

Title of report: Retender of external audit contracts

Meeting: Audit and governance committee

Meeting date: Wednesday 24 November 2021

Report by: Head of corporate finance

Classification

Open

Decision type

This is not an executive decision

Wards affected

(All Wards)

Purpose

For the committee to consider the options available to them in relation to the retender of the external audit contract and to recommend to Council their preferred option.

Recommendation(s)

That:

- a) **The committee recommends to Council their preferred method for re-procuring external audit services.**

Alternative options

1. The content of this report describes the options available to the council in re-procuring its external audit services. Full Council must approve the committee's recommended preference.

Key considerations

Background

2. Following the closure of the Audit Commission the Secretary of State specified Public Sector Audit Appointments Limited (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.
3. The PSAA is a not-for-profit, independent company limited by guarantee incorporated by the Local Government Association. PSAA is an active member of the Local Audit Liaison Committee and have established an advisory panel.
4. The process for retendering for external audit contracts in local authorities in England, for contracts due to start from 2023/24, is underway and this council must decide, before 11 March 2022, whether to procure its own external auditor or opt into the national procurement framework hosted by PSAA.
5. The length of the compulsory appointing period covers the audits of the five consecutive financial years commencing 1 April 2023, five years being the compulsory appointing period for the purposes of the regulations which govern the national scheme.
6. The Secretary of State has confirmed that the Public Sector Audit Appointments Limited (PSAA) will continue to be an appointing person for the purposes of the Regulations. Herefordshire Council has been invited to become an opted-in council in accordance with the Regulations.
7. Joining PSAA's national scheme for auditor appointments is one of the choices available, the alternative is to independently procure the audit service. This paper aims to explain the varying risks and opportunities of each procurement option.
8. The Local Government Association (LGA) is aware that many external audits have been delayed and dozens of audits remain uncompleted from 2019/20. Nevertheless, the LGA's view is that the national framework remains the best option for councils.
9. A lack of capacity in the audit market has been exacerbated by increased requirements placed on external auditors by the audit regulator. There is a limited number of firms in the market and too few qualified auditors employed by those firms. This has led to a situation where many audits have been delayed and dozens of audit opinions remain outstanding from 2019/20 and 2020/21. Auditors have also been asking for additional fees to pay for extra work.
10. The nature and scope of the audit is determined by codes of practice and guidance and the regulation of the audit market is undertaken by a third party, currently the Financial Reporting Council.
11. The introduction of new standards and the emergence of some difficult audit issues such as the McCloud judgement (a legal case which affected the valuation of pension liabilities) and COVID-19 highlighted the lack of capacity in the supplier side of the market and led to considerable delays.

Public Sector Audit Appointments Limited (PSAA)

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

13. If we continue to opt in PSAA will appoint an auditor for each of the five financial years beginning 1 April 2023. They will aim for all opted-in bodies to receive an audit service of the required quality at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local audit. The focus of PSAAs quality assessment will include resourcing capacity and capability including sector knowledge, and client relationship management and communication.

Opting into the national arrangement

14. It is recognised that in a suppliers' market it is likely that councils acting together to have the best chance of influencing the market and for nationally coordinated efforts to improve the supply side of the market to be effective.
15. To expand the supply side of the market bids from challenger firms need to be encouraged. This is more likely to be successful if a large number of councils sign up to the national scheme.

Advantages

16. PSAA has the ability to negotiate contracts with external audit firms nationally, maximising the opportunities for the most economic and efficient approach to procurement of external audit on behalf of the whole sector.
17. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
18. By offering large contract values the firms would be able to offer better rates and lower fees than are likely to result from local negotiation.
19. Any conflicts at individual authorities would be managed by PSAA who would have a number of contracted firms to call upon.
20. The PSAA will act in the collective interests of the 'opt-in' authorities.
21. A transparent and independent auditor appointment via a third party.
22. The best opportunity to secure the appointment of a qualified, registered auditor.
23. Access to a specialist PSAA team with significant experience of working within the context of the relevant regulations to appoint auditors, managing contracts with audit firms, and setting and determining audit fees.
24. A value for money offer based on minimising PSAA costs and distribution of any surpluses to scheme members.
25. Collective efficiency savings for the sector through undertaking one major procurement as opposed to a multiplicity of smaller procurements.
26. Avoids the necessity for local bodies to establish an auditor panel and undertake an auditor procurement, enabling time and resources to be deployed on other pressing priorities.
27. Updates from PSAA to Section 151 officers and audit committee chairs on a range of local audit related matters to inform and support effective auditor-audited body relationships.

28. Joining concerted efforts to work with other stakeholders to develop a more sustainable local audit market.

Disadvantages

29. Individual elected members will have less opportunity for direct involvement in the appointment process other than through the stakeholder representative groups.
30. Greatest economies of scale will come from the maximum number of councils acting collectively and opting-in. Current fees are based on discounted rates offered by the firms in return for substantial market share.

