

This Report will be made public on 30 November 2021



Report Number **AuG/21/19**

**To:** Audit and Governance Committee  
**Date:** 08 December 2021  
**Responsible Member:** Cllr David Monk, Leader of the Council  
**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.

**RECOMMENDATIONS:**

1. To receive and note report AuG/21/19.
2. 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.

## 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 Folkestone & Hythe 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.

## **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. Details relating to PSAA's invitation are provided in Appendix 1 to this report.
- 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 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.
- 2.4 The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office), the format of the financial statements (specified by CIPFA/LASAAC1) and the application of auditing standards regulated by the FRC. These factors apply to all local audits irrespective of whether an eligible body decides to opt into PSAA's national scheme or chooses to make its own separate arrangements. The requirements are mandatory; they shape the work auditors undertake and have a bearing on the actual fees required.
- 2.5 There are currently nine audit providers eligible to audit local authorities and other relevant bodies under local audit legislation, however a majority of audits are currently undertaken by two firms. 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 procurements must deliver the same audit scope and requirements as a national procurement, reflecting the auditor's statutory responsibilities.

- 2.6 The national offer provides the appointment of an independent auditor with limited administrative cost to the Council. By joining the scheme, the Council would be acting with other councils to optimise the opportunity to influence the market that a national procurement provides.
- 2.7 In order to 'opt in' to the national scheme, the council must make a decision to do so at a meeting of its Full Council and return the Form of Acceptance Notice (issued with the opt-in invitation) by 11 March 2022.
- 2.8 If the Council does not accept the opt-in invitation but subsequently wishes to join the scheme it may apply to opt in at a later date, but only after the appointing period has commenced, that is on or after 1 April 2023. If the request is accepted, PSAA may recover its reasonable costs for making arrangements to appoint a local auditor from the Council.

**Context: changes in the audit market**

- 2.9 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.
- 2.10 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.
- 2.11 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. In some cases where new legislation is not required, significant change is already underway, for example 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.
- 2.12 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.

- 2.13 The 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. Both the 2019/20 and 2020/21 audit periods have also presented significant challenges with many authorities and audit teams unable to meet even the delayed audit deadlines.
- 2.14 The timeliness problem creates disruption and potential reputational damage for all 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 have indicated that they are fully committed to do all they can to contribute to achieving that goal.
- 2.15 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.
- 2.16 These problems are not unique to local government audit. Similar challenges have been seen throughout other sectors where, for example, increased fees and disappointing responses to tender invitations have been experienced during the past two years.
- 2.17 The national scheme to be set up for 2023/24 onwards will build on the current scheme with PSAA having listened to the feedback from scheme members, suppliers and other stakeholders and learning from the collective post-2018 experience.

### **3. OPTIONS**

#### **3.1 Option1 – Stand Alone Appointment**

- 3.1.1 The Council may elect to appoint its own external auditor under the Act, which would require the Council to:
  - Establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council itself, and the members of the panel must be wholly, or a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees, excluding current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input to assessing bids and choosing which audit firm to award a contract for the Council's external audit.
  - Manage the contract for its duration, overseen by the Auditor Panel.

### 3.1.2 Advantages

- Setting up an auditor panel allows the Council to have local input to the decision.
- Potentially having some control over the Council's auditors. The PSAA route has been promoted as guaranteeing auditor independence. But the independence that matters in this context is that auditors should not be under undue influence to be forgiving in their audit work. It does not have to mean that authorities give up all influence over how auditors work, in particular in relation to the timing and staffing of audits and the determination of fees. With self-appointment, the Council may be able to secure better commitment from the auditors than has been seen in recent years but potentially at a cost.

### 3.1.3 Disadvantages

- Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract could increase the Council's costs because they would be more resource-intensive processes to implement for the Council and potentially more expensive in fees.
- Without the bulk buying power of the sector-led procurement it could be likely to result in a more costly service.
- Potentially more difficult to manage quality and independence requirements through a local appointment process.
- Possible inability to secure competitive bids or any bids. Auditors can only be appointed from a list of nine maintained by the Institute of Chartered Accountants in England and Wales. As such the Council undertaking its own procurement may not get any more choice than the PSAA arrangement currently offers and there is a risk that no bids are secured. PSAA is promising to work to increase the pool of KAPs and Government is considering how barriers to entry could be reduced. This may mean that the choice of auditor available may be greater in the future.

## 3.2 Option 2 – Joint Auditor Panel

3.2.1 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.

### 3.2.2 Advantages

- The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities offering a more cost-effective route than Option 1.
- There will be greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

### 3.2.3 Disadvantages

- The decision-making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor panel is used or possibly only one elected member representing

each council, depending on the constitution agreed with the other bodies involved.

- The choice of auditor could be complicated where individual councils have independence issues. An independence issue occurs where the auditor has recently or is currently carrying out work such as consultancy or advisory work for a council. Where this occurs, some auditors may be prevented from being appointed by the terms of their professional standards.
- There is a risk that if the joint auditor panel chooses a firm that is conflicted for this Council then the Council may still need to make a separate appointment with all the attendant costs and loss of economies possible through joint procurement.
- Due to the lack of available auditors it is possible that even through this route, limited or no bids are secured for the audits.

3.2.4 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.

### 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 Advantages

- 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.

#### 3.3.4 Disadvantages

- 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.
- 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.

## 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. If Audit & Governance Committee recommends this option to Council, Council would also formally be 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,	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.



<b>Perceived risk</b>	<b>Seriousness</b>	<b>Likelihood</b>	<b>Preventative action</b>
	risking higher cost and reputational damage.		
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 be at higher cost, regardless of which option is chosen.	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 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

Patricia Phillipson

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### **Appendices:**

Appendix 1: Invitation