

This Report will be made
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Report Number **A/21/26**

To: Council
Date: 10 February 2022
Responsible Member: Cllr David Monk, Leader of the Council
Cllr Philip Martin, Chair of Audit & Governance
Committee
Responsible Officer: Charlotte Spendley, Director of Corporate Services

SUBJECT: APPOINTMENT OF EXTERNAL AUDITOR

SUMMARY: This report sets out an update on the options available and a recommended course of action regarding the appointment of the External Auditor to the Council, following consideration by the Audit & Governance Committee on 8 December 2021 (AuG/21/19).

RECOMMENDATIONS:

1. To receive and note report A/21/26.
2. To accept the recommendation of the Audit & Governance Committee to enter into the procurement exercise led by the Public Sector Audit Appointments Ltd (PSAA) for the appointment of external auditors (option 3) for a period of five financial years from 1st April 2023.

1. BACKGROUND

- 1.1 The Public Sector Audit Appointments Limited (PSAA) is a not-for-profit, independent company limited by guarantee incorporated by the Local Government Association in August 2014. Since 2018/19 the PSAA has been regulated to make audit appointments for local authorities.
- 1.2 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 now has three options:
 - undertake an individual auditor procurement and appointment exercise.
 - undertake a joint audit procurement and appointing exercise with other bodies (e.g. other Kent Councils)
 - Join PSAA’s national scheme (known as ‘opt in’)
- 1.3 Full Council at its meeting on 22 February 2017 approved the ‘opt in’ arrangements for the appointment of external auditors for five years covering the accounts for 2018/19 to 2022/23.
- 1.4 Grant Thornton have been the appointed auditor since 2018/19 accounts.
- 1.5 PSAA published its scheme prospectus on 22 September 2021, alongside formally issuing invitations to all eligible bodies to opt into the national scheme for local auditor appointments for the next appointing period. This will span the audits of accounts for the five financial years 2023/2024 to 2027/2028.
- 1.6 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.
- 1.7 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.
- 1.8 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.
- 1.9 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.
- 1.10 The council has very limited influence over the nature of the audit services it is procuring, the nature and quality of which are determined or overseen by third parties.

- 1.11 The Audit & Governance Committee considered the options available to the Council at its meeting on 8 December 2021 (Report AuG/21/19 refers). They resolved to
“To recommend to Full Council the option (3) to enter into the procurement exercise led by the Public Sector Audit Appointments Ltd (PSAA) for the appointment of external auditors for a period of five financial years from 1 April 2023.” All committee members voted in favour of this recommendation.

2. PSAA INVITATION

- 2.1 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.
- 2.2 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.
- 2.3 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.

Context: changes in the audit market

- 2.4 The audit market was relatively stable when the Local Audit and Accountability Act received Royal Assent in 2014 and in 2017 PSAA benefitted from that continuing stability. Their initial procurement on behalf of more than 480 bodies (98% of those eligible to join the national scheme) was very successful, attracting very competitive bids from firms. As a result, they were able to enter into long term contracts with five experienced and respected firms and to make auditor appointments to all bodies.
- 2.5 2018 proved to be a very significant turning point for the audit industry. A series of financial crises and failures in the private sector gave rise to

questioning about the role of auditors and the focus and value of their work. In rapid succession the Government commissioned four independent reviews, all of which have subsequently reported:

- 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.

2.6 In total the four reviews set out more than 170 recommendations which are at various stages of consideration by Government with the clear implication that a series of significant reforms could follow.

3. OPTIONS

3.1 Option1 – Stand Alone Appointment

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.

3.2 Option 2 – Joint Auditor Panel

The Act enables the Council to join with other authorities to establish a joint auditor panel. 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.

The Kent Section 151 Officers have met and discussed the potential of a joint Kent wide audit panel. The discussion found that there is no local appetite to set up a Joint Auditor Panel/local joint procurement arrangements. The primary concerns being the lack of active auditors within the market and the risk of being unable to appoint an auditor. At the time of writing it is understood that all Kent authorities are likely to recommend the sector led body option.

