



Committee Name: Audit

Committee Date: 23/11/2021

Report Title: Appointment of External Auditors

Portfolio:	Councillor Kendrick, cabinet member for resources
Report from:	Executive director of corporate and commercial services (S151 officer)
Wards:	All wards
OPEN PUBLIC ITEM	

Purpose

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

Recommendation:

To recommend to Cabinet and Council that the authority 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.

Policy Framework

The Council has three corporate priorities, which are:

- People living well
- Great neighbourhoods, housing and environment
- Inclusive economy

This report meets all the corporate priorities

This report addresses healthy organisation strategic action in the Corporate Plan

Report Details

Procurement of External Audit for the period 2023/24 to 2027/28

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;
 - (a) To appoint its own auditor, which requires it to follow the procedure set out in the Act.
 - (b) To act jointly with other authorities to procure an auditor following the procedures in the Act.
 - (c) 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).
2. In order to opt-in to the national scheme, a council must make a decision at a meeting of the Full Council.

The Appointed Auditor

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.
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.
5. The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC) 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.
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.
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/Authority itself or jointly

8. The council may elect to appoint its own external auditor under the Act, which would require the council to:
 - (a) Establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council/Authority 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/Authority's external audit.
 - (b) Manage the contract for its duration, overseen by the Auditor Panel.
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

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.
11. In summary the national opt-in scheme provides the following:
 - (a) the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1 April 2023;
 - (b) 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;
 - (c) 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;

- (d) ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period;
- (e) minimising the scheme management costs and returning any surpluses to scheme members;
- (f) consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed;
- (g) consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk; and
- (h) 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

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.
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.
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.

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.
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

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/Authority's auditor. Details relating to PSAA's invitation are provided in Appendix 1.

The next audit procurement

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:
 - (a) 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;
 - (b) 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 principle of the national collective scheme);
 - (c) 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.
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.

20. The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office¹), 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.
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

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/Authority's external audit.
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.
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

¹ MHCLG's Spring statement proposes that overarching responsibility for Code will in due course transfer to the system leader, namely ARGA, the new regulator being established to replace the FRC.

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.

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.
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.
27. The recommended approach is therefore to opt in to the national auditor appointment scheme.

The way forward

28. 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/Authority (meeting as a whole), except where the authority is a corporation sole.
29. The Council/Authority 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).
30. 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.

Consultation

31. 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).
32. The purpose of this report is to enable Audit Committee members to review the proposals prior to its presentation to Cabinet and then Full Council for approval.

Implications

Financial and Resources

33. Any decision to reduce or increase resources or alternatively increase income must be made within the context of the council's stated priorities, as set out in its Corporate Plan 2019-22 and Budget.
34. 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.

35. Under the current arrangements, PSAA annually set a scale for each authority. The external auditors are then able to submit fee variation proposals which are reviewed and assessed by PSAA to arrive at an approved total fee. The council's scale fee set by PSAA for the 2019/20 external audit was £61,534, although following a fee variation, PSAA confirmed the total fee for 2019/20 was £105,244.
36. 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.
37. If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement.
38. 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.

Legal

39. 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.
40. 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 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.
41. 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.
42. 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.

Statutory Considerations

Consideration:	Details of any implications and proposed measures to address:
Equality and Diversity	No direct implications.
Health, Social and Economic Impact	No direct implications.
Crime and Disorder	No direct implications.
Children and Adults Safeguarding	No direct implications.
Environmental Impact	No direct implications.

Risk Management

43. The principal risks are that the Council/Authority:

(a) fails to appoint an auditor in accordance with the requirements and timing specified in local audit legislation; or

(b) does not achieve value for money in the appointment process.

44. These risks are considered best mitigated by opting into the sector-led approach through PSAA.

Other Options Considered

45. The alternative options available and an assessment of these is contained within the report.

Reasons for the decision/recommendation

46. To enable the Audit Committee to review and comments on the proposal ahead of consideration by Full Council.

47. A decision is needed to ensure the council can meet its requirements under the Local Government Audit & Accountability Act 2014 ("the Act") to appoint an auditor to audit its accounts for each financial year.

