

Report to Audit Committee

1 December 2021

By the Director of Corporate Resources

DECISION REQUIRED



**Horsham
District
Council**

Not Exempt

Provision of the External Audit of the Annual Accounts

Executive Summary

The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Council opted into the 'appointing person' national auditor appointment arrangements established by Public Sector Audit Appointments (PSAA) for the period covering the accounts for 2018/19 to 2022/23.

PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. During Autumn 2021 all local government bodies need to make important decisions about their external audit arrangements from 2023/24. They have options to arrange their own procurement and make the appointment themselves or in conjunction with other bodies, or they can join and take advantage of the national collective scheme administered by PSAA.

The report explains that current audit arrangements are unsatisfactory due to problems with the timeliness of the audits and variability of price.

The decision whether to opt-in to the PSAA contract or not is very finely balanced. There is no doubt our future audits will be more expensive than at present whichever route Council chooses. The large audit firms have told us it is likely timeliness will not improve. Going alone, however, carries the chance the Council may find an auditor that can deliver the audit on time. Going alone carries the risk the Council will not be able to appoint an auditor at all and the Secretary of State will do so. Going alone also carries a higher administrative burden.

The report concludes that going with the PSAA is unlikely to lead to any improvement for Horsham District Council simply because it is a district council and has, therefore, a lower priority with the large audit firms. The recommendation is to go alone, despite the risks, because it might lead to a better outcome for the Council.

Recommendations

That the Audit Committee recommends to Council that:

- i) The Council declines 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.

- ii) The Council instructs the officers to seek to establish an independent audit panel and refers the appointment of this Panel back to its February 2022 meeting.

Reasons for Recommendations

- i) There is a possibility the position with regards to the timeliness of the audit could improve with a local appointment and there appears to be little chance of this in joining the PSAA arrangements.
- ii) If the Council goes alone it must appoint an independent panel and then complete the procurement by 31 December 2022.

Background Papers

None

Wards affected: all

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Background Information

1. Introduction

- 1.1. The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Council opted into the 'appointing person' national auditor appointment arrangements established by Public Sector Audit Appointments (PSAA) for the period covering the accounts for 2018/19 to 2022/23.

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

- 2.1. 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:
 - To appoint its own auditor, which requires it to follow the procedure set out in the Act.
 - To act jointly with other authorities to procure an auditor following the procedures in the Act.
 - 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).
- 2.2. In order to opt in to the national scheme, a council must make a decision at a meeting of the Full Council.

3. The Appointed Auditor

- 3.1. The auditor appointed at the end of the procurement process will undertake the statutory audit of accounts and Best Value assessment of the council in each financial year, in accordance with all relevant codes of practice and guidance. The appointed auditor is also responsible for investigating questions raised by electors and has powers and responsibilities in relation to Public Interest Reports and statutory recommendations.
- 3.2. The auditor must act independently of the Council and the main purpose of the procurement legislation is to ensure that the appointed auditor is sufficiently qualified and independent.
- 3.3. The auditor must be registered to undertake local audits by the Financial Reporting Council employ authorised Key Audit Partners to oversee the work. As the report below sets out there is a currently a shortage of registered firms and Key Audit Partners.
- 3.4. Auditors are regulated by the Financial Reporting Council, which will be replaced by a new body with wider powers, the Audit, Reporting and Governance Authority (ARGA) during the course of the next audit contract.
- 3.5. 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.

4. Appointment by the Council itself or jointly

- 4.1. The Council may choose to appoint its own external auditor under the Act. To do this the Council would have to:
 - 4.1.1. Establish an independent auditor panel to advise on the selection and appointment of its own external auditor. 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. It must be chaired by an independent member. Independent members for this purpose are independent appointees, excluding current or former members within 5 years of them standing (or officers) and their close families and friends. The Council will be expected to follow the advice of the independent auditor panel.
 - 4.1.2. Manage the contract for its duration, overseen by the Auditor Panel.
 - 4.1.3. Alternatively, the Act enables the Council to join with other authorities to establish a joint auditor panel. Again, this will need to be constituted in the same way described above, of wholly or a majority of independent appointees. Further agreement 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.