3.3 Option 3 – Sector Led Body (PSAA) (Recommended Option)

3.3.1 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.

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

3.3.3 This is the recommended option as it is considered to have the following advantages over the other options:

- The procurement process is managed to ensure both quality and price criteria are satisfied. PSAA has sought views from the sector to help inform its detailed procurement strategy.
- The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt in authorities.
- Consultation with the Council on auditor appointments, giving the Council the opportunity to influence which auditor is appointed.
- 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.
- 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.
- Consultation with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk.
- Ongoing contract and performance management of the contracts once these have been let.

It should be noted however that with the sector led option individual elected Members will have less opportunity for direct involvement in the appointment process other than through the Local Government Association and/or stakeholder representative groups. Additionally the PSAA will need Councils to indicate their intention to opt in before final contract prices are known, to enable them to be viable and to be placed in the strongest possible negotiating position.

3.4 The Audit and Governance Committee considered the advantages and disadvantages of the three options available and recommend to Full Council the appointment through the Sector Lead body PSAA.

4. **SUMMARY**

4.1 A standalone appointment (Option 1) is felt to present financial risks as the Council may suffer higher audit fees as it would not benefit from the bulk purchasing discounts offered by Option 3. Option 1 would require significant investment in the recruitment, training, servicing and allowances to maintain

an Auditor Panel, additionally given the current market conditions non-appointment is possible. Option 2 is viable as there is no appetite within Kent to proceed on this basis and it also presents many of the same risks as option 1.

4.2 Therefore the recommend route is that the Council's interests would be best served by opting in to a Sector Led Body, as set out in Option 3. Full Council are therefore asked to agree, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015, to accept Public Sector Audit Appointments' invitation to become an opted in authority for the purposes of the appointment of external auditors for five financial years commencing 1 April 2023.

4.3 Full Council have until December 2022 to make an appointment. In order to opt into the national scheme as set out in Option 3, the PSAA must receive formal acceptance of the invitation to join by Friday 11 March 2022.

5. RISK MANAGEMENT ISSUES

5.1 The Council is in a good position to manage the risks stated below.

Perceived risk	Seriousness	Likelihood	Preventative action
Failure to appoint external auditor.	External audit is a statutory requirement for local authorities and the Secretary of State must appoint an auditor if the Council fails to make arrangements, risking higher cost and reputational damage.	The process to appoint an external auditor has begun well in advance of the end of the current contract to reduce the likelihood.	Act upon the recommendation in the report.
Increased costs of the external audit contract	The Council will have to accommodate any increased costs within its budget.	With increases in the scope and complexity of public sector audit and public scrutiny through the Redmond Review, it is highly likely that the next contract will	Collective procurement as recommended at Option 3, would enable the Council to benefit from economies of scale and avoid the costs associated with a single or joint procurement exercise. Prepare for a budget increase when

Perceived risk	Seriousness	Likelihood	Preventative action
		be at higher cost, regardless of which option is chosen.	setting the budget for 2023/24.

6. LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

6.1 Legal Officer's Comments (AK)

The legal implications have been set out in the report. The Local Audit and Accountability Act 2014 (the Act) 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. The Act also outlines the procedure for appointment including auditor panels and selection and appointment of a local auditor. The Act makes provision for the failure to appoint a local auditor and the action that must be taken in those circumstances.

Section 19 of the Local Audit (Appointing Person) Regulations 2015 specifies that the decision to accept an invitation to become an opted in authority is a matter for Full Council.

5.2 Finance Officer's Comments

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.

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.

5.3 Diversities and Equalities Implications

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

6. CONTACT OFFICERS AND BACKGROUND DOCUMENTS

Councillors with any questions arising out of this report should contact the following officer prior to the meeting

Charlotte Spendley

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