Background papers:

None

Appendices:

Appendix 1 – PSAA Prospectus

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PROSPECTUS

The national scheme for local auditor appointments

All eligible bodies

September 2021

www.psaa.co.uk

About PSAA

Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.

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 auditors and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme, overseeing issues of auditor independence and monitoring compliance by the auditor with the contracts we enter into with the audit firms.

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Introduction

PSAA has issued its formal invitation to all eligible bodies to opt into the national scheme for local auditor appointments for the second appointing period, which will provide external audit arrangements for the period commencing from the financial year 2023/24.

This prospectus is published to provide details of the national scheme and to assist eligible bodies in deciding whether or not to accept PSAA's invitation. The scheme has been shaped by [your feedback to the June 2021 consultation](#) on our draft prospectus. The key areas of our approach that have been refined in response to consultation feedback are set out later in this prospectus.

In relation to appointing auditors, eligible bodies 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.

A decision to become an opted-in authority must be taken in accordance with the Regulations, that is by the members of an authority meeting as a whole, i.e. in Full Council, except where the authority is a corporation sole, such as a police and crime commissioner, in which case this decision must be taken by the holder of that office.

An eligible body that has decided to join the scheme must inform PSAA by returning the Form of Acceptance Notice (issued with the opt-in invitation) **no later than midnight on Friday 11 March 2022**.

An eligible body that does not accept the opt-in invitation but subsequently wishes to join the scheme may apply to opt in only after the appointing period has commenced, that is on or after 1 April 2023. In accordance with the regulations, as the appointing person, PSAA must: consider a request to join its scheme; agree to the request unless it has reasonable grounds for refusing it; and notify the eligible body within four weeks of its decision with an explanation if the request is refused. Where the request is accepted, PSAA may recover its reasonable costs for making arrangements to appoint a local auditor from the opted-in body.

Audit does matter

The purpose of audit is to provide an independent opinion on the truth and fairness of the financial statements, whether they have been properly prepared and to report on certain other requirements. In relation to local audit the auditor has a number of distinctive duties including assessing the arrangements in place to deliver value for money, and dealing with electors' objections and issuing public interest reports.

Good quality independent audit is one of the cornerstones of public accountability. It gives assurance that taxpayers' money has been well managed and properly expended. It helps to inspire trust and confidence in the organisations and people responsible for managing public money.

“The LGA set up PSAA to provide a way for councils to meet the legislative requirements of audit procurement without unnecessary bureaucracy and to provide leverage for councils by collaborating in a difficult market. It is now more important than ever that councils work together to ensure we get what we need from the audit market.”

James Jamieson. Chairman of the Local Government Association

Context: changes in the audit market

In 2014 when the Local Audit and Accountability Act received Royal Assent the audit market was relatively stable. In 2017 PSAA benefitted from that continuing stability. Our 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, we were able to enter into long term contracts with five experienced and respected firms and to make auditor appointments to all bodies. However, although we did not know it at the time, this was the calm before the storm.

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.

In total the four reviews set out more than 170 recommendations which are now at various stages of consideration by Government with the clear implication that a series of significant reforms could follow. Indeed, in some cases where new legislation is not required, significant change is already underway. A particular case in point concerns the FRC, where the Kingman Review has inspired an urgent drive to deliver rapid, measurable improvements in audit quality. This has already created a major pressure for firms and an imperative to ensure full compliance with regulatory requirements and expectations in every audit they undertake.

By the time firms were conducting 2018/19 local audits, the measures which they were putting in place were clearly visible in response to a more focused regulator that was determined to achieve change. In order to deliver the necessary improvements in audit quality, firms were requiring their audit teams to undertake additional work to gain higher levels of assurance. However, additional work requires more time, posing a threat to firms' ability to complete all of their audits by the target date for publication of audited accounts (then 31 July) - a threat accentuated by growing recruitment and retention challenges, the complexity of local government financial statements, and increasing levels of technical challenges as bodies explored innovative ways of developing new or enhanced income streams to help fund services for local people.