5. The national auditor appointment scheme

- 5.1. 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. 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.
- 5.2. In summary the national opt-in scheme provides the following:
 - the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1 April 2023;
 - appointing the same auditor to other opted-in bodies that are involved in formal collaboration or joint working initiatives to the extent this is possible with other constraints;
 - managing the procurement process to ensure both quality and price criteria are satisfied. PSAA has sought views from the sector to help inform its detailed procurement strategy;
 - ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period;
 - minimising the scheme management costs and returning any surpluses to scheme members;
 - consulting with authorities on auditor appointments, giving the Council/Authority the opportunity to influence which auditor is appointed;

- consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk; and
- on-going contract and performance management of the contracts once these have been let.

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

- 6.1. 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.
- 6.2. 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, 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.
- 6.3. The Kingman review has led to an urgent drive for the Financial Reporting Council 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 Financial Reporting Council'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.
- 6.4. 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.
- 6.5. The PSAA advises 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.

7. Pressures experienced by Horsham District Council arising from the market issues

- 7.1. Horsham District Council's PSAA appointed auditors for the period are EY (formerly known as Ernst & Young). Our finance team completed its draft accounts by the due date in all three years so far audited by the deadlines. However, in 2019/20, only the second year of the current contract, EY announced they would not be able to complete the audit on time due to COVID-19. The audit was completed and the accounts signed on 20 October 2020.
- 7.2. On 27 May 2021 EY's audit lead informed the Director of Corporate Resources she would not begin the 2020/21 audit until November 2021. The reason for the proposed delay was lack of staff and an instruction from senior management at EY to start district and borough Council audits after the County Council and unitary Council audits were complete. The audit lead said this reason for this decision by EY was because county and unitary councils' accounts are included in the whole of government accounts produced nationwide and district and borough accounts are not. An audit of accounts in November and December would have created considerable pressure on the three-person senior accountancy team in putting the audit into the same time period as setting the Council's budget.
- 7.3. In reality the EY audit lead found some capacity to carry out the work on Horsham District's audit in August 2021. There was then a further delay awaiting national guidance on a technical issue and the accounts were finally signed and published on 11 November 2021.
- 7.4. The second pressure experienced is in the increase in fees above the current level. The 2019/20 final fee, moderated by the PSAA, was agreed by the Director of Corporate Resources, in consultation with the Chairman of this Committee in November. This fee was agreed at £56,208, £17,636 above the fee originally contracted.

8. The invitation

- 8.1. 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 A to this report.
- 8.2. 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 has said it will:
 - seek to encourage realistic fee levels and to benefit from the economies of scale associated with procuring on behalf of a significant number of bodies;
 - continue to pool scheme costs and charge fees to opted-in bodies in accordance with the published fee scale as amended following consultations with scheme members and other interested parties (pooling means that everyone within the scheme will benefit from the prices secured via a competitive procurement process

- a key tenet of the national collective scheme);
 - continue to minimise its own costs, around 4% of scheme costs, and as a not-for-profit company will return any surplus funds to scheme members. In 2019 it returned a total £3.5million to relevant bodies and in 2021 a further £5.6million was returned.
- 8.3. PSAA has said it 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.
- 8.4. The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office)¹, the format of the financial statements (specified by CIPFA/LASAAC) and the application of auditing standards regulated by the Financial Reporting Council. 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.
- 8.5. 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 unless they are on this list. Local procurements must deliver the same audit scope and requirements as a national procurement, reflecting the auditor's statutory responsibilities. The nine firms included on the list are: BDO, Cardens Accountants, Deloitte, EY, Grant Thornton, KPMG, Mazars, PriceWaterhouseCoopers, Azets Audit Services Ltd. Cardens Accountants is a Hove based firm.

