

 Brent	Audit and Standards Advisory Committee 31st January 2022
	Report of the Director of Finance
External Audit Appointment for 2023/24 to 2028/29	

Wards Affected:	ALL
Key or Non-Key Decision:	KEY
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	OPEN
No. of Appendices:	n/a
Background Papers:	
Contact Officer(s): (Name, Title, Contact Details)	Minesh Patel, Director of Finance 020 8937 4043 minesh.patel@brent.gov.uk Ben Ainsworth, Head of Finance 020 8937 1731 Benjamin.ainsworth@brent.gov.uk

1.0 Summary

- 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.
- 1.2. The Council is currently 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.
- 1.3. PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. 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.
- 1.4. The report concludes 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.
- 1.5. 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. To opt into the national scheme from 2023/24, the Council needs to return completed opt-in documents to PSAA by 11 March 2022.

2.0 Recommendation

- 2.1 That the Council accepts Public Sector Audit Appointments' 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.

3.0 Background

- 3.1 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 Council has three options:
1. To appoint its own auditor, which requires it to follow the procedure set out in the Act.
 2. To act jointly with other authorities to procure an auditor following the procedures in the Act.
 3. 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).
- 3.2 In order to opt in to the national scheme, a Council must make a decision at a meeting of the Full Council.
- 3.3 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.

- 3.4 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.
- 3.5 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.
- 3.6 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.
- 3.7 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.

Appointment by the Council itself or jointly

- 3.8 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.
 - Manage the contract for its duration, overseen by the Auditor Panel.
- 3.9 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.

The national auditor appointment scheme

- 3.10 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.

3.11 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.

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

3.12 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.

3.13 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.

- 3.14 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.
- 3.15 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.
- 3.16 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.

The invitation

- 3.17 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.

The next audit procurement

- 3.18 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.

- 3.19 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.
- 3.20 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.
- 3.21 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.

Assessment of options and officer recommendation

- 3.22 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. 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.
- 3.23 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.
- 3.24 These 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.

- 3.25 The Council and its auditor panel would need to maintain ongoing oversight of the contract. Local contract management cannot, however, influence the scope or delivery of an audit.
- 3.26 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.
- 3.27 The recommended approach is therefore to opt in to the national auditor appointment scheme.

Risk Management

- 3.28 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.
- 3.29 These are also concerns over the quality of the audits and the timeliness of audits as only 9% of the 2020/21 Local Authority audits (including Brent) were completed by the statutory deadline of 30th September 2021. These risks are:
- A lack of experienced Local Authority auditors, across UK there are only 97 Key Audit Partners who are authorised to act as engagement leads for local audits and only 9 approved audit firms, of this only 5 have contracts with PSAA in the current appointment period. Lack of auditors with contracts with PSAA reduces capacity for each audit, which affects quality and ability to meet statutory deadline.
 - The low cost achieved by PSAA in the current round of appointment may have affected audit quality. The Kingman report published in December 2018 references the reductions in audit fees for principal local authorities (both the 23% reduction achieved by PSAA and earlier reductions, which amounted to some 55%, compared to previous fees). It states that 'The Review has serious concern that these arrangements, in practice, may well be prioritising a reduction in cost of audit, at the expense of audit quality. Furthermore a survey by PSAA of the 9 approved audit firms shows that they are unanimous in their view that fees have not kept pace with the increasing risks (both from increased scrutiny over external audit and from the impact of austerity).
 - The government set target date of 31st July for the audit of Local Authorities was extended to 30th September for 2 years from 2020/21, with a review at the end on whether there is a continued need to have an extended deadline. If the target date reverts back to 31st July this would cause problems for audit firms as it reduces capacity, which is already stretched, by restricting the number of auditor hours available to a two month period. This may encourage firms to fill the gap with inexperienced resources drawn from other sectors and disciplines, which would impact quality.

- 3.30 In response to these risks PSAA has made some changes to their procurement, including changes to their bidding rules relating to lots to encourage more bidders and increasing the quality:price ratio to 80:20 for evaluating tender bids. However, it is unclear whether this will have the desired effect, therefore the Council will have to work closely with their external auditor to ensure a quality and timely audit.
- 3.31 If the council were to procure this contract itself these risks would still exist, a key issue is that the Ethical Standards that the FRC sets for the Audit firms prohibit conventional contract management tools, such as linking payment to delivery of the contractual requirements on time. This prohibition is to limit the extent to which clients can influence the outcome of audits.
- 3.32 It is therefore considered that the best option for the council is to opt into the PSAA scheme, as opting out would create a significant administrative burden and increase the risk of not appointing an auditor in accordance with the requirements and timing specified in local audit legislation.

4.0 Financial Implications

- 4.1 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.
- 4.2 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.
- 4.3 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.

5.0 Legal Implications

- 5.1 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.
- 5.2 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.
- 5.3 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.

5.4 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.

6.0 Equality Implications

6.1 There are no direct equality implications in agreeing the report.

7.0 Human Resources Implications

7.1 There are no direct Human Resources implications in agreeing the report.

Report sign off:

Minesh Patel
Director of Finance