

EAST SUSSEX FIRE AUTHORITY

Date	9 December 2021
Title of Report	Appointment of External Auditors
By	Duncan Savage, Assistant Director of Resources/Treasurer
Lead Officer	Duncan Savage, Assistant Director of Resources/Treasurer
Lead Member	Cllr Wendy Maples, Chair of Scrutiny & Audit Panel

Background Papers Scrutiny & Audit Panel, 26 May 2016 (Item 026) – Changes to the arrangements for the appointment of External Auditors
Scrutiny & Audit Panel, 2 February 2017 (Item 069) – Appointment of External Auditors
Fire Authority, 14 February 2017 (Item 972) – Appointment of External Auditors

Appendices 1. PSAA – invitation to opt in 22 September 2021

Implications

CORPORATE RISK		LEGAL	✓
ENVIRONMENTAL		POLICY	
FINANCIAL	✓	POLITICAL	
HEALTH & SAFETY		OTHER (please specify)	
HUMAN RESOURCES		CORE BRIEF	
EQUALITY IMPACT ASSESSMENT			

PURPOSE OF REPORT To set out proposals for appointing the external auditor to the Authority for the accounts for the five-year period from 2023/24.

EXECUTIVE SUMMARY The current contract with PSAA for the appointment of the Authority's external auditors ends on 31 March 2023 (with the audit of the 2022/23 accounts).

This report sets out the requirements to comply with the appointment legislation and recommends that the Authority continues to appoint its External Auditors through Public Sector Audit Appointments Limited (PSAA).

The Local Audit (Appointing Person) Regulations 2015 require that the Fire Authority may only make the decision to

'opt-into' the appointing person arrangement by the members of the Fire Authority, meeting as a whole.

Current indications are that other local authorities in East Sussex and most other fire authorities will also opt into PSAA. It is understood that PCCs may consider a separate joint procurement.

RECOMMENDATION

The Fire Authority is recommended to:

- (i) accept Public Sector Audit Appointments' (PSAA) 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) Delegate authority to the Assistant Director Resources/Treasurer to put in place any arrangements necessary to give effect to this decision.

1. BACKGROUND

- 1.1 The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Authority 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.
- 1.2 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.
- 1.3 The report concludes that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Authority than a procurement undertaken locally because:
 - collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;
 - if it does not use the national appointment arrangements, the Authority will need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement and ongoing management of an audit contract;

- it is the best opportunity to secure the appointment of a qualified, registered auditor - there are only nine accredited local audit firms, and a local procurement would be drawing from the same limited supply of auditor resources as PSAA's national procurement; and
- supporting the sector-led body offers the best way of ensuring there is a continuing and sustainable public audit market into the medium and long term.

1.4 If the Authority wishes to take advantage of the national auditor appointment arrangements, it is required under the local audit regulations to make the decision at full Authority. The opt-in period starts on 22 September 2021 and closes on 11 March 2022. To opt into the national scheme from 2023/24, the Authority needs to return completed opt-in documents to PSAA by 11 March 2022.

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 Authority is required to appoint an auditor to audit its accounts for each financial year. The Authority 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 into 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 into the national scheme, an Authority must make a decision at a meeting of the full Authority.

3 THE APPOINTED AUDITOR

3.1 The auditor appointed at the end of the procurement process will undertake the statutory audit of accounts and value for money assessment of the Authority 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 Authority 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 Authority (FRC) and 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 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.
- 3.5 Authorities 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 AUTHORITY/AUTHORITY ITSELF OR JOINTLY

- 4.1 The Authority may elect to appoint its own external auditor under the Act, which would require the Authority to:
- Establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the 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 Authority's external audit.
 - Manage the contract for its duration, overseen by the Auditor Panel.
- 4.2 Alternatively, the Act enables the Authority 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 Authority under the Act and the Authority 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 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
- ongoing 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 Authority (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.

- 6.3 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.
- 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 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. THE INVITATION

- 7.1 PSAA is now inviting the Authority 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 Authority's auditor. Details relating to PSAA's invitation are provided in the Appendix to this report

8. THE NEXT AUDIT PROCUREMENT

- 8.1 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. In 2019 it returned a total £3.5m to relevant bodies and in 2021 a further £5.6m was returned.

8.2 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.

8.3 The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office)¹, 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.

8.4 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.

9. ASSESSMENT OF OPTIONS AND OFFICER RECOMMENDATION

9.1 If the Authority 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 Authority/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 Authority/Authority's external audit.

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.

- 9.2 Alternatively, the Act enables the Authority/Authority 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 Authority under the Act and the Authority would need to liaise with other local authorities to assess the appetite for such an arrangement.
- 9.3 These would be more resource-intensive processes to implement for the Authority, 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 appointment process. The Authority is unable to influence the scope of the audit and the regulatory regime inhibits the Authority's ability to affect quality.
- 9.4 The Authority 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.
- 9.5 The national offer provides the appointment of an independent auditor with limited administrative cost to the Authority. By joining the scheme, the Authority would be acting with other Authorities to optimise the opportunity to influence the market that a national procurement provides.
- 9.6 The recommended approach is therefore to opt into the national auditor appointment scheme.

10. NEXT STEPS

- 10.1 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 Authority (meeting as a whole), except where the authority is a corporation sole.
- 10.2 The 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). 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.

11. LEGAL IMPLICATIONS

- 11.1 The Local Audit and Accountability Act 2014 (the Act):
- Section 7 - 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.

- 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.
- 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.

12. FINANCIAL IMPLICATIONS

- 12.1 The Authority's current scale fee for external audit is £23,690. In the light of the scale fee variations submitted by EY for 2019/20 and the expectation that changes to the Audit Code and international auditing standards would lead to further increases in costs the budget for 2021/22 was increased by £30,000 to £53,690. There is a significant risk that the scale fees for 2023/24 onward will be higher than those currently in place, for the reasons set out in this report, e.g. limited market, increasing regulatory requirements, recruitment and retention difficulties. Budget provision will be reviewed once the new scale fees are known.
- 12.2 Opting-in to PSAA provides maximum opportunity to limit the extent of any increases by entering into a large-scale collective procurement arrangement and would remove the costs of establishing an auditor panel.