Procure its own external auditor

31. The scope of the audit will be specified nationally, the National Audit Office is responsible for writing the Code of Audit Practice which all firms appointed to carry out the council's audit must follow. Not all accounting firms will be eligible to compete for the work, they will need to demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council. Possible suppliers are limited to the small pool of registered firms with accredited Key Audit Partners.
32. In order to make a stand-alone appointment, the council will need to set up an Auditor Panel. The members of the panel must be wholly or a majority independent members as defined by the Act. Independent members for this purpose are independent appointees, this excludes current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input to assessing bids and choosing which firm of accountants to award a contract for the council's external audit. A new independent auditor panel established by the council will be responsible for selecting the auditor.

Advantages

33. Setting up an auditor panel allows the council to take maximum advantage of the local appointment regime and have local input to the decision.

Disadvantages

34. The procurement process is an administrative burden on council staff already struggling for capacity. Contract management would be an ongoing burden.
35. There would be additional costs for the recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contract plus on going expenses and allowances.
36. The council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
37. The assessment of bids and decision on awarding contracts will be taken by independent appointees and not solely by elected members.

Conclusion

38. The council needs to take action to implement new arrangements for the appointment of its external auditors. In order that more detailed proposals can be developed the committee is asked to give early consideration to the preferred approach.

Community impact

39. The council is committed to maintaining high standards of corporate governance in order to achieve the council's vision of "people, organisations and businesses working together to bring sustainable prosperity and well-being for all, in the outstanding natural environment of Herefordshire." A principle of the council's code of corporate governance is to implement good practices in transparency, reporting, and audit to deliver effective accountability.

Environmental impact

40. Herefordshire Council provides and purchases a wide range of services for the people of Herefordshire. Together with partner organisations in the private, public and voluntary sectors we share a strong commitment to improving our environmental sustainability, achieving carbon neutrality and to protect and enhance Herefordshire's outstanding natural environment.
41. Whilst this is a decision on back office functions and will have minimal environmental impacts, consideration has been made to minimise waste and resource use in line with the council's Environmental Policy.

Equality duty

42. Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows:

A public authority must, in the exercise of its functions, have due regard to the need to –

- a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
 - b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
 - c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.
43. The public sector equality duty (specific duty) requires us to consider how we can positively contribute to the advancement of equality and good relations, and demonstrate that we are paying 'due regard' in our decision making in the design of policies and in the delivery of services. As this is a decision on back office functions, we do not believe that it will have an impact on our equality duty.

Resource implications

44. The cost of independently appointing an external auditor would need to be estimated and would need to include the cost of recruiting independent appointees (members), servicing an auditor panel, running a bidding and tender evaluation process, letting a contract and paying members fees and allowances.

45. Opting-in to the national PSAA arrangement would provide the maximum opportunity to limit the extent of any increases in fees by entering in to a large scale collective procurement arrangement and would remove the costs of establishing an auditor panel.
46. The duty to prescribe scales of audit fees is a statutory function delegated to PSAA by the Secretary of State for Communities and Local Government. Before prescribing any scale of fees, PSAA have a statutory duty to consult councils. Following consultation, PSAA publish the work programme on their website each year with the scale fee for each audited body. The PSAA will consult on scale fees and will publish confirmed scale fees for opted-in bodies on their website.
47. The scale fees for individual audited bodies are normally based on the scale fee for the previous year, reflecting the auditor's assessment of audit risk and complexity. PSAA can approve proposed variations to the scale fee for an individual audited body, to reflect changes in circumstances. Scale fees are based on the expectation that audited bodies are able to provide the auditor with complete and materially accurate financial statements, with supporting working papers, within agreed timeframes.
48. PSAA will charge fees for considering objections from the point at which auditors accept an objection as valid, or any special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998, as a variation to the scale fee.

Legal implications

49. Section 7 of 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. Section 8 governs the procedure for appointment including that the authority must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Schedule 3 provides that where a relevant authority is a local authority operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the authority under those arrangements. This means this is a decision for Full Council as the decision has not been delegated in the constitution.
50. Section 12 makes provision for the failure to appoint a local auditor: the authority must immediately inform the Secretary of State, who may direct the authority to appoint the auditor named in the direction or appoint a local auditor on behalf of the authority.
51. 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.
52. Local Audit (Appointing Person) Regulations 2015 specifies the PSAA as an appointed person. By opting into this arrangement the council will confer to the PSAA the appointment of the auditors and before doing so the PSAA must consult with the council about the proposals.

Risk management

53. There is no immediate risk to the council, however, early consideration by the council of its preferred approach will enable detailed planning to take place so as to achieve successful transition to the new arrangement in a timely and efficient manner.
54. By accepting the PSAA invitation the procurement and auditor requirement risks are minimised, PSAA are committed to ensuring that the quality of the audit work provided is of the highest standards. To promote transparency and encourage best practice, they provide a number of reports on their website.

Consultees

55. None

Appendices

None

Background papers

None identified.