

## Procurement of External Auditor

Date: 26<sup>th</sup> November 2021

Report of: Chief Officer Financial Services

Report to: Corporate Governance and Audit Committee

Will the decision be open for call in?  Yes  No

Does the report contain confidential or exempt information?  Yes  No

### **What is this report about?**

#### **Including how it contributes to the city's and council's ambitions**

- The Council's current external auditor is Grant Thornton who were appointed following the Council's decision on the 22<sup>nd</sup> February 2017 to opt into a sector led procurement via Public Sector Audit Appointments (PSAA) Limited. Their appointment covers the audit of the Council's statutory accounts for financial years 2018/19 to 2022/23. During Autumn 2021, the Council needs to make the decision on how it will appoint external auditors for accounting periods 2023/24 onwards. External Auditors will need to be appointed for the accounting period 2023/24 by the statutory deadline of 31<sup>st</sup> December 2022.
- This report sets out the proposals for appointing the external auditor to the Council for the statutory financial accounts for the five year period from 2023/24.
- As well as undertaking the statutory annual audit of the Council's Statement of Accounts, the external auditor contributes towards providing the assurance that the Council has established an effective financial control environment including robust arrangements for strategic financial planning combined with effective financial management and control.
- The Best Council Plan is the Council's current strategic plan which sets out its ambitions, outcomes and priorities for the City of Leeds and for the Local Authority. The Best Council Plan can only be delivered through a sound understanding of the organisation's longer-term financial sustainability, which enables decisions to be made that balance the resource implications of the Council's policies against financial constraints. This is the primary purpose of the Medium Term Financial Strategy (MTFS) and the external auditor contributes by providing the assurance that the Council has a robust financial framework for managing the annual budget and has realistic plans to ensure that in future years its financial position is robust, resilient, sustainable and affordable.

## Recommendation

- a) Corporate Governance and Audit Committee are asked to recommend to Full Council that the Council accepts Public Sector Audit Appointments' invitation to opt into the sector led option for the appointment of external auditors from 2023/24.

## Why is the proposal being put forward?

- 1 The appointment period for the Council's current external auditor services expires after the 2022/23 financial year. Under the Local Government Audit and Accountability Act 2014 ("the Act") the Council is required to secure the appointment of an auditor to audit its accounts for each financial year. In doing so 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 local 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 After consideration of the three options it is concluded that the sector wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council 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 Council/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 to ensuring there is a continuing and sustainable public audit market into the medium and long term.
- 3 Whilst the terms of reference of this committee include the consideration of the Council's arrangements relating to external audit requirements, Regulation 19 of the Local Audit (Appointing Persons) Regulations 2015 requires the decision to opt into this procurement must be made by a meeting of the Council.
- 4 The Council needs to respond formally to PSAA's invitation in the form specified by PSAA by the close of the opt-in period (11<sup>th</sup> March 2022).

## What impact will this proposal have?

### Wards affected:

Have ward members been consulted?

Yes

No

- 5 To opt into the PSAA procurement process for an external auditor when the current contract expires in 2022/23.

### **What consultation and engagement has taken place?**

- 6 Both the Deputy Leader/ Executive Member for Resources and the Director of Resources have been consulted and support the recommendation

### **What are the resource implications?**

- 7 The Council's proposed external audit fee for 2020/21 is £275.6k. This current external audit fee which is competitive was derived from the previous PSAA procurement exercise and it is not anticipated that this process will deliver further savings. In fact there is every likelihood that external fees will increase from this current budgeted amount.
- 8 Under the PSAA procurement option there will not be a fee to join the sector-led arrangements. The audit fees that opted-in bodies will be charged will cover the costs to PSAA of appointing auditors and managing the arrangements. Audit fees achieved through large contracts should be lower than the costs that individual authorities will be able to negotiate. The fee for the audit of a body that opts into the sector-led procurement will reflect the size, audit risk and complexity of the work required. The PSAA have established a system for setting the fee which allocates audit costs across all opted-in authorities based on these characteristics. As a not-for-profit organisation, PSAA will be able to return any surpluses to opted-in authorities after all costs have been met.
- 9 By opting into the PSAA led procurement the Council will avoid the costs of a local procurement and management of a contract and also the requirement to set up an auditor panel with independent members.