9. Market Consultation

- 9.1. Due to their dissatisfaction with the current audit situation, mostly over timings but also over uncertainty of price, the Director of Corporate Resources and the Chairman of the Audit Committee carried out some local market consultation during October about the possibility of not joining the PSAA arrangements. They met with representatives of three firms: EY, our incumbent auditor; KPMG, a national firm that won no contracts in the last PSAA exercise due to price; Cardens Accountants, a Hove-based firm that won no contracts in the last PSAA exercise due to size and experience.
- 9.2. The findings from the discussions were:
- 9.2.1. Delivery – the general responses were the big national firms would always put

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

district council audits after audits involved in the whole of government accounts if they won PSAA contracts. Therefore for us, being in or out of the PSAA would lead to no difference. For the small firm delivery on time was more likely as long as they did not take on too many councils at the relet. Four was the most they felt they could handle.

- 9.2.2. Experience – EY had the most up to date experience as they have current local government audits. KPMG has only one, East Hampshire, but has the training and buying power to recover quickly. Cardens has an ex-Audit Commission partner and experience in the area in Housing work but not District Council final accounts audit.
- 9.2.3. Price – inevitably the audit fee will rise inside or outside the PSAA. KPMG said they will only bid for contracts with 80% of scores to quality and 20% to price, which the PSAA are proposing this time. Suggestions of around £70,000 a year for simple district council with good quality audit papers were mentioned. Horsham District Council is such a council.
- 9.2.4. Who to go out with and would they bid – one of the national firms said they would not bid for less than 10 councils, ideally a mixture of County, Police and Districts; Cardens would not bid for more than four. All would have to take the proposal through their Board who could reject it in an under-supplied market.

The Director of Corporate Resources has spoken to six local authorities who might be interested in tendering with Horsham District Council. Of these two have the complicating factor of a Housing Revenue Account, one has substantial out of district property investments and another has not yet had their 2019/20 accounts closed.

- 9.2.5. Staff quality – the large audit firms have training departments to train auditors in the work, small firms do not. The Chartered Institute of Finance and Accountancy are proposing training in audit of public bodies for smaller businesses that may win contracts this time.

10. Assessment of options and officer recommendation

- 10.1. There are three main options for the Audit Committee, and Council, to consider in deciding whether to join the PSAA tender.
- 10.2. Option one – Join the PSAA tender

For

- Avoids the need for an independent panel.
- Lowest workload for the officers in letting the contract.
- Administrative costs of running the contract are limited to 4%.

Against

- Delivery will probably remain variable and put pressure on our finance service if audits complete after the 30 September deadline.
- Price will be higher than at present due to the 80/20 quality/price split. It is not clear from consultation whether this will be the best price available but it

was in the 2017 contract let.

- Price increases in the contract period are made by the PSAA.

10.3. Option two – Tender alone

For

- Horsham District Council with its independent panel will decide lot size.
- There is a chance our terms and conditions might lead to delivery on time, although they may not.

Against

- There is a risk there will be no bids. Our understanding is this leads to an appointment of an auditor by the Financial Reporting Council or its successor body.
- The workload for the officers will be higher than PSAA route but lower than tendering with others.
- Price will be higher than at present, it is not known if this will be cheaper or more expensive than the PSAA route. The PSSA has economies of scale. However, under the PSAA Horsham District pays the same as all districts and gains no advantage for having simple accounts with good working papers.
- Administrative costs of running the contract are unknown.

10.4. Option three – tender together with others

For

- Horsham District Council with its independent panel will decide lot size.
- There is a chance our terms and conditions might lead to delivery on time although they may not.

Against

- Further legal advice on the constitution of an independent panel with partners will be needed.
- The workload of the Director of Corporate Resources and Head of Finance and Performance will be the highest from this option because of the complexity of lots and a wider independent panel.
- There is a risk there will be no bids. Our understanding is this leads to an appointment of an auditor by the Financial Reporting Council or its successor body.
- Price will be higher than the PSAA tender. It seems unlikely there will be much economies of scale over the tender alone route.
- Administrative costs are unknown.

11. Relevant Council policy

- 11.1. Appointing an auditor is not a policy matter, it is the law. However with all its services the Council seeks to follow its policy objective to provide quality, value for money services.

