avoids the necessity for local bodies to establish an auditor panel and undertake an auditor procurement, enabling time and resources to be deployed on other pressing priorities;
- updates from PSAA to Section 151 officers and Audit Committee Chairs on a range of local audit related matters to inform and support effective auditor-audited body relationships; and
- concerted efforts to work with other stakeholders to develop a more sustainable local audit market.

We are committed to keep developing our scheme, taking into account feedback from scheme members, suppliers and other stakeholders, and learning from the collective post-2018 experience. This work is ongoing, and we have taken a number of initiatives to improve the operation of the scheme for the benefit of all parties.

Importantly we have listened to your feedback to our recent consultation, and our response is reflected in [the scheme prospectus](#).