This risk to the delivery of timely audit opinions first emerged in April 2019 when one of PSAA's contracted firms flagged the possible delayed completion of approximately 20 audits. Less than four months later, all firms were reporting similar difficulties, resulting in more than 200 delayed audit opinions.

2019/20 audits have presented even greater challenges. With Covid-19 in the mix both finance and audit teams have found themselves in uncharted waters. Even with the benefit of an extended timetable targeting publication of audited accounts by 30 November, more than 260 opinions remained outstanding. The timeliness problem is extremely troubling. It creates disruption and reputational damage for affected parties. There are no easy solutions, and so it is vital that co-ordinated action is taken across the system by all involved in the accounts and audit process to address the current position and achieve sustainable improvement without compromising audit quality. PSAA is fully committed to do all it can to contribute to achieving that goal.

Delayed opinions are not the only consequence of the regulatory drive to improve audit quality. Additional audit work must also be paid for. As a result, many more fee variation claims have been received than in prior years and audit costs have increased.

None of these problems are unique to local government audit. Similar challenges have played out throughout other sectors where, for example, increased fees and disappointing responses to tender invitations have been experienced during the past two years.

All of this paints a picture of an audit industry under enormous pressure, and of a local audit system which is experiencing its share of the strain and instability as impacts cascade down to the frontline of individual audits. We highlight some of the initiatives which we have taken to try to manage through this troubled post-2018 audit era in this prospectus.

We look forward to the challenge of getting beyond managing serial problems within a fragile system and working with other local audit stakeholders to help design and implement a system which is more stable, more resilient, and more sustainable.

Responding to the post-2018 pressures

MHCLG's¹ Spring statement proposes changes to the current arrangements. At the time of writing, a formal consultation on the proposals in the Spring statement is underway and is due to close on 22 September 2021. The significant work to reform audit in the wake of the four independent reviews is underway. Further wide-ranging change is almost certain to occur during the next few years, and is very likely to have an impact during the appointing period that will commence in April 2023. Organisations attempting to procure audit services of an appropriate quality during this period are likely to experience markedly greater challenges than pre-2018.

Local government audit will not be immune from these difficulties. However, we do believe that PSAA's national scheme will be the best option to enable local bodies to secure audit services in a very challenging market. Firms are more likely to make positive decisions to bid for larger, long term contracts, offering secure income streams, than they are to invest in bidding for a multitude of individual opportunities.

We believe that the national scheme already offers a range of benefits for its 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 and value for money;
- on-going management of any independence issues which may arise;
- access to a dedicated 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;
- collective savings for the sector through undertaking one major procurement as opposed to a multiplicity of smaller procurements;
- a sector-led collaborative scheme supported by an established advisory panel of sector representatives to help inform the design and operation of the scheme;

¹ Immediately prior to the publication of this document it was announced that MHCLG has been renamed to Department for Levelling Up, Housing and Communities (DLUHC). The document refers to the department as MHCLG.

- avoiding 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;
- providing regular updates to Section 151 officers on a range of local audit related matters and our work, to inform and support effective auditor-audited body relationships; and
- concerted efforts to develop a more sustainable local audit market.

The national scheme from 2023/24 will build on the current scheme having listened to the feedback from scheme members, suppliers and other stakeholders and learning from the collective post-2018 experience.

Since 2018 we have taken a number of initiatives to improve the operation of the scheme for the benefit of all parties including:

- commissioning an independent review undertaken by Cardiff Business School of the design of the scheme and implementation of our appointing person role to help shape our thinking about future arrangements;
- commissioning an independent review by consultancy firm Touchstone Renard of the sustainability of the local government audit market, which identified a number of distinctive challenges in the current local audit market. We published the report to inform debate and support ongoing work to strengthen the system and help to deliver long term sustainability;
- proactively and constructively engaging with the various independent reviews, including the significant Redmond Review into Local Authority Financial Reporting and External Audit;
- working with MHCLG to identify ways to address concerns about fees by developing a new approach to fee variations which would seek wherever possible to determine additional fees at a national level where changes in audit work apply to all or most opted-in bodies;
- establishing the Local Audit Quality Forum, which has to date held five well attended events on relevant topics, to strengthen engagement with Audit Committee Chairs and Chief Finance Officers;
- using our advisory panel and attending meetings of the various Treasurers' Societies and S151 officer meetings to share updates on our work, discuss audit-related developments, and listen to feedback;
- maintaining contact with those registered audit firms that are not currently contracted with us, to build relationships and understand their thinking on working within the local audit market;
- undertaking research to enable a better understanding of the outcomes of electors' objections and statements of reasons issued since our establishment in April 2015; and
- sharing our experiences with and learning from other organisations that commission local audit services such as Audit Scotland, the NAO, and Crown Commercial Services.

As a member of the newly formed Local Audit Liaison Committee (established by MHCLG as outlined in its Spring statement), we are working closely with a range of local audit stakeholders including MHCLG, FRC, NAO, ICAEW, CIPFA and the LGA to help identify and develop further initiatives to strengthen local audit. In many cases desirable improvements are not within PSAA's sole gift and, accordingly, it is essential that this work is undertaken collaboratively with a common aim to ensure that local bodies continue to be served by an audit market which is able to meet the sector's needs and which is attractive to a range of well-equipped suppliers.

One of PSAA's most important obligations is to make an appropriate auditor appointment to each and every opted-in body. Prior to making appointments for the second appointing period, commencing on 1 April 2023, we plan to undertake a major procurement enabling suppliers to enter into new long term contracts with PSAA.

In the event that the procurement fails to attract sufficient capacity to enable auditor appointments to every opted-in body or realistic market prices, we have fallback options to extend one or more existing contracts for 2023/24 and also 2024/25.

We are very conscious of the value represented by these contract extension options, particularly given the current challenging market conditions. However, rather than simply extending existing contracts for two years (with significant uncertainty attaching to the likely success of a further procurement to take effect from 1 April 2025), we believe that it is preferable, if possible, to enter into new long term contracts with suppliers at realistic market prices to coincide with the commencement of the next appointing period.

MHCLG has recently undertaken a consultation proposing amendments to the Appointing Person Regulations. We have set the length of the next compulsory appointing period to cover the audits of the five consecutive financial years commencing 1 April 2023.

PSAA is well placed to lead the national scheme

As outlined earlier, the past few years have posed unprecedented challenges for the UK audit market. Alongside other stakeholders PSAA has learned a great deal as we have tried to address the difficulties and problems arising and mitigate risks. It has been a steep learning curve but nevertheless one which places us in a strong position to continue to lead the national scheme going forward. MHCLG's Spring statement confirmed Government's confidence in us to continue as appointing person, citing our strong technical expertise and the proactive work we have done to help to identify improvements that can be made to the process.

The company is staffed by a team with significant experience of working within the context of the regulations to appoint auditors, managing contracts with audit firms, and setting and determining audit fees. All of these roles are undertaken with a detailed, ongoing, and up-to-date understanding of the distinctive context and challenges facing

both the sector and a highly regulated service and profession which is subject to dynamic pressures for change. Where appropriate we have worked with MHCLG to change our regulations where they are preventing efficiency.

We believe that the national collective, sector-led scheme stands out as the best option for all eligible bodies - especially in the current challenging market conditions. It offers excellent value for money and assures the independence of the auditor appointment.

Membership of the scheme will save time and resources for local bodies - time and resources which can be deployed to address other pressing priorities. Bodies can avoid the necessity to establish an auditor panel (required by the Local Audit & Accountability Act, 2014) and the need to manage their own auditor procurement. Assuming a high level of participation, the scheme can make a significant contribution to supporting market sustainability and encouraging realistic prices in a challenging market.

The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the NAO²), 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 scope of public audit is wider than for private sector organisations. For example, for 2020/21 onwards it involves providing a new commentary on the body's arrangements for securing value for money, as well as dealing with electors' enquiries and objections, and in some circumstances issuing public interest reports.