### **What are the legal implications?**

- 10 Under the Local Government Audit and Accountability Act 2014 the Council is required to appoint an auditor to audit its accounts for each financial year.
- 11 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. This decision is timetabled to be received at Council on January 12<sup>th</sup> 2022. As such, the recommendation in this report is not subject to call in, as the matter that will ultimately be determined by full Council.

### **What are the key risks and how are they being managed?**

- 12 The Council must appoint its external auditor to audit its accounts for a financial year not later than the 31<sup>st</sup> December in the preceding financial year. Therefore the Council must have appointed its next external auditor by 31<sup>st</sup> December 2022. If it does not do so then the Secretary of State can either appoint an auditor on the Council's behalf or direct it to appoint a particular auditor.
- 13 Opting into the sector wide procurement led by PSAA will ensure that the Council meets these statutory requirements. It is also likely that this option will reduce the risks to the Council in terms of alleviating the need to manage a local procurement exercise and set up a local auditor panel and will be the most financially favourable in terms of the cost of the procurement exercise and the level of audit fee.

## Does this proposal support the council's three Key Pillars?

Inclusive Growth

Health and Wellbeing

Climate Emergency

- 14 Supporting the Best Council Plan – the approved Medium Term Financial Strategy recognises the Council's ambition to be the best city by being a strong economy and a compassionate city as well as achieving its best City priorities. Financial Services have a key role to play in this around supporting the Council to realise its ambitions. As well as there being the continued focus upon value for money, the approved budget means that the Council can target its resources to drive inclusive economic growth, promote health and wellbeing, tackle deprivation and other deep-rooted challenges to improve the quality of life for our residents.
- 15 The role of external audit is to provide the assurance to Councillors and the citizens of Leeds that the annual statement of accounts give a true and fair view at the end of each financial year, that they have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom and have been prepared in accordance with the requirements of the Local Audit and Accountability Act.
- 16 In addition the external auditors give their opinion as to whether the Council has proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Ensuring that the Council has appropriate financial management systems and procedures in place is clearly a key aspect in providing assurance, albeit not comprehensive, that money is being spent wisely.

## Options, timescales and measuring success

### What other options were considered?

- 17 The options for appointing local auditors are a) to undertake an individual procurement and appointment exercise, b) to undertake a joint procurement and appointing exercise with other Local Authorities and c) join a sector led body arrangement as the Council did in 2018. In respect of that last option, the Council will need to 'opt in' to the sector led body arrangement by 11<sup>th</sup> March 2022 having firstly obtained Full Council approval to do so. (A requirement of the Local Audit (Appointing Person) Regulations 2015).
- 18 The scope of external audit work is specified nationally by the National Audit Office in their Code of Audit Practice. Not all firms are eligible to compete for the work as they need to be registered with a Registered Supervising Body approved by the Financial Reporting Council. It is unlikely that small local firms will meet the eligibility criteria to undertake the work. Given the complexity of Local Authority audit work, it is envisaged that contracts would be awarded for a minimum of 4 to 5 years.
- 19 For options a) and b) the Council would undertake the procurement exercise either itself (a) or with its chosen partners (b) using an Auditor Panel. This will need to be done in accordance with guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The membership of the Audit Panel must be wholly or have a majority of independent members. Independent members for this purpose are independent appointees; this excludes current and former elected members (or officers) and their close families and friends. Therefore, elected members would not have a majority input to the selection and appointment process. Independent members of the Audit Committee may be eligible but this would need to be confirmed. If the Council decided to join with other authorities to establish a joint Auditor Panel, this would again need to be constituted of wholly or a majority of independent members with legal advice needed on the exact constitution, depending on the Councils involved.

**Option A: Undertaking an individual auditor procurement and appointment**

- 20 Advantages of this route include having local input to the decision as panel members could be appointed locally. However, recruitment and servicing of the required Audit Panel, running the bidding exercise and negotiating the contract would be time consuming and costly to the Council. In addition, the Council would not be able to take advantage of reduced audit fees and economies of scale that may be available through joint or national procurement contracts. The council would also be procuring in what is a very challenging market currently.
- 21 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.
- 22 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.
- 23 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.
- 24 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.
- 25 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.