12. Details

- 12.1. The current situation with regards to the audit of the Council's accounts is unsatisfactory. In deciding a way forward there is limited evidence matters will improve much. It appears prices will rise whichever option the Council takes. It appears our audit will not be a high priority for any large nationally appointed auditor whichever route to market is taken and the local market is limited to one firm whose delivery is unknown because they have never had the opportunity to do the work.
- 12.2. On balance it appears unlikely the current situation will improve for a District Council joining the PSAA arrangement. It might, or might not, improve or be more or less expensive tendering outside the PSAA. It appears tendering alone may be a lower risk than tendering in a group where the behaviours of others could affect our price and delivery.

13. Next Steps

- 13.1. The Audit Committee needs to consider this finely balanced decision in detail. On reaching a conclusion it must make a recommendation to full Council on 8 December 2021.
- 13.2. If the Council decides to not join the PSAA arrangement the Director of Corporate Resources will advertise for people to join the independent panel early in the New Year, prepare tender documents and advertise in the late spring. The appointment of the auditor will be made by the full Council no later than at its meeting in December 2022.
- 13.3. The Director of Corporate Resources is in discussion with one of our partners in the procurement partnership about a possible joint procurement. Subject to the views of the independent panel, it is likely that inclusion of another partner would be as an additional lot to retain any price advantage Horsham District may have as a Council with simple accounts and good working papers.

14. Views of the Policy Development Advisory Group and Outcome of Consultations

- 14.1. As this is a report to the Audit Committee and a decision by full Council there is no need for Cabinet or Policy Development Advisory Group involvement.
- 14.2. The Director of Corporate Resources wrote this report based on a standard report issued by the PSAA. The Monitoring Officer and the Head of Finance and Performance have checked its contents and legality.
- 14.3. The Chief Executive and the Chairman of the Audit Committee have been consulted throughout the development of the report.

15. Other Courses of Action Considered but Rejected

- 15.1. Option one, joining the PSAA is rejected because the Chairman, Chief Executive and officers do not believe joining the contract this time will improve the situation

with auditing the Council's accounts.

- 15.2. Option three, tendering with others, is rejected because of the complexity of the independent panel members and the extra officer workload involved. Running separate tenders at the same time as other members of our procurement partnership, should they wish to do so, remains an option.

16. Resource Consequences

- 16.1. Not joining the PSAA will lead to more work for the officers during the tender process and the audits. However it may prevent the potential late autumn workload clashes threatened in the current year.
- 16.2. The new audit contract will cost more than the current one. This is inevitable due to the changes in the industry. This will appear in the 2023/24 budget.

17. Legal Considerations and Implications

- 17.1. Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year, in this case 31 December 2022.
- 17.2. Section 8 governs the procedure for appointment including that the Council must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 provides that where a relevant Council is a local Council operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements.
- 17.3. Section 12 makes provision for the failure to appoint a local auditor. The Council must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council. This could occur if no listed auditors applied for the work.

18. Risk Assessment

- 18.1. There is a moderate to high risk going alone will not lead to any improvement in timeliness of our audit.
- 18.2. There is a very high risk prices will increase over current levels. The PSAA and the LGA are of the view that 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.
- 18.3. There is a risk that no firms will tender for the contract and the Secretary of State will appoint our auditor.
- 18.4. There is a moderate risk we will struggle to appoint a suitably experienced independent panel to advise Council on the appointment of an auditor.

19. Procurement implications

19.1. A full public procurement by advertisement will be needed.

20. Equalities and Human Rights implications / Public Sector Equality Duty

20.1. There are no equalities or human rights matters associated with this report.

21. Environmental Implications

21.1. The only environmental implications of our external audits are the distances travelled by our auditors. In a public procurement these are not matters we are likely to be able to control.

22. Other Considerations

22.1. External auditors are allowed full access to all data held by the Council. In procuring the contract we will need to be careful of where the applicants process their data to ensure it meets the full requirements of UK Data Protection Law.