Auditors must be independent of the bodies they audit to enable them to carry out their work with objectivity and credibility, and to do so in a way that commands public confidence. We will continue to make every effort to ensure that auditors meet the relevant independence criteria at the point at which they are appointed, and to address any identified threats to independence which arise from time to time. We will also monitor any significant proposals for auditors to carry out consultancy or other non-audit work with the aim of ensuring that these do not undermine independence and public confidence.

The scheme will also endeavour to appoint the same auditor to bodies involved in formal collaboration/joint working initiatives, if the parties consider that a common auditor will enhance efficiency and value for money.

² MHCLG's Spring statement proposes that overarching responsibility for the Code will in due course transfer to the system leader, namely ARGA, the new regulator being established to replace the FRC.

PSAA's commitments

PSAA will contract with appropriately qualified suppliers

In accordance with the 2014 Act, audit firms must be registered with one of the chartered accountancy institutes - currently the Institute of Chartered Accountants in England and Wales (ICAEW) - acting in the capacity of a Recognised Supervisory Body (RSB). The quality of their work will then be subject to inspection by either or potentially both the RSB and the FRC. Currently there are fewer than ten firms registered to carry out local audit work.

We will take a close interest in the results of RSB and FRC inspections and the subsequent plans that firms develop to address any areas in which inspectors highlight the need for improvement. We will also focus on the rigour and effectiveness of firms' own internal quality assurance arrangements, recognising that these represent some of the earliest and most important safety nets for identifying and remedying any problems arising. To help inform our scrutiny of both external inspections and internal quality assurance processes, we will invite regular feedback from both audit committee chairs and chief finance officers of audited bodies.

PSAA will support market sustainability

We are very conscious that our next procurement will take place at a very difficult time given all of the fragility and uncertainties within the external audit market.

Throughout our work we will be alert to new and relevant developments that may emerge from the Government's response to the Kingman, CMA and Brydon Reviews, as well as its response to the issues relating specifically to local audit highlighted by the Redmond Review. We will adjust or tailor our approach as necessary to maximise the achievement of our procurement objectives.

A top priority must be to encourage market sustainability. 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 which suppliers must undertake, firms will be informed as to which developments should be priced into their bids. Other regulatory changes will be addressed through the fee variation process, where appropriate in the form of national variations.

PSAA will offer value for money

Audit fees must ultimately be met by individual audited bodies. The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies.

We believe that the most likely way to secure competitive arrangements in a suppliers' market is to work collectively together as a sector.

We 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. We will also continue to seek to minimise our own costs (which represent approximately 4% of overall scheme costs). We are a not-for-profit company and any surplus funds will be returned to scheme members. For example, 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.

We will continue to pool scheme costs and charge fees to opted-in bodies in accordance with our published fee scale as amended from time to time following consultations with scheme members and other interested parties. Pooling is a key tenet of the national collective scheme.

Additional fees (fee variations) are part of the statutory framework. They only occur if auditors are required to do substantially more work than anticipated, for example, if local circumstances or the Code of Audit Practice change or the regulator (the FRC) increases its requirement on auditors.

Audit developments since 2018 have focused considerable attention on audit fees. The drive to improve audit quality has created significant fee pressures as auditors have needed to extend their work to ensure compliance with increased regulatory requirements. Changes in audit scope and technical standards, such as the requirement in the new Code of Audit Practice 2020 for the auditor to provide a VFM arrangements commentary, have also had an impact. Fees are rising in response to the volume of additional audit work now required.

The outcome is awaited of MHCLG's recent consultation on changes to the regulations, designed to provide the appointing person with greater flexibility to allow a fee scale to be set during the audit year (rather than before it starts). If implemented, these changes will enable approved recurring fee variations to be baked into the scale fee at an earlier date so the scale fees are more accurate and the volume of fee variations is reduced.

It is important to emphasise that by opting into the national scheme you have the reassurance that we review and robustly assess each fee variation proposal in line with statutory requirements. We draw on our technical knowledge and extensive experience in order to assess each submission, comparing with similar submissions in respect of other bodies/auditors before reaching a decision.