### **Option B: Undertaking a joint audit procurement and appointing exercise with other Local Authorities**

- 26 The Local Audit and Accountability Act 2014 enables the Council to join other local authorities in setting up an Auditor Panel. Advantages of this approach include sharing the cost of setting up the panel, running the procurement process and negotiating contacts across a number of authorities. It may also bring opportunity for negotiating economies of scale from a combined contract value.

- 27 Disadvantages of this approach might include frustrations in the choice of auditor available. Accountancy and Audit firms often complete non audit work for Local Authorities (e.g., consultancy/ advisory work) which may limit firms who are appointable by a joint process due to independence issues. Should the firm selected be conflicted with Leeds City Council in any way then the Council would then need to make a separate appointment.
- 28 The availability of this option to the Council will also depend on the extent to which the other Local Authorities prefer to use either option A or C in preference to this.
- 29 The comments above in Option A about the state of the current market for the appointment of external auditors and the challenge faced in addressing these also apply to Option B.

**Option C: To opt into the Sector Led Arrangement operated by Public Sector Audit and Appointments Ltd (PSAA Ltd)**

- 30 In July 2016, the Secretary of State for Housing Communities and Local Government specified PSAA Ltd 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. PSAA Ltd has a responsibility for:
- appointing auditors to all relevant authorities;
  - setting scales of fees, and charging fees, for the audit of accounts of relevant authorities and consulting with relevant parties in relation to those scales of fees;
  - ensuring effective management of contracts with audit firms for the delivery of consistent, quality and effective audit services to relevant authorities;
  - ensuring that public money continues to be properly accounted for and protected;
  - being financially responsible having regard to the efficiency of operating costs and transparently safeguarding fees charged to audited bodies; and
  - leading its people as a good employer, ensuring that it continues to be fit-for-purpose; motivating and supporting its staff; and communicating with them in an open, honest and timely way.
- 31 The PSAA will appoint the external auditors for all opted in bodies for a period of 5 years with an option to extend to for a further two years by mutual agreement.
- 32 Advantages of this approach include a fully independent approach to appointment of the external auditors and saving time and resources by avoiding the need for setting up independent audit panels and undertaking procurement processes. The costs of a procurement and appointing exercise would be shared across participating councils. A national exercise offering large contract values may also encourage participating firms to offer more realistic prices in what is currently a challenging market. Independence issues would be managed by PSAA Ltd who would have a number of contracted firms to call on.
- 33 The main disadvantage to this approach is the inability to influence the appointment and the procurement negotiations to reflect the Council's approach to procurement. To remain viable and place itself well in terms of negotiating position, PSAA Ltd will need to secure opt in from a good number of Councils. A consultation by PSAA Ltd asked for an indication of whether Councils would opt into the scheme. 57% of eligible bodies answered 'Yes' with a further 34% answering 'Maybe' which suggests this is not an issue.
- 34 PSAA Ltd have undertaken a consultation of authorities who opted into the first appointment period arrangements (covering the audit of accounting periods 2018/19 – 2022/23) to learn and enhance arrangement going forward. Their findings are published and include a commitment to further enhance arrangements related to monitoring quality of service, delays in audits and auditors staffing issues, contract management and value for money in fee setting.

### **How will success be measured?**

35 That an external auditor is appointed within statutory deadline of the 31<sup>st</sup> December 2022 and the assurance that the costs associated with the requirement to appoint an external auditor represent the best Value for Money for the Council.

### **What is the timetable for implementation?**

36 The PSAA have advised an expected timetable as follows for the appointment process:

- September 2021 – Councils receive their invitation to opt into the Sector Led arrangement.
- 11<sup>th</sup> March 2022 – Deadline for formal ‘Opt in’ from Councils. (therefore Full Council approval to ‘opt in’ will be required before this date)
- Spring/Summer 2022 – Process for making individual appointments for opted in LA’s will be published
- August 2022 – Procurement of Audit Services will have been completed
- Autumn 2022 – Consultation with opted in LA’s on proposed auditor appointments
- 31<sup>st</sup> December 2022 – Confirmation of appointed auditor received.

### **Appendices**

37 None

### **Background papers**

38 None