Procurement Strategy

Our [procurement strategy](#) sets out the detail and scope of the procurement to deliver contracts from which the auditor appointments will be made for eligible bodies that decide to accept the invitation to opt into PSAA's scheme.

Our primary aim is to secure the delivery of an audit service of the required quality for every opted-in body at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local public audit services.

We expect to initiate a new procurement for audit services in February 2022 and, subject to a satisfactory outcome, to award contracts in August 2022. Subject to consultations with opted-in bodies and audit firms, we plan to make auditor appointments by 31 December 2022 (as required by the regulations).

Response to consultation feedback

PSAA consulted with eligible bodies and other stakeholders on our draft prospectus for the national scheme for local auditor arrangements from April 2023, and with the audit services market on important features of its procurement strategy. The insight provided from both these important consultations has helped to shape the arrangements that PSAA will implement from 2023/24. Key areas are highlighted below.

Evolution of the Local Audit Framework

The consultation responses highlight the need for system-wide change. In many areas it is not within PSAA's remit to effect the significant change required.

The newly formed Local Audit Liaison Committee (as outlined in MHCLG's Spring statement), has enabled PSAA to highlight the need for a range of actions to tackle the identified issues that are essential to support a more stable, more resilient, and more sustainable local audit system. Sometimes the actions can be taken by individual organisations, but more frequently responsibility lies collectively across the system. The Liaison Committee and its members are now taking actions forward, including:

- All stakeholders to communicate the importance of audit timeliness as a consistent message to audit firms;
- PSAA to work with the FRC to develop the approach to quality evaluation of tenders;
- MHCLG and other stakeholders to understand the extent of potential increased audit costs for all eligible bodies and to consider how these might be met;
- All stakeholders to consider ways in which to attract new entrants (firms and Key Audit Partners) into the market;
- Central government departments to provide clarity on the direction of local audit policy to inform firms' consideration ahead of next procurement;
- The NAO and FRC to work together to consider how they can provide clarity about the future direction of the Code of Audit Practice to firms ahead of the next procurement; and
- MHCLG, CIPFA and the LGA to consider how to support finance departments with accounting and audit requirements.

In the vast majority of the areas consulted on which were within PSAA's remit, responses were supportive of our proposals for the national scheme from 2023/24 which is very encouraging. Areas where we have revisited and evolved our approach are highlighted below.

Minimum Audit Fees

Audit fees are rising in all sectors in response to increased regulatory requirements for audit quality and changes in audit scope and technical standards. Striving to ensure realistic fee levels is a vital prerequisite to achieving a more sustainable and stable local audit market.

Where individual audits currently attract scale fees that do not cover the basic costs of the audit work needed for a Code-compliant audit, we propose to implement a minimum fee level at the start of the next appointing period, for the audit of the 2023/24 accounts. Our independent research indicates a minimum fee level of £31,000 should apply, based on the 2020/21 scope of audit work, to any opted-in body (a police and crime commissioner and a chief constable constitute one body for this purpose).

We cannot anticipate scale fees for the next appointing period at this stage, because they will depend on the prices achieved in the procurement and any changes in audit requirements. Where any price increase means that the scale fee for a body does not reach the floor set by the minimum fee, the fee for that body would increase to reach the minimum level. It is likely, given current expectations, that the introduction of a minimum fee specifically would lead to an increase in fees for a relatively small number of local bodies. PSAA consults each year on the fee scale and will consult in 2023 on the 2023/24 fee scale.

Introducing a minimum fee is a one-off exercise designed to improve the accuracy of the fee scale for the next appointing period. Fee variations would continue to apply where the local circumstances of an audited body require additional audit work that was not expected at the time the fee scale was set.

Standardised fee variations

Current local audit regulations allow PSAA to approve fee variation requests only at individual bodies, for additional audit requirements that become apparent during the course of an audit year. MHCLG has announced the intention to amend the regulations, following a consultation, to provide more flexibility. This would include the ability for PSAA to approve standardised fee variations to apply to all or groupings of bodies where it may be possible to determine additional fees for some new requirements nationally rather than for each opted-in body individually. Where it is possible to do this, it would have the effect of reducing the need for local fee variations.

Approach to social value in the evaluation of tenders

We plan to retain our original proposal of a 5% weighting but to broaden the criteria by asking bidders to describe the additional social value they will deliver from the contract, which could include the creation of audit apprenticeships and meaningful training opportunities. Bidders will also be asked to describe how their delivery of social value will be measured and evidenced.

Contract Management

The quality of the audit services received by opted-in bodies is very important to both the bodies themselves and to PSAA. Our intention is therefore to focus a significant majority of the quality assessment of tender submissions on resourcing, capacity and capability (including sector knowledge) and on client relationship management and communication. Correspondingly, we intend to apply a lesser weighting to those criteria that are regularly assessed by the regulator. We will seek the views of the regulator in developing the detail of our approach.

We will also review the contract terms used in 2017 ahead of the next procurement of audit services. In particular we will consider the potential to introduce enhanced performance management arrangements aligned to the greater emphasis on quality within the tender evaluation process. Any such revision must ensure continued compliance with the FRC's Ethical Standard which prevents audit fees from being "*calculated on a predetermined basis relating to the outcome or result of a transaction, or other event, or the result of the work performed*".

Information and Communication

Following the success of the webinars held to support the recent consultation, PSAA will be running a series of webinars starting in October 2021. The webinars will provide eligible bodies with the opportunity to hear and ask questions about specific areas of scheme arrangements and PSAA's work, and our progress to prepare for the second appointing period. Details of the [webinar series](#) can be found on our website.

Eligible Principal Bodies in England

The following bodies are eligible to join the proposed national scheme for appointment of auditors to local bodies:

- county councils
- metropolitan borough councils
- London borough councils
- unitary councils
- combined authorities
- passenger transport executives
- police and crime commissioners for a police area
- chief constables for an area
- national park authorities for a national park
- conservation boards
- fire and rescue authorities
- waste authorities
- the Greater London Authority and its functional bodies
- any smaller bodies whose expenditure in any year exceeds £6.5m (e.g. Internal Drainage Boards) or who have chosen to be a full audit authority (Regulation 8 of Local Audit (Smaller Authorities) Regulations 2015).

Board Members

Steve Freer (Chairman)

Keith House

Caroline Gardner CBE

Marta Phillips OBE

Stephen Sellers

PSAA Board members bring a wealth of executive and non-executive experience to the company. Areas of particularly relevant expertise include public governance, management and leadership; local government and contract law; and public audit and financial management.

Further information about PSAA's Board can be found at <https://www.psaa.co.uk/about-us/who-we-are/board-members/>

Senior Executive Team

Tony Crawley, Chief Executive

Sandy Parbhoo, Chief Finance Officer

Andrew Chappell, Senior Quality Manager

Julie Schofield, Senior Manager Business & Procurement

Within the PSAA senior executive team there is extensive and detailed knowledge and experience of public audit, developed through long standing careers either as auditors or in senior finance and business management roles in relevant organisations.

Further information about PSAA's senior team can be found at <https://www.psaa.co.uk/about-us/who-we-are/executive-team/>

Annex - Procurement Options

Our Preferred Option

A 5 year contract with the fallback of the right to extend one or more of the current contracts if there are insufficient or unaffordable bids.

Other Options Considered and Rejected

Option 1

Extending the existing contracts for 2 years and deferring the procurement. We want to secure 5 year contracts if we can because we believe this option is more attractive to the market.

Option 2

A 5 year contract with a commitment not to extend the existing contracts. We need the back stop of the right to extend the existing contracts if there are insufficient bids to allow us to make auditor appointments to all opted in bodies or if any of the bids received propose unacceptable prices.

Option 3

A 5 year contract with pre-determined prices for years 1 and 2 thereby avoiding the need for firms to price in the value of the right to extend the existing contracts. We believe such an arrangement will be unattractive to the market. Firms should be able to offer their own prices for years 1